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MEXICO

GLOBAL CREDIT PROGRAM FOR SAFEGUARDING THE PRODUCTIVE FABRIC AND ECONOMIC RECOVERY

(ME-L1308)

LOAN PROPOSAL

This document was prepared by the project team consisting of: Fernando de Olloqui (IFD/CMF), Project Team Leader; Leticia Riquelme (IFD/CMF), Alternate Project Team Leader; José Antonio Urteaga (INE/ENE); Judith Morrison (SCL/GDI); Amado Crotte (INE/TSP); Karina Azar, Isabelle Braly-Cartillier, Javier Gavilanez, Claudia Márquez, and Fanny Porras (IFD/CMF); Jacqueline Bueso-Merriam (SPD/SDV); Gloria Visconti (CSD/CCS); Agustin Filippo, Claudia Grayeb, Gloria Lugo, and Uriel Barrios (CID/CME); Miriam Garza (VPC/FMP); and Monica Lugo (LEG/SGO).

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ABBREVIATIONS

CCLIP	Conditional credit line for investment projects
CNBV	Comisión Nacional Bancaria y de Valores [National Banking and Securities Commission]
FIRA	Fideicomisos Instituidos en Relación con la Agricultura
IMF	International Monetary Fund
INEGI	Instituto Nacional de Estadística y Geografía [National Institute of Statistics and Geography]
MSMEs	Micro, small, and medium-sized enterprises
NAFIN	Nacional Financiera S.N.C.
OECD	Organisation for Economic Co-operation and Development
PDBs	Public development banks
SFP	Secretaría de la Función Pública [Civil Service Department]
SMEs	Small and medium-sized enterprises
UERs	Unidades económicas rurales [rural economic units]
WHO	World Health Organization

PROJECT SUMMARY

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Financial Terms and Conditions				
Borrower and executing agency:			**Flexible Financing Facility**[(a)]	
Nacional Financiera S.N.C. Institución de Banca de Desarrollo (NAFIN)			**Amortization period:**	25 years
			Disbursement period:	2 years
Guarantor:			**Grace period:**	5.5 years[(b)]
United Mexican States				
Source	**Amount (US$)**	**%**	**Interest rate:**	LIBOR-based[(c)]
IDB (Ordinary Capital):	US$200 million	100%	**Credit fee:**	[(d)]
			Inspection and supervision fee:	[(d)]
Total:	US$200 million	100%	**Weighted average life:**	15.25 years
			Currency of approval:	U.S. dollars
Project at a Glance				
Project objective/description: The general objective is to support the sustainability of micro, small, and medium-size enterprises (MSMEs) as the main source of employment in Mexico amid the COVID-19 crisis. The specific objective is to promote economic recovery through access to production-oriented finance for MSMEs.				
Special contractual conditions precedent to first disbursement: The borrower will provide evidence, to the Bank's satisfaction, that: (i) the program coordinator has been designated at NAFIN, and (ii) the program Operating Regulations have been approved on the terms previously agreed upon with the Bank (see paragraph 3.7).				
Exceptions to Bank policies: None.				
Strategic Alignment				
Challenges:[(e)]	SI ☒		PI ☒	EI ☐
Crosscutting themes:[(e)]	GE ☒ and DI ☐		CC ☒ and ES ☐	IC ☐

(a) Under the terms of the Flexible Financing Facility (document FN-655-1), the borrower has the option of requesting changes to the amortization schedule, as well as currency, interest rate, commodity, and catastrophe protection conversions. The Bank will take operational and risk management considerations into account when reviewing such requests.

(b) Under the flexible repayment options of the Flexible Financing Facility, changes to the grace period are permitted provided that they do not entail any extension of the original weighted average life of the loan or the last payment date as documented in the loan contract.

(c) In keeping with document FN-729 (Strategy and Operational Readiness for the Execution of the LIBOR Transition for the IDB Balance Sheet) and document CF-257-1 (Base Rate Replacement for Sovereign Guaranteed LIBOR-based Loans), this loan will be subject to the SOFR-based interest rate, upon notification to the borrower by the Bank or at the borrower's request, pursuant to the provisions of the loan contract.

(d) The credit fee and inspection and supervision fee will be established periodically by the Board of Executive Directors as part of its review of the Bank's lending charges, in accordance with the relevant policies.

(e) SI (Social Inclusion and Equality); PI (Productivity and Innovation); and EI (Economic Integration).

(f) GE (Gender Equality) and DI (Diversity); CC (Climate Change) and ES (Environmental Sustainability); and IC (Institutional Capacity and Rule of Law).

I. DESCRIPTION AND RESULTS MONITORING

A. Background, problem to be addressed, and rationale

1.1 **COVID-19 context in Mexico.** On 11 March 2020, the World Health Organization (WHO) declared a pandemic in response to the outbreak of COVID-19, the disease caused by the SARS-CoV-2 virus. As of 14 November 2021, there had been more than 3.8 million confirmed cases of COVID-19 in Mexico, resulting in 291,089 deaths [1].[1] The impact of third wave of COVID-19 in the country has lessened, and daily numbers of both cases and deaths have tapered. The health authorities have stated that there will be no return to a complete shutdown of nonessential activities. Contracts for 244 million vaccine doses have been announced, making Mexico one of the leading countries of the region. Some 99 million vaccine doses have been administered, and 44.5 million adults are now fully vaccinated.

1.2 **Macroeconomic context.** The economic impact of the pandemic in Mexico has been unprecedented, resulting in an 8.2% decline in GDP in 2020. Despite the challenging context with generalized uncertainty surrounding the pandemic, the Mexican economy has rebounded on the strength of the vaccination program, the reopening of economies internationally, and better-than-expected economic performance in the United States. Mexico's economy grew 19.5% in the second quarter of 2021 (compared with the same period in 2020), and economic growth forecasts have been revised upward to 6.3% for 2021 and 4.2% for 2022 [2].

1.3 Monetary policy was initially supportive of economic recovery, but inflationary pressures have led to an increase in the Central Bank of Mexico's benchmark interest rate. Inflation is expected to remain above the central bank's target band (3% ± 1%) for the rest of 2021, and expectations are for readings of 5.5% or more even in the last quarter, leaving little room for future monetary policy measures. Meanwhile, the fiscal response to the pandemic has been relatively limited compared with other G-20 countries, in line with the government's efforts to maintain fiscal discipline. Despite this, an overall deficit of 4.2% of GDP is projected in 2021 (exceeding the government's original estimate of 3.3%), and is expected to reach 3.5% of GDP in 2022.

1.4 Gaps in access to vaccines has become the main determining factor for recovery in the different countries, yet recovery is still not assured, even for those countries with low rates of infection, as long as the virus continues to circulate elsewhere [3]. Uncertainty surrounding the path of the pandemic has immediate manifestations and will have lingering effects, even once the health emergency has ended. The economic shockwaves created by the pandemic have reverberated throughout the country. First, a simultaneous, direct impact on overall demand and supply in the economy has led to a slowdown in economic activity and required higher public spending on the health sector response and social safety nets. Second is the indirect impact associated with the changes in individual behavior necessary to curtail the spread of COVID-19. These behaviors may be the result of government mandates (closing schools, canceling public events, etc.), decisions made by companies and other institutions (teleworking, cutting back production, etc.), and decisions made by consumers (reducing social contact). Moreover, recent price pressures largely reflect pandemic-related factors and temporary mismatches

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[1] References (see optional link 3).

between supply and demand that may persist.[2] This would lead to a hardening of financial terms for emerging economies like Mexico.

1.5 **Economic impact in Mexico.** Mexico was one of countries of the region hardest hit by the crisis, especially in the second quarter of 2020. GDP fell 17.3% over the previous quarter, due to the sharp decline in private consumption, reduction in exports resulting from lower demand in the United States, supply constraints, and a slowdown in industrial activity and investment (notably manufacturing and construction) that began in 2019. Between February and June 2020, total employment fell by almost 20%, and formal employment by 5%, resulting in a deterioration in social indicators.

1.6 To mitigate the impact of the crisis and prepare for reopening, the Bank of Mexico prepared a package of financial policies to provide liquidity to the financial and productive system (see paragraph 1.15). At the same time, the government boosted social spending and allowed the fiscal deficit to expand to around 4% (still within an overall policy context inclined toward austerity). The measures contributed to keep the economy running satisfactorily, including the financial and banking system in particular, but were insufficient to generate an expansion of credit to the private sector.

