

TC Document

I. Basic Information for TC

▪ Country/Region:	REGIONAL
▪ TC Name:	Micro Small and Medium Enterprise (MSME) Support Facility
▪ TC Number:	RG-T3495
▪ Team Leader/Members:	Sierra Gonzalez, Eduardo (IFD/CMF) Team Leader; Pelaez Zambrano, Paula (INO/NFP) Alternate Team Leader; Alves Pinto, Romario (INO/FNP); Bernedo, Cecilia (IFD/CMF); Gallagher, Terence Liam (INO/FLI); Greco, Maria Sofia (LEG/SGO); Maffioli, Alessandro (DSP/DVF); Martinez Lopez, Cynthia Guadalupe (IFD/CMF); Sanchez Ramirez, Ana Paula (INO/NFP); Yanez Pagans, Patricia (DSP/DVF)
▪ Taxonomy:	Research and Dissemination
▪ Operation Supported by the TC:	N.A.
▪ Date of TC Abstract authorization:	18 Jun 2019.
▪ Beneficiary:	Member Countries in Latin America and the Caribbean (LAC)
▪ Executing Agency and contact name:	Inter-American Development Bank
▪ Donors providing funding:	OC Strategic Development Program for Countries(CTY)
▪ IDB Funding Requested:	US\$1,250,000.00
▪ Local counterpart funding, if any:	US\$0
▪ Disbursement period (which includes Execution period):	36 months (execution period: 33 months)
▪ Required start date:	November, 2019
▪ Types of consultants:	Firms and individuals consultants
▪ Prepared by Unit:	IFD/CMF-Connectivity Markets and Finance Division
▪ Unit of Disbursement Responsibility:	IFD-Institutions for Development Sector
▪ TC included in Country Strategy (y/n):	No
▪ TC included in CPD (y/n):	No
▪ Alignment to the Update to the Institutional Strategy 2010-2020:	Productivity and innovation; Economic integration; Gender equality

II. Objectives and Justification of the TC

2.1 Micro, Small and Medium Enterprises (MSME) in Latin America and the Caribbean (LAC) account for 99% of businesses and 61% of formal productive employment, and they are critical motors for growth and social inclusiveness in the region.¹ However, a significant number of MSMEs in the region tend to stay small, compete with a large informal sector, and have lower productivity than other larger firms in the region.² This is mostly caused by the lack of knowledge about adequate productive investments and technologies and convenient financing alternatives. MSMEs need access to adequate financing options to finance working capital, exports and imports, and innovation activities that can improve productivity and promote growth. Without access to

¹ For studies showcasing the positive relationship of SME and growth, please check OECD and CAF (2019). <http://www.oecd.org/industry/latin-america-and-the-caribbean-2019-d9e1e5f0-en.htm>. Also, Beck, Demircuc-Kunt and Levine (2003). <https://www.nber.org/papers/w11224.pdf>.

² MSMEs in Latin America. Dini y Stumpo, ECLAC, 2018.

adequate financing firms are more exposed to economic shocks, may be unable to purchase inventory or make timely payments to suppliers or employees, and may face limits in capital investments and technology adoption.³ The most important market failures preventing MSMEs from accessing adequate financing include asymmetric information, the presence of economies of scale, and externalities –including inflexible regulations and high transaction costs, among others. The microenterprise finance gap in LAC is estimated at US\$718.8 billion, and the SME finance gap at US\$4.5 trillion. The finance gap (23% of the total finance gap in developing countries) represents the second largest after the East Asia region.⁴

- 2.2 Tackling this funding gap to unlock MSME growth will require working with a wide range of Financial Commercial Intermediaries (FCI), including financial institutions, financial cooperatives, corporate value chains, Fintechs and other relevant technology providers. FCIs have an important role to play, both providing access to finance to MSMEs, but also facilitating access to markets as they increase their sourcing of goods and inputs from MSMEs. FCIs can also be pivotal in providing non-financial support to strengthen the business performance of MSMEs, for example, through training or improving awareness on sustainable business practices, among others. FCIs actions may also be targeted to specific MSMEs segments, such as women-led MSMEs or MSMEs operating in vulnerable or poor areas. The role of large corporates as anchor companies