1.7 **Diagnostic assessment of micro, small, and medium sized enterprises (MSMEs) and MSME financing**.[3] There are 4.7 million MSMEs in Mexico,[4] more than 95% of which are microenterprises. A large share of economic activity (52%) and jobs (68.4%) is closely tied to these companies, demonstrating their importance to the economic dynamics of the country. In terms of the major sectors, around half (46.7%) of MSMEs operate in the trade sector, employing 37.9% of the working population. Private nonfinancial services account for a further 39.2% of MSMEs and 39.3% of employment, followed by industry (12.1% and 15.2%, respectively [4]).

1.8 The Mexican financial system exhibits generally low levels of penetration, and this is reflected in financing terms. Domestic lending to the private sector amounts to 36% of GDP, versus 49% in Latin America and the Caribbean and 90% in countries of the Organisation for Economic Co-operation and Development (OECD).[5] MSMEs face greater credit constraints, however, due largely to the size of the informal sector in Mexico. The informal sector generated 22.5% of GDP in 2018 [5] and, according to a Banco de México study, accounts for 73.31% of MSMEs.

1.9 The annual flow of resources for private sector financing remains dramatically lower than before the pandemic. Total financing to Mexican private nonfinancial companies contracted in the first half of 2021. In terms of real annual variation, this

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2 IMF (2021), op cit.

3 For more information, see optional link 5.

4 According to the Department of Economy's official classification, MSMEs can have up to 250 employees and Mex$250 million (US$12,051,250) in annual sales. They account for 99% of the total number of companies.

5 Other countries like Chile (112% of GDP), Colombia (47% of GDP), and Brazil (60% of GDP) have higher rates than Mexico. The indicator is defined as domestic credit provided by financial and nonfinancial entities and the public sector to the private sector (as a percentage of GDP). This is the broad World Bank definition from its World Development Indicators. Data from 2017.

credit aggregate decreased 5.4% in the second quarter of 2021, which was less than the contraction seen in the first quarter (6.5% [6]). In particular, the portfolio of credit to smaller companies has continued to shrink, a trend in behavior observed since the first quarter of 2019 affecting all of the principal economic sectors. Weak credit activity with respect to small and medium-sized enterprises (SMEs) has affected the share of these businesses in bank lending to the business sectors. SMEs account for only 17.8% [7] of this category, a significantly low level considering the relative importance of smaller businesses in the country's economy.

1.10 MSMEs are more vulnerable to economic shocks, as they depend to a greater extent on liquidity financing when faced with fluctuations in the economic cycle.[6] Credit constraints intensify in times of crisis, meaning that MSME production and employment may fall short of desired levels.

1.11 **Financing gaps faced by women.** Although a lack of firm-level data and analyses disaggregated by sex hinders precise assessment of the specific barriers faced by women-led MSMEs in Mexico, the available literature shows that women entrepreneurs face both demand- and supply-side barriers.[7] For example, women tend to own or accumulate fewer assets that can be used as collateral, and their businesses are often concentrated in sectors in which collateral is less accessible, as in the case of the service sector. There are also limitations on the supply side, such as gender biases in lending (conscious or unconscious) and the lack of financial products and services offering the right value propositions for women entrepreneurs [8]. In addition to the systematic difficulties faced by businesses in the country, the COVID-19 crisis has had a more severe impact on women entrepreneurs, who also face greater obstacles in accessing credit. From a production perspective, women-led MSMEs are concentrated in the country's trade and services sectors, which have been most affected by the crisis [9]. Although Mexico is one of the leading countries in terms of financial inclusion data disaggregated by sex at the individual level, its data disaggregated by sex in terms of women-owned or women-led businesses is still inadequate. Nonetheless, available survey data suggest that 30% of MSMEs are owned by women, double the 13% average for Latin America and the Caribbean [10]. In terms of financial constraints faced by MSMEs, 35% of women-owned or women-led MSMEs face partial or complete lending limitations, versus 28% for their men counterparts. Lastly, the proportion of women-led MSMEs that report using banks to finance investments is significantly lower than for men: 3.9% versus 17.4% [11].

1.12 The financial sector faces a series of limitations regarding the financing that MSMEs will need during the pandemic, in terms of both ensuring the immediate survival of MSMEs and stimulating a rapid recovery of economic activity and employment in the country. This is important given that Mexican MSMEs employ on average 77% of workers in the sectors hardest hit by the pandemic [12].

6 MSMEs are more sensitive to economic fluctuations because they face greater credit constraints. See Gertler, M. and Gilchrist, S., "Monetary Policy, Business Cycles, and the Behavior of Small Manufacturing Firms," Quarterly Journal of Economics, Vol. 109, No. 2 (1994).

7 Género y Acceso al Financiamiento Empresario, IDB, 2020.

1.13 **Challenges and progress.** In shielding the economic fabric from the economic hardships associated with the COVID-19 crisis, the challenge will be to support the recovery of the greatest possible number of MSMEs that were commercially viable before the crisis, as well as to support the value chains contributing to the integration of a greater number of MSMEs, so that they can continue operating and contribute to the economic recovery.

1.14 Mexico has been relying on public development banks (PDBs) to provide MSMEs with access to finance. The different institutions comprising the PDB system[8] serve these companies based on their economic sector: industrial, export, rural, construction, etc. An estimated 65% of MSME loans in Mexico are backed by the PDBs.

1.15 Financial regulation will return to normal after the extraordinary measures imposed in 2020 to address the pandemic. Providing liquidity and improving access to credit have been the policies most frequently adopted by governments to support the productive structure and avoid layoffs and shuttering of businesses in their economies. These have required a number of regulatory changes, as well as the allocation of additional public funding for credit lines and guarantees, including special credit lines to finance working capital, interest rate cuts, extended grace periods, and more favorable terms for productive investment, particularly by SMEs. Credit facilities have been the most significant source of funds across the region, though in many cases they are still considered insufficient to address the magnitude of the problem. Although these measures may have helped to preserve adequate liquidity in Mexico, they have been insufficient for an expansion in credit. Looking ahead, banks will be required to resume standard accounting and reporting arrangements, and this may lead to a tightening of credit conditions. With this program, the government aims to strengthen the response of PDBs to the current crisis.

1.16 **Targeting of the program.** This program seeks to alleviate the credit constraints faced by MSMEs in the economic recovery period following the economic crisis created by COVID-19. In terms of sectors, the program will provide support for industrial, commercial, and service activities. The depth of the contraction depends on the exposure of each sector and subsector to the channels of transmission of the crisis, as well as pre-existing vulnerabilities resulting from the economic deterioration experienced since the end of 2018. Accordingly, the industrial sector experienced the sharpest decline in 2020 (-10%).[9] Moreover, based on prepandemic constraints and their position during the pandemic, the two sectors in Mexico with the least potential for an independent recovery in bank lending are the manufacturing industries and trade,[10] so public credit policy efforts should focus on these.

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[8] NAFIN; Banco Nacional de Comercio Exterior S.N.C. (BANCOMEXT); Sociedad Hipotecaria Federal, S.N.C. (SHF); Financiera Nacional de Desarrollo Agropecuario, Rural, Forestal y Pesquero (FND); Fideicomisos Instituidos en Relación con la Agricultura (FIRA); and Banco Nacional de Obras y Servicios Públicos, S.N.C. (BANOBRAS).

[9] National Institute of Statistics and Geography (INEGI).

[10] Potencial de Recuperación Pospandemia: Crédito Bancario por Sectores Productivos en América Latina y el Caribe, IDB, September 2021 (see optional link 7).

1.17 Priority will be given to the industrial sector, which is the most important for the country's short-term economic recovery. The manufacturing industry is key, due to its contribution to GDP,[11] and high-value-added sectors in particular are expected to support recovery.[12] The current importance of the industrial sector has been reflected in its marked recovery in 2021. Driven by manufacturing, sector growth of 27.9% in the second quarter, compared with the same period a year earlier, has led overall growth in GDP, although overall output remains below its prepandemic level.[13]

1.18 It will also be important to continue supporting the trade and services sectors. Although these seem headed for a slower recovery and have less of an impact on economic recovery in the short term, they are considered strategic due to their representativeness (see paragraph 1.7) and their importance in terms of job creation (trade and services together account for 77% of national employment), investment attraction, and share of GDP, all of which make them indispensable for achieving sustained recovery in the medium term. Accordingly, the program will also provide support for these sectors, although less than for industry.

1.19 The consequences of the health emergency involve a decline in the underlying economic activity of MSMEs, which already faced challenges in access to finance under normal circumstances. There is therefore an urgent need for financial support for existing borrowers and other businesses not currently financed by the system. In benefiting MSMEs, which tend to face greater hurdles in accessing credit during a crisis, the program is effectively helping to maintain the level of employment. To help accelerate the economic recovery, support will be provided to expand the supply of commercial credit to MSMEs in multiple sectors (mainly within industry). To this end, funding will be required for loans to finance both fixed assets and working capital of MSMEs.

1.20 It will also be important to continue deepening support for women-led businesses., With the aim of improving financial inclusion among women, since 2016 the Bank has provided support to the Mexican financial system through the National Banking and Securities Commission (CNBV) for a series of activities to improve its capacity to gather and analyze data disaggregated by gender. Accordingly, this program should support gender-related data collection at the company level, in addition to financing the development of businesses led by women.

1.21 In terms of the types of investments to be prioritized, the search for greater efficiency in the use of resources as part of the crisis response provides an opportunity to stimulate green investments, such as those offered by energy efficiency technologies. There is a growing consensus that government efforts to

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[11] Due to the strength of private consumption, the services sector accounts for the largest share of GDP, at around two thirds (66.4%), followed by the industrial sector (which includes the productive sectors of mining, electricity, construction, and manufacturing) with a 30.3% share. The manufacturing sector is prime within the latter.

[12] LAC Post COVID-19: Challenges and Opportunities for Central America, Haiti, Mexico, Panama and the Dominican Republic, IDB (2020). In terms of trade in goods, and as part of its advanced integration into international markets, the country has a high level of participation in medium- and high-tech value chains such as automotive, aerospace, and electronics. At the product level, it is a net exporter of manufactured goods.

[13] INEGI.

rebuild the world economy should be consistent with their pre-COVID-19 commitments to address climate change, prioritizing industries and activities that can help to further promote sustainability [13]. To support sustainable economic recovery, the program will thus also channel its resources to energy efficiency projects in the industrial sector. Emphasis will be put on distributed generation, where it is estimated that more than one fourth of MSMEs could benefit from installed distributed generation in the long run. Energy regulations in Mexico allow for nonutility generation systems of up to 30 kilowatts in small companies without special permit, and of up to 0.5 megawatts with a simple connection to the grid.

1.22 At the same time, there is a pressing need to support the digitalization efforts of MSMEs. On average, the initial conditions for recovery are less favorable in the countries of Latin American and the Caribbean than in the rest of the world, or when compared with countries of similar income levels [14]. Among the reasons for differences in supply-side conditions is a significant resilience factor, which concerns connectivity. Lockdown measures during the pandemic served to highlight the importance of digital technologies in offsetting isolation and keeping economic systems running. The share of companies with Internet access is above 85% in all countries of the region, but technology underadoption can be seen in the smaller share with websites (only 49.79% in Mexico, compared with 66% in Brazil) and digital sales channels (only 8.6% in Mexico) [15]. Digitalization has also accelerated as a means of survival, particularly in the case of MSMEs, which face the great challenge of not falling behind in the field of e-commerce, which grew 81% in Mexico in 2020 and accounts for 9% of retail sales [16]. For MSMEs to strengthen their adoption of e-commerce, they will need to digitalize business processes in some or all of the following dimensions: (i) payment methods, (ii) transaction platforms, and (iii) logistics [17]. The digital transformation will require MSMEs to overcome barriers in access to financial resources [18] and investment capabilities, as well as limitations in digital infrastructure and technology use and capabilities. For example, 76.6% of companies in Mexico use electronic banking—lower than in Colombia (95%) or Brazil (88%)—and the likelihood of supply disruptions is increased by weaknesses in the logistics chain (only 13.47% of companies in Mexico purchase inputs online, for instance, compared with 66% in Brazil and 46% in Argentina) [19].

1.23 **Proposed intervention.** The program seeks to alleviate the constraints on credit access faced by businesses, including those led by women, which tend to experience greater obstacles to accessing credit during a crisis, to support business survival, safeguard employment, and sustain production and services in the economy during the recovery period.

1.24 The proposed intervention will boost the supply of liquidity to companies, channeling funds through second-tier lending by Nacional Financiera S.N.C. (NAFIN). NAFIN is the main PDB serving MSMEs in the country (see paragraph 3.2). Its primary objective is to support the country's growth- and development-oriented industrial and technology policies in order to create more and better companies creating more and better jobs. NAFIN plays an important role in private financing for smaller companies, guaranteeing around 60% of private loans to SMEs. This underscores NAFIN's importance in ensuring that credit continues to flow, particularly to MSMEs.

1.25 **The Bank's experience and lessons learned.** The Bank has extensive experience in designing sovereign-guaranteed loan programs aimed at improving MSME access to finance through financial intermediaries [20]. These programs have been implemented in times of economic expansion, when support focuses on access to long-term finance for production-oriented investments, and in times of economic recession, when support focuses on ensuring that MSMEs do not lose access to liquidity to continue their economic activity. In the last financial crisis confronted by the region, the Bank played a countercyclical role by expanding the amount of financing and facilities used to address the lack of access to credit faced by the region's MSMEs. For example, liquidity programs for growth sustainability were approved in 2008 and 2009[14] with the aim of reestablishing access to finance for working capital and foreign trade in the productive sectors. This helped to temporarily offset part of the deficit in financing flows to MSMEs resulting from the international financial crisis. With the same objective of stimulating the supply of credit to the productive sectors, the period following the crisis (2009-2013) saw the approval of contingent credit lines[15] for providing liquidity to the financial system, as well as multisector global credit programs and, chiefly, specific productive financing programs for MSMEs (see optional link 2). The 2008-2009 financial crisis showed that Mexico's PDBs can be used as a vehicle for implementing countercyclical policies through the experience operating a broad array of instruments to meet producers' financing needs.

1.26 The Bank has considerable experience working with Mexico's PDBs, including the financing of MSMEs, particularly in the agricultural and rural sectors: (i) under conditional credit line for investment projects (CCLIP) ME-X1024 (US$1 billion), three operations with Financiera Nacional de Desarrollo Agropecuario, Rural, Forestal y Pesquero (FND) (3302/OC-ME, 3531/OC-ME, and 4276/OC-ME)[16] with the objectives of raising productivity in the primary sector by improving access to finance for productive investment for rural economic units (UERs) and promoting financial inclusion to benefit the rural sector by improving UER access to productive credit; and (ii) under CCLIP ME-X1021 (US$300 million), two operations with Fideicomisos Instituidos en Relación con la Agricultura (FIRA) as executing agency (3335/OC-ME and 3701/OC-ME)[17] with the objective of promoting private investment in productive restructuring and enterprise- and export-development projects that increase productivity or promote more efficient use of natural resources, primarily in Mexico's rural sector, through long-term financing to help increase the supply of credit for such investments. Execution of the aforementioned operations has been highly satisfactory. The current intervention is consistent with previous initiatives to support MSMEs, with the

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[14] In 2008, the IDB created the Liquidity Program for Growth Sustainability under the emergency lending category (document GN-2492-3).

[15] "Contingent Credit Line for Development Sustainability" in the "Proposal to Establish a Set of Contingent Lending Instruments of the IDB" (document GN-2667-2).

[16] 3302/OC-ME, First Program for Productive Rural Financing (US$400 million, approved in 2014); 3531/OC-ME, Second Program for Productive and Inclusive Rural Financing (US$400 million, approved in 2015); and 4276/OC-ME, Third Program for Productive and Inclusive Rural Financing (US$500 million, approved in 2017).

[17] 3335/OC-ME, First Program for the Financing of Rural Sector Production Restructuring and Investment Projects (US$50 million, approved in 2014); 3701/OC-ME, Second Program for the Financing of Rural Sector Production Restructuring and Investment Projects (US$50 million, approved in 2016).

difference that it emphasizes financing for companies in the current context of the emergency created by COVID-19, as well as expands the number of MSME sectors served to ensure a multisector approach that includes trade, services, and industry. With NAFIN, two programs were implemented under CCLIP ME-X1010 (US$1.2 billion), 2226/OC-ME and 2671/OC-ME,[18] aimed at promoting the development of SME suppliers and contractors for the national oil industry and providing medium- and long-term financing for renewable energy projects. Together with resources allocated from the Clean Technology Fund under operation 2843/OC-ME,[19] these programs focused on renewable energy projects with exceptional results.

1.27 **Lessons learned.** The Bank has extensive experience and has generated substantial knowledge regarding the design and implementation of policies to support MSME finance with a special focus on certain sectors or value chains [21]. In order for these policy solutions to be effective, it is crucial to: (i) identify the market failures to be addressed; (ii) strengthen collaboration between public actors with expertise in the relevant area; (iii) strengthen collaboration between the public and private sectors, since the private sector can help to identify solutions to problems; (iv) target interventions to overcome obstacles encountered; (v) identify the financial instrument or set of instruments that can be implemented in each situation; and (vi) utilize the most cost-effective combination of instruments for each situation. The importance of effectively targeting and identifying the instrument (funding) to address the specific financing needs (support for economic recovery) of strategic sectors (see paragraph 1.16) through a public actor specialized in the area (NAFIN) is embedded in this program.

1.28 The Bank also has relevant experience in designing solutions to mitigate the problems of access to finance faced by MSMEs and value chains. The following lessons learned from those activities have been used in the design of this operation: (i) promote the countercyclical role of this type of operation in times of tightening credit, such as the current crisis; (ii) target resources to segments where credit has a greater impact on the functioning of the economy and social welfare (in this case, MSMEs); and (iii) ensure that the executing agency has the institutional capacity to operate the intervention and to monitor and evaluate the subloans (see paragraphs 2.6 and 3.4).[20]

1.29 **Coordination with other IDB Group projects.** The program coordinates efforts with other initiatives in Mexico to address needs arising from the pandemic, especially the need to safeguard the productive fabric and employment. On 30 June 2020, a Global Credit Program for Safeguarding the Productive Fabric and Employment was approved to support MSMEs in the agroindustrial sector, with

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18 2226/OC-ME, Program to Promote the Development of SME Suppliers and Contractors for the National Oil Industry (US$301 million, approved in 2009); 2671/OC-ME, Second Individual Operation under the Expanded CCLIP to Support Business Development in Mexico (US$50 million, approved in 2011).

19 2843/OC-ME, Third Individual Operation under the Expanded CCLIP to Support Business Development in Mexico (US$100 million, approved in 2012).

20 Section IV of the Support to SMEs and Financial Access/Supervision Sector Framework Document (document GN-2768-7) provides a more extensive and detailed set of lessons learned from the Bank's experience in the sector, as well as the experience of other multilaterals, academic research, and other major actors relevant to the design of policies to support MSMEs.

NAFIN as borrower and FIRA as executing agency (5063/OC-ME, US$100 million). Another loan to NAFIN (3178/OC-ME, US$54.3 million) was reformulated under the same prototype, primarily to address the needs of MSMEs in the trade and services sector by financing their immediate working capital needs. This program complements those two operations—which focused on short-term and working capital loans to meet liquidity needs, keep businesses operating, and preserve employment with resources to support the medium-term sustainability of businesses and economic recovery. This program seeks to broaden the focus to include industrial sectors, particularly manufacturing, as well as trade and services. Also under preparation is a Global Credit Program to Support Economic Recovery in Mexico, with Banco Nacional de Comercio Exterior (BANCOMEXT). Whereas the current program serves smaller companies with a focus on the industrial, trade, and service sectors, the BANCOMEXT operation will complement this by supporting larger SMEs participating in export chains and the tourism sector.

1.30 **Complementarity with nonreimbursable operations.** This program will be complemented by another operation supported with nonreimbursable resources from the Clean Technology Fund (CTF), which will finance the implementation of a system of results-based guarantees for distributed generation projects covering risks related to lower-than-expected power generation or energy prices. Similarly, regional technical cooperation operation ATN/OC-18036-RG will support NAFIN's efforts to disaggregate data by sex in order, to improve its ability to design products targeted women entrepreneurs (paragraph **Error! Reference source not found.**).

1.31 **Strategic alignment.** The program is consistent with the second Update to the Institutional Strategy (document AB-3190-2) and aligned with the challenges of (i) social inclusion and equality, through support for MSME employment (with emphasis on smaller MSMEs); and (ii) productivity and innovation, through financing to keep businesses running and support the digitalization efforts of MSMEs. It is also aligned with the crosscutting themes of: (i) gender equality, by contributing to eliminate the credit access gaps faced by women-led MSMEs through the specific allocation of 20% of program resources (US$40 million) (paragraph 1.35), consistent with Operational Policy OP-765 on Gender Equality in Development. The operation is consistent with the Update to the Gender Action Plan for Operations 2020-2021 (document GN-2531-19), through the line of action to promote women's financial inclusion by strengthening the capacity of financial regulators and PDBs to include them; and (ii) climate change, through the use of program funds to provide loans for energy efficiency and distributed generation, consistent with the country's support for sustainable economic recovery. Based on the joint methodology of the multilateral development banks for tracking climate finance, 30% of funds under the operation will be invested in climate change mitigation and adaptation activities. These funds contribute to the IDB Group's goal of increasing financing for climate change-related projects to 30% of total approvals by end-2021. The operation is also consistent with the priority area of resource mobilization, through the proposed mechanisms to stimulate the mobilization of private financial sector resources for MSME finance, as well as the company shareholders' own funds. The program will contribute to the Corporate Results Framework 2020-2023 (document GN-2727-12) through the indicator of the number of MSMEs financed. The program is consistent with the Proposal for the IDB Group's Governance Response to the COVID-19 Pandemic Outbreak

(document GN-2995), as part of the support for safeguarding the productive fabric and employment. Additionally, it is consistent with the Support to SMEs and Financial Access/Supervision Sector Framework Document (document GN-2768-7), as it supports financing for SMEs. Lastly, the operation is included in the Update to Annex III of the 2021 Operational Program Report (document GN-3034-2).

1.32 **Gender considerations.** NAFIN's Gender Equality Policy establishes guidelines to ensure that the institution contributes to gender equality and women's empowerment, mainstreaming the gender perspective within the scope of its authority consistent with its charter. The lines of action under the policy include gender mainstreaming in processes and procedures (including the lending process), as well as a focus on the monitoring and disaggregation of data by sex. However, as is the case in the rest of the financial system, NAFIN lacks the institutional capacity to gather firm-level data disaggregated by sex. Moreover, the gap in gender data is more pronounced for companies in the industrial and service sectors, hindering the effective evaluation of women's participation in the relevant NAFIN program portfolios and of the specific barriers faced by them. This absence of data hinders the data-led development of products and services and is aggravated by the fact that women tend to self-exclude more than men when it comes to applying for a loan from a financial institution. Through technical cooperation operation ATN/OC-18036-RG (paragraph 1.30), the Bank will support NAFIN in defining, collecting, monitoring, and analyzing data disaggregated by sex (with reference to company leadership and ownership), consistent with international best practices. This data will serve as a foundation for preparing the institution's value proposition. This program will promote targeted support to women-led companies through the allocation of 20% of program resources to the financing of such businesses. This will be possible, once the technical cooperation operation has been executed.

B. Objectives, components, and cost

1.33 **Objectives.** The general objective is to support the sustainability of micro, small, and medium-size enterprises (MSMEs) as the main source of employment in Mexico amid the COVID-19 crisis. The specific objective is to promote economic recovery through access to production-oriented finance for MSMEs.

1.34 **Sole component: MSME access to finance in support of economic recovery (US$200 million).** The resources will be used to support economic recovery by providing financing to MSMEs for their eligible activities[21] (paragraph 1.36). Support will be provided to facilitate new lending to these businesses, including women-led MSMEs, giving them ongoing access to the financing they need to reestablish production capacity and meet higher demand during the recovery phase, as well as to repair the value chains affected by the crisis.

1.35 Resources under the component will be channeled through NAFIN's second-tier operations in the form of traditional lending through eligible financial intermediaries belonging to the NAFIN network. Support will be provided for the economic recovery with emphasis on the industrial sector, which is expected to provide greater impetus to the economy in the short term. This will include companies

[21] Investments in fixed assets and working capital will be eligible for financing.

linked to supply chains that foster the recovery of regional economies and help safeguard employment, particularly in the south and southeast of the country. Key strategic subsectors within industry include textiles, footwear and leather, manufacturing, capital goods and electrical equipment, health, transportation equipment, and information technology,[22] although companies in the trade and services sectors are also important, given their impact on the labor sector. Crosscutting support will also be provided for the digitalization efforts of MSMEs and for lending to women-led companies, amounting in the latter case to 20% of total program resources (US$40 million).[23] In addition, approximately 30% of the total program amount (US$60 million) will be channeled to the funding of energy efficiency projects (specifically distributed generation), to support sustainable economic recovery efforts.

1.36 The program's main conditions will be reflected in the program Operating Regulations and will include: (i) the features of the MSMEs, which are microenterprises, small businesses, and medium-sized enterprises organized and operating under Mexican law with up to 250 employees and Mex$250 million (US$12,051,250) in annual sales (see additional criteria in paragraphs 1.7 and 3.6); (ii) eligible activities (industry, particularly manufacturing, as well as services[24] and trade[25]); (iii) criteria and processes for identifying eligible financial intermediaries (see paragraph 3.5); (iv) the maximum amount of a subloan to a subborrower (US$1 million); and (v) eligible types of credit. The financing conditions of subloans with the program funds will be market terms, in accordance with the lending policies of NAFIN and the financial intermediaries, and subloans will be denominated in Mexican pesos.

1.37 **Program administration.** Administration, monitoring, evaluation, and audit expenses will be covered with NAFIN funds.

1.38 **Beneficiaries.** Resources under this intervention will be directed to MSMEs affected by the COVID-19 crisis. Based on an average loan amount of US$85,586 (including leveraged resources), the number of MSMEs that potentially stand to benefit under the program is 2,337. The program is expected to benefit a greater proportion of smaller MSMEs, including MSMEs in vulnerable sectors due to the employment that they generate (e.g., trade and services).

C. Key results indicators

1.39 **Expected results.** In terms of program impact, the intervention is expected to support the sustainability of micro, small, and medium-size enterprises (MSMEs) as the main source of employment in Mexico amid the COVID-19 crisis, measured as follows: (i) sales revenue at MSMEs in the sectors supported by the program; and (ii) employment in the sectors supported by the program as a percentage of total MSME employment in the country. The outcome indicators for the program

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22 These loans fall primarily under NAFIN's "Programa Impulso."

23 Under technical cooperation operation ATN/OC-18036-RG, the Bank will work with NAFIN to follow best practices when assessing ownership and leadership in the definition of women-led businesses.

24 Includes the following subsectors: (i) restaurants; (ii) hotels and other temporary accommodation services; (iii) automotive repair and maintenance services; and (iv) real estate services.

25 Includes the following subsectors: (i) consumer goods purchases; (ii) automotive retail services; and (iii) food retail and wholesale services.

will be as follows: (i) the arrears rate for NAFIN's portfolio of MSME production-oriented loans supported by the program, compared with the rate for the MSME portfolio of the national financial system; (ii) the degree to which resources are leveraged for MSME production-oriented finance as a result of program support; (iii) the total stock of NAFIN credit for MSME production-oriented finance; (iv) annual greenhouse gas emissions avoided through energy efficiency and distributed generation projects in the financed portfolio; and (v) the share of women-led MSMEs in the total portfolio financed.

1.40 **Economic viability.** The economic evaluation identifies the flows of benefits and costs generated by the program. The benefits consist of the economic value of the reduction in sales revenue losses, the benefits from the higher rate of company survival, and the benefits from jobs preserved as a result of the program. Calculations of the aforementioned flows (discounted at a rate of 12%) show that the program is expected to yield an aggregate net benefit of US$30.2 million with an internal rate of return of 14%. Additionally, the sensitivity analysis shows that the net present value of the program remains positive for a reasonable range of values of the parameters considered key for the analysis, which include (i) the initial reduction in MSME sales with and without program support; (ii) value of average MSME employment; (iii) value of tons of CO_2 emissions avoided; and (iv) distribution of the supported portfolio by size of enterprise (see optional link 1).

II. Financing Structure and Main Risks

A. Financing instruments

2.1 The total program amount is US$200 million, financed from the Bank's Ordinary Capital. The instrument will be a global credit investment loan, since the program involves financial intermediation to beneficiary MSMEs.

2.2 The disbursement period will be two years, since the nature of the program is to help companies with urgent liquidity needs, and NAFIN has confirmed that there is a high demand for financing among MSMEs. Nevertheless, financing for energy efficiency projects and women-led MSMEs will take longer to mature, in terms of both institutional capacity at NAFIN and the specific development of each of these markets, so part of the resources are expected to be disbursed in the second year.

Table 1. Costs and financing (US$ million)

Components	IDB	%
Sole component. MSME access to finance in support of economic recovery	200	100
Total	**200**	**100**

Table 2. Disbursement schedule (US$ million)

Source	Year 1	Year 2	Total
IDB (Total)	150	50	200

B. Environmental and social safeguard risks

2.3 This operation cannot be classified ex ante under directive B.13 of the Environment and Safeguards Compliance Policy (Operational Policy OP-703), since it involves financial intermediation. The environmental and social due diligence was performed in compliance with Directive B.13, analyzing the program's potential socioenvironmental risks and the executing agency's ability to manage them. Based on the due diligence findings, and given the low risk profile of the eligible loans with program resources, this operation is regarded as low financial intermediation risk (FI-3). Given their size and nature—small subloans to MSMEs, with average financing of US$85,586 and a maximum of US$1 million, focused primarily on the industrial sector—the lending will be category "C." Lending in categories "A" and "B" will be ineligible for financing. It should be noted that a small proportion of subloans will finance solar panels (small-scale, up to 0.5 megawatts of installed capacity). Forced labor risks in the polysilicon solar panel supply chain have been assessed and are adequately mitigated by NAFIN's policies and processes in conjunction with Mexican regulations. The environmental and social strategy and the planned measures to address the risk of forced labor in the polysilicon solar panel supply chain in this operation are fully aligned with: (i) the IDB Group Measures to Address Risk of Forced Labor in the Supply Chain of Silicon-based Solar Modules (document GN-3062-1); (ii) the new requirements of the IDB's Environmental and Social Policy Framework (document GN-2965-23); and (iii) the IDB's Procurement Policies (documents GN-2340-15 and GN-2350-15).[26] Moreover, generated distribution projects have positive environmental impacts, and the potentially negative environmental and social risks and impacts of these projects are low.

2.4 Resources under the operation will not be used to finance any of the activities on the program exclusion list (Annex C of the environmental and social management report), including activities/sectors involving (i) high socioenvironmental risk, (ii) involuntary physical or economic resettlement of persons, (iii) negative impact on indigenous groups, (iv) potential damage to cultural sites or critical cultural sites, (v) negative impact on protected areas or RAMSAR sites, or (vi) the use of invasive species.

2.5 The requirements for managing and mitigating potential environmental and social impacts will be included in the program Operating Regulations, approval of which by the IDB is a special contractual condition precedent to the first disbursement (see the environmental and social management report).

C. Fiduciary risks

2.6 NAFIN has executed several prior operations (2226/OC-ME, 2671/OC-ME, 2843/OC-ME, 3178/OC-ME, and 3237/OC-ME), and its institutional capacity and high level of development of its fiduciary systems have therefore been verified. Accordingly, the level of fiduciary risk for program execution is low. No weaknesses have been identified that could jeopardize effective execution of the program.

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[26] For more information, see Annex E of the environmental and social management report.

D. Other key risks and issues

2.7 **Economic and financial risk.** A medium-high risk was identified that a deterioration in macroeconomic conditions could reduce credit demand for energy efficiency projects on the part of MSMEs, which in times of crisis tend to prioritize other types of investments. This could lead to delays or revisions to the execution of resources for these purposes. To mitigate this risk, an operation supported with nonreimbursable investment funds from the Clean Technology Fund (CTF) will help to structure and implement risk mitigation mechanisms, foster capacity development, and provide operational assistance to the program for energy efficiency investments (paragraph 1.30).

2.8 **Internal process risk**. A medium-high risk was identified that delays in identifying and implementing processes at NAFIN and the financial intermediaries for collecting data disaggregated by sex could affect execution of the program resources aimed at closing the gender gap. To mitigate this risk, technical cooperation operation ATN/OC-18036-RG will support the efforts of BANCOMEXT to develop policies that specifically target women-led SMEs (paragraph **Error! Reference source not found.**).

2.9 **Sustainability.** The program is expected to help alleviate the credit constraints faced by MSMEs as a consequence of the COVID-19 pandemic and thereby support the economic recovery. The program offers the country the opportunity to leave support mechanisms in place, and the demonstration effect of the interventions is expected to enable the development of programs to reduce MSME vulnerability.

III. IMPLEMENTATION AND MANAGEMENT PLAN

A. Summary of implementation arrangements

3.1 **Borrower and executing agency.** NAFIN will be the borrower and the executing agency. The executing agency will be responsible for the administration, execution, control, and monitoring of resources under the operation. This operation will have the sovereign guarantee of the United Mexican States for the financial obligations of the borrower.

3.2 **Execution and administration.** NAFIN is an entity of the federal public administration with legal personhood and its own budget. Its purpose is to promote Mexico's economic development by facilitating access to finance and other business development services for MSMEs, entrepreneurs, and priority investment projects, as well as contributing to financial market development and acting as a trustee and financial agent of the federal government. In doing this, it seeks to drive innovation and improve productivity, competitiveness, job creation, and regional growth. NAFIN is governed by financial system laws and regulations and is subject to supervision and monitoring by the CNBV. NAFIN is a solvent institution with good risk management practices, assets of US$30 billion, a private sector credit

portfolio totaling US$22 million,[27] and capital of around US$2 billion as of end-2019.

3.3 The loan proceeds will be used by NAFIN to provide financing to its authorized financial intermediaries, which may offer eligible beneficiaries subloans on suitable terms, to finance eligible investment projects.

3.4 The executing agency, through its human and technological resources, will be responsible for execution and supervision of the proper use of the resources channeled by financial intermediaries for eligible subloans. It will perform the following functions: (i) making disbursements of the subloans to eligible financial intermediaries for placement with subborrowers[28] with a view to meeting the program objectives under the stipulations of the program Operating Regulations; (ii) preparing execution and financial progress reports for the Bank; (iii) monitoring compliance with environmental and social safeguards, as established in the program Operating Regulations; and (iv) monitoring, supervising, and evaluating the program.

3.5 The eligible financial intermediaries are the 148 entities currently in the NAFIN network of financial intermediaries, 98 of which are nonbank (66%) and 50 are banks and their subsidiaries (34%), as well as new intermediaries joining the network during program execution. To be eligible, the intermediaries must meet the qualitative and quantitative requirements set by NAFIN for its network, which include: (i) a minimum of two years' lending experience; (ii) accounting records based on CNBV criteria; (iii) all stages of the credit process documented (policies and procedures); (iv) facilities, structure, and information systems that allow effective management of the different stages of the lending process; (v) minimum criteria for capitalization and arrears rates; (vi) portfolio and loan loss reserve rating methodologies; and (vii) maximum portfolio concentration. NAFIN will verify that all financial intermediaries satisfy the above requirements to remain eligible for the program. Eligible financial intermediaries will assess subborrower risk and make decisions to issue financing in accordance with the program Operating Regulations and NAFIN's operating guidelines.

3.6 In addition to the meeting the requirements set under the description of the Sole Component, MSMEs will be eligible to receive credit if they are MSMEs under Mexican law that are dedicated to eligible activities and satisfy the requirements set by the financial intermediary for receiving the subloan.

3.7 **As special contractual conditions precedent to first disbursement, the borrower will provide evidence, to the Bank's satisfaction, that: (i) the program coordinator has been designated at NAFIN, and (ii) the program Operating Regulations have been approved on the terms previously agreed upon with the Bank.** The first condition reflects the need to ensure satisfactory interagency coordination in execution and administration of the program, since it involves different NAFIN departments. The second is important because this

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[27] Of this amount, the guarantee program accounts for 46%, traditional loans 44%, and the supply chains program (factoring) the remaining 10%. Second-tier credit to the private sector is nearly US$7 billion.

[28] MSMEs engaged in eligible activities that meet the requirements set by the eligible financial intermediaries to be benefitted and obligated by the credit, in accordance with the provisions of the loan contract and program Operating Regulations.

instrument establishes the structure, guidelines, and procedures for successful program execution (see paragraph 3.8).

3.8 The program Operating Regulations will include at least the following: (i) the eligibility requirements for subborrowers; (ii) the activities, sectors, and subsectors eligible for financing with the subloans; (iii) the criteria and processes for identifying eligible financial intermediaries; (iv) the loan limits per MSME; (v) the eligible types of credit; (vi) the financing terms of the subloans financed with program resources, including market conditions, in accordance with the lending policies of NAFIN and the financial intermediaries, in Mexican pesos; and (vii) the program's environmental and social management commitments. The program Operating Regulations will be consistent with NAFIN and IDB policies and with Mexico's financial laws and practices. Any modifications will require the IDB's no objection. The executing agency currently has a detailed draft of the program Operating Regulations.

3.9 **Procurement.** As a demand-driven financial intermediation program, no procurement of goods, works, nonconsulting services, or consulting services is anticipated as part of execution. No project execution plan or procurement plan is therefore included in this proposal. Any procurement of nonconsulting or consulting services required as part of program administration and/or evaluation will be conducted in accordance with the Policies for the Procurement of Goods and Works Financed by the IDB (document GN-2349-15) and Policies for the Selection and Contracting of Consultants Financed by the IDB (document GN-2350-15) or subsequent updates. For additional details, see the Fiduciary Agreements and Requirements (Annex III).

3.10 **Disbursements.** Resources for the program components will be disbursed by the IDB to NAFIN via the modality of advance of funds and/or reimbursements, as established in the Financial Management Guidelines for IDB-financed Projects (document OP-273-12) or current IDB policies. Disbursements will be made to reimburse NAFIN for transfers to financial intermediaries that have both available credit and have submitted contracts for subloans meeting the eligibility criteria established in the program Operating Regulations. Verification of disbursements will be on an ex post basis, subject to review of the subloans.

3.11 **Retroactive financing.** The Bank may retroactively finance up to US$40 million (20% of the loan amount) in eligible expenditures incurred by the borrower for loans to MSMEs prior to the loan approval date, provided that requirements substantially similar to those established in the loan contract have been met. Such expenditures must have been incurred on or after 1 June 2021, the date on which NAFIN began expanding its portfolio stock after a substantial decline from March 2020 onwards. The authorization of retroactive financing as of 1 June 2021 is justified in light of the exceptional circumstances of the economic crisis caused by the pandemic and the significance of the economic recovery as of the first quarter 2021 (paragraphs **Error! Reference source not found.** and **Error! Reference source not found.**). There has been exceptional demand for funding from NAFIN financial intermediaries since that date, due to the need for resources to support that recovery.

3.12 **Financial statements and audit.** The executing agency will deliver annual audited financial statements for the project within 180 days after the close of the fiscal year,

in accordance with the terms of reference agreed upon with the Civil Service Department (SFP). The last of these financial statements will be delivered within 180 days after the last disbursement. The fiscal year runs from 1 January to 31 December.

B. Summary of arrangements for monitoring results

3.13 **Monitoring.** Project execution will be monitored via six-monthly progress reports from the executing agency delivered within 60 days after the close of each six-month period. The reports will be based on the reporting commitments included in the results matrix for each operation and the financial progress reports indicated in the General Conditions of the Loan Contract, as well as meeting the eligibility criteria described in the program Operating Regulations (see required link 1). These reports will be reflected in the progress monitoring report (PMR).

3.14 **Evaluation.** In addition to a qualitative and portfolio analysis, the strategy for evaluating program results will follow the approach of a reflexive evaluation, before and after the program, to show the achievement of results. The evaluation strategy is described in the monitoring and evaluation plan (see required link 1). The costs of monitoring and evaluation will be covered by the executing agency.

3.15 **Information for program monitoring and evaluation.** The executing agency will be responsible for maintaining data gathering and monitoring systems (see required link 1). The executing agency will undertake to maintain a monitoring and evaluation system for all components, which it will use to prepare the reports and data to be sent to the Bank. For the purposes of the evaluation, the executing agency will compile, store, and retain all information, indicators, and parameters necessary to prepare the project completion report (PCR), including annual plans and the final evaluation. The costs of monitoring and evaluation will be covered by the executing agency. The additional information required for the evaluation exercise will be drawn from national and international secondary sources of statistical data, as well as possible reports by relevant organizations.

Development Effectiveness Matrix		
Summary	ME-L1308	
I. Corporate and Country Priorities		
1. IDB Group Strategic Priorities and CRF Indicators		
Development Challenges & Cross-cutting Themes	-Social Inclusion and Equality -Productivity and Innovation -Gender Equality and Diversity -Climate Change and Environmental Sustainability	
CRF Level 2 Indicators: IDB Group Contributions to Development Results	-Micro / small / medium enterprises financed (#)	
2. Country Development Objectives		
Country Strategy Results Matrix		
Country Program Results Matrix	GN-3034-2	The intervention is included in the 2021 Operations Program
Relevance of this project to country development challenges (If not aligned to country strategy or country program)		The program is aligned IDB Governance Response to the COVID-19 Pandemic Outbreak – Proposed Resolution (GN-2995) as it supports the productive sector and employment. See paragraphs 1.23 and 1.24 of main document
II. Development Outcomes - Evaluability		Evaluable
3. Evidence-based Assessment & Solution	9.6	
3.1 Program Diagnosis	3.0	
3.2 Proposed Interventions or Solutions	3.6	
3.3 Results Matrix Quality	3.0	
4. Ex ante Economic Analysis	10.0	
4.1 Program has an ERR/NPV, or key outcomes identified for CEA	3.0	
4.2 Identified and Quantified Benefits and Costs	3.0	
4.3 Reasonable Assumptions	1.0	
4.4 Sensitivity Analysis	2.0	
4.5 Consistency with results matrix	1.0	
5. Monitoring and Evaluation	7.0	
5.1 Monitoring Mechanisms	2.5	
5.2 Evaluation Plan	4.5	
III. Risks & Mitigation Monitoring Matrix		
Overall risks rate = magnitude of risks*likelihood	Low	
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)	Yes	Financial Management: Budget, Treasury, External Control, Internal Audit. Procurement: Information System.
Non-Fiduciary		
The IDB's involvement promotes additional improvements of the intended beneficiaries and/or public sector entity in the following dimensions:		
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	The EA will receive resources from ATN/OC-18036-RG to strengthen its institutional capacity and monitoring and evaluation systems on gender issues. See paragraph 1.32 of the main document

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

The operation ME-L1308, in the amount of US$200 million, is part of the Bank's operational response to the COVID-19 Pandemic, Global Credit Programs for the Protection of the Productive Sector and Employment. The general objective of the program is to support the sustainability of micro, small, and medium-sized enterprises (MSMEs) as employment providers in Mexico amid the COVID-19 crisis. The specific objective is to promote the economic recovery of MSMEs through access to production-oriented financing.

The loan proposal presents a solid diagnosis of the problem, as well as a review of international evidence. The proposed solutions are an appropriate response to the problems identified in the proposal and their contributing factors. The results matrix is consistent with the vertical logic of the project, presenting adequate indicators at the level of outcomes and impacts. The outcome indicators are appropriately defined to measure the achievements of the project's specific objectives. The impact indicators – (i) sales revenue at MSMEs in the sectors supported by the program, and (ii) employment in MSMEs in the sectors supported by the program as a percentage of total MSME employment in the country - reflect the contribution to the final objective of the operation.

The economic evaluation shows that the operation is efficient, with an internal rate of return of 14% and an NPV of US$30.2 million. In a context of high uncertainty, the analysis considers the benefits which are derived from the reduction in sales revenue losses in benefitted companies, as well as of jobs preserved in firms which survive as a result of the program, and the benefit of the environmental externalities from the energy efficiency projects financed as part of the program.

The monitoring and evaluation plan proposes a reflective analysis of the outcome and impact indicators included in the result matrix, complemented by an analysis of the NAFIN portfolio as well as a qualitative study of the main challenges in the execution of the program and the proposed solutions. The monitoring and evaluation activities will be carried out by NAFIN as the executing agency, in coordination with the Bank.

INDICATIVE RESULTS MATRIX

Project objective:	The general objective is to support the sustainability of micro, small, and medium-size enterprises (MSMEs) as the main source of employment in Mexico amid the COVID-19 crisis. The specific objective is to promote economic recovery through access to production-oriented finance for MSMEs.

EXPECTED IMPACT

Indicators	Unit of measure	Baseline	Final target (2024)	Means of verification	Comments
General objective: Support the sustainability of micro, small, and medium-size enterprises (MSMEs) as the main source of employment in Mexico amid the COVID-19 crisis.					
Indicator 1: Sales revenue at MSMEs in the sectors supported by the program.	US$ million	0.91	0.91	Information published by the Department of Economy and NAFIN distribution by firm size	The indicator measures projected sales revenue at MSMEs in the sectors supported by the program. The target sought is a return to the precrisis condition. The baseline is the Department of Economy's sector-disaggregated data. The sectors supported under the program are industry, trade, and services, and the average annual revenue of MSMEs in all eligible sectors have been taken into account (84% micro, 10% small, and 6% medium-sized).
Indicator 2: MSME employment in the sectors supported by the program as a percentage of total MSME employment in the country.	%	70.54	70.54	Data published by the National Institute of Statistics and Geography (INEGI)	Data on manufacturing, trade, nonfinancial services, and all other economic activities will be used to calculate MSME employment in the supported sectors, based on the INEGI classification and to the maximum available degree of disaggregation. The target sought is a return to the precrisis condition.

EXPECTED OUTCOMES

Indicators	Unit of measure	Baseline	Final target	Means of verification	Comments
Specific objective: Promote economic recovery through access to production-oriented finance for MSMEs.					
Indicator 1: Arrears rate for NAFIN's portfolio of MSME production-oriented loans supported by the program, compared with the rate for the MSME portfolio of the national financial system.	%	135	135	Program monitoring and supervision information collected by NAFIN and CNBV	This indicator is constructed as a fraction, where the numerator is the weighted average arrears of the financial intermediaries with which NAFIN expects to work under the program for its portfolio of MSME production-oriented finance, and the denominator is the average arrears rate of the MSME portfolio of the national financial system. To approximate arrears in the supported portfolio for the baseline, the MSME arrears rate for NAFIN was calculated using the loss ratio for the NAFIN-guaranteed MSME portfolio as a proxy. During the program, the arrears rate for the portfolios of the main financial intermediaries supported by the program will be sought, to calculate the targets met (see monitoring and evaluation plan). The MSME arrears rate for the financial system is obtained using the ratio for all commercial banks, as shown in the CNBV's monthly report. The indicator is defined as follows: $Indicator\ 1 = \frac{MSME\ arrears\ rate\ for\ NAFIN}{MSME\ arrears\ rate\ for\ financial\ system}$ The baseline reflects the latest available data, for February 2020 (MSME arrears rate for NAFIN = 8%; MSME arrears rate for financial system = 5.93%). The desired target is to maintain the ratio calculated for the precrisis conditions.
Indicator 2: Leveraging of resources for MSME production-oriented finance as a result of program support.	US$ million	0	85.7	Program monitoring and supervision information collected by NAFIN	Includes details of resource mobilization from other sources with program support. Production-oriented finance accounts for up to 80% of total investment. This is the starting point for the indicator target, which seeks to surpass this minimum by achieving a leverage ratio of 30%, for total investment of US$285.7 million.
Indicator 3: Total stock of NAFIN credit for MSME production-oriented finance.	US$ million	6,333	6,533	Program monitoring and supervision information collected by NAFIN	Includes only the second-tier stock of credit, according to NAFIN's consolidated balance sheet (commercial loans, financial entities). The baseline is as of end-June 2021 (Mex$126,661), converted to U.S. dollars at an exchange rate of Mex$20/US$1.

Indicators	Unit of measure	Baseline	Final target	Means of verification	Comments
Specific objective: Promote economic recovery through access to production-oriented finance for MSMEs.					
Indicator 4: Annual greenhouse gas emissions avoided through energy efficiency and distributed generation projects in the financed portfolio.	tCO_2e	0	6,750	Program monitoring and supervision information collected by NAFIN; IDB calculations	The indicator measures the number of tons of greenhouse gases avoided, based on the emissions factor for Mexico multiplied by the effective generation of energy efficiency and distributed generation systems installed at beneficiary companies. Due to installation times and the time frames for presenting results according to IDB standards, only projects financed before the end of the first year of execution will be considered. For reference, the total reduction in emissions based on the total amount of resources allocated for this purpose is projected at 39,420 tCO_2e.
Indicator 5: Share of women-led MSMEs in the total portfolio financed.	%	TBD	Baseline +10%	Program monitoring and supervision information collected by NAFIN	Pro-gender indicator. Women-led MSMEs are defined as companies led or owned by women, with over 50% of the capital stock held by women, or at least 25% of the capital stock held by women and at least one woman in a decision-making position. Due to a lack of gender-disaggregated data at the time of approval, the baseline will be set subsequently as part of the activities under technical cooperation operation ATN/OC-18036-RG. The target has been set as growth of at least 10% over the baseline.

OUTPUTS

Outputs	Unit of measure	Baseline (2021)	Year 1	Year 2	Final target	Means of verification	Comments
Sole component: MSME access to finance for economic recovery							
Output 1: Amount of production-oriented finance provided to MSMEs for economic recovery.	US$ million	0	60	40	100	Monitoring and supervision information processed by NAFIN	Funds may be used for both working capital and fixed assets. Includes the industry, trade, and services sectors, regardless of the type of investment financed or gender considerations.
Annual cost:		0	60	40	100		
Output 2: Amount of production-oriented finance provided to women-led MSMEs for economic recovery.	US$ million	0	-10	-30	-40	Monitoring and supervision information processed by NAFIN	Pro-gender indicator. NAFIN is receiving support under technical cooperation operation ATN/OC-18036-RG to support the strengthening of gender monitoring in its portfolio, and 20% of program resources have been allocated to the financing of women-led MSMEs. Women-led MSMEs are defined as companies led or owned by women, with over 50% of the capital stock held by women, or at least 25% of the capital stock held by

Outputs	Unit of measure	Baseline (2021)	Year 1	Year 2	Final target	Means of verification	Comments
							women and at least one woman in a decision-making position.
Annual cost:			10	30	40		
Output 3: Amount of production-oriented finance provided to MSMEs in the energy efficiency and distributed generation subsectors.	US$ million	0	10	50	60	Monitoring and supervision information processed by NAFIN	30% of program resources will be allocated to the financing of MSME energy efficiency and distributed generation investments to support sustainable economic recovery efforts.
Annual cost:			10	50	60		

Country Mexico **Sector:** IFD/CMF **Project No.:** ME-L1308 **Year:** 2021

FIDUCIARY AGREEMENTS AND REQUIREMENTS

Executing agency: Nacional Financiera S.N.C. Institución de Banca de Desarrollo (NAFIN)
Project name: Global Credit Program for Safeguarding the Productive Fabric and Economic Recovery

I. FIDUCIARY CONTEXT OF THE EXECUTING AGENCY

1. Use of country systems in the project[1]

Budget ☒	Reporting ☐	Information system ☒	NCB ☐
Treasury ☒	Internal auditing ☒	Shopping ☐	Advanced NCB ☐
Accounting ☐	External control ☒	Individual consultants ☐	Consulting firm ☐

2. Fiduciary capacity of the executing agency

NAFIN has executed several prior operations (2226/OC-ME, 2671/OC-ME, 2843/OC-ME, 3178/OC-ME, and 3237/OC-ME), and its institutional capacity and high level of development of its fiduciary systems have therefore been verified. Accordingly, the level of fiduciary risk for program execution is low. No weaknesses have been identified that could jeopardize effective execution of the program.

3. Fiduciary risks and mitigation actions

Fiduciary risk: High ☐; Medium ☐; Low ☒

II. CONSIDERATIONS FOR THE SPECIAL PROVISIONS OF THE CONTRACT

Exchange rate: The exchange rate used for accountability reporting will be the rate published in the Official Gazette of the Federation on the effective date when the executing agency makes the respective payments or transfers. Article 4.01(b)(ii) of the General Conditions.
Program audited financial statements: The executing agency will deliver annual audited financial statements for the project within 180 calendar days after the close of the fiscal year, in accordance with the terms of reference agreed upon with the Civil Service Department (SFP). The last of these financial statements will be delivered within 180 calendar days after the last disbursement. The fiscal year runs from 1 January to 31 December.

[1] Any system or subsystem that is subsequently approved may be applicable to the operation, in accordance with the terms of validation by the Bank.

III. AGREEMENTS AND REQUIREMENTS FOR PROCUREMENT EXECUTION

Exceptions to policies and guidelines

• No exceptions are planned.

Retroactive financing and/or advance procurement[2]	• The Bank may retroactively finance up to US$40 million (20% of the loan amount) in eligible expenditures incurred by the borrower for loans to MSMEs prior to the loan approval date, provided that requirements substantially similar to those established in the loan contract have been met. Such expenditures must have been incurred on or after 1 June 2021, the date on which NAFIN began expanding its portfolio stock after a substantial decline from March 2020 onwards. The authorization of retroactive financing as of 1 June 2021 is justified in light of the exceptional circumstances of the economic crisis caused by the pandemic and the significance of the economic recovery as of the first quarter 2021. There has been exceptional demand for funding from NAFIN financial intermediaries since that date, due to the need for resources to support that recovery.
Additional procurement support	• N/A.
Alternative procurement arrangements	• N/A.
Projects with financial intermediaries	• As this loan is for global credit programs and other operations in which resources are provided to financial intermediaries for subloans or other subfinancing modalities, it will be stipulated that the Bank's prohibited practices clauses are to be included in agreements between the borrower and its financial intermediaries, and between them and the subborrowers, as well as in contracts for goods, works, and consulting and nonconsulting services arising from such agreements, and any other contracts financed with Bank resources. Alternatively, if the effective inclusion of these clauses in the aforementioned contracts is not possible or practical in view of the circumstances of the project, the project team may examine other mechanisms to adopt acceptable controls and duly obligate the relevant third parties to the Sanctions Procedures. To do so, the project team will coordinate the design of such mechanisms with the

2 In accordance with the Bank Policy on Retroactive Financing, Recognition of Expenditures, and Advance Procurement (document GN-2259-1), or equivalent policy in effect at the time of the operation.

	Office of Institutional Integrity (OII), with the support of the Legal Department, and will describe them in the program Operating Regulations.
Procurement agents	• N/A.
Direct contracting	• N/A.

Operational expenditures: □ N/A.	**Domestic preference:** □ N/A.
Overall project procurement supervision method:	
Supervision method: N/A.	**For:** N/A.

Country thresholds: www.iadb.org/procurement**.**

IV. Agreements and Requirements for Financial Management

Programming and budget	• Disbursements under this operation will be classified as external credit and included in the budget ceiling allocated to NAFIN.
Cash management and disbursements	• Disbursements will be made in the form of advances of funds and reimbursements. • The disbursements mechanism will be upon the submission of disbursement requests through the e-disbursement system. Given the emergency and in accordance with instructions from the Bank's Legal Department, scanned disbursement requests will also be accepted electronically. • **Financial plan:** Advances will be made for a period of up to 12 months, depending on the demand for loans. For advances exceeding 6 months, justification must be provided of the need for a term longer than 6 months. • **Percentage for accountability reporting:** 80% of the balance of advances pending justification. • **Project cash flow:** Funds will be disbursed to NAFIN as borrower and executing agency. • Financing is provided for working capital subloans because working capital is an indispensable part of the program, as it covers companies' operational and liquidity needs, particularly given the current context of the economic crisis, by offering ongoing access to the short and medium-term financing that they need to rebuild production capacity.
Accounting, information systems, and reporting	• **Specific accounting standards:** Government Accounting Act and Government Accounting System, partly based on International Financial Reporting Standards (IFRS). • **Accountability reports:** List of transfers via eligible credits in accordance with the program Operating Regulations. • **Accounting method and currency:** Cash basis. Reports will be submitted in local currency and U.S. dollars.

External control	• **External audit:** The borrower and executing agency will select and engage the services of an eligible auditor acceptable to the Bank, in accordance with the terms of reference previously agreed upon with the Civil Service Department (SFP).
Financial supervision of the project	• **Ex post supervision:** Financial supervision will be through visits to NAFIN, working meetings, and review of reports and audited financial statements.

V. RELEVANT INFORMATION FOR THE OPERATION

Applicable policies and guidelines

Financial management	Procurement
• GN-2811 [OP-273-12]	• GN-2349-15 • GN-2350-15

Records and files

NAFIN has digital and physical files, as well as procedures and instructions for keeping proper records and files.

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-__/21

Mexico. Loan _____/OC-ME to Nacional Financiera S.N.C.
Institución de Banca de Desarrollo (NAFIN)
Global Credit Program for Safeguarding the Productive
Fabric and Economic Recovery

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 the Nacional Financiera S.N.C. Institución de Banca de Desarrollo (NAFIN), as Borrower, and with the United Mexican States, as Guarantor, for the purpose of granting it a financing to cooperate in the execution of a "Global Credit Program for Safeguarding the Productive Fabric and Economic Recovery". Such financing will be for the amount of up to US$200,000,000, 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 __ ________ 2021)

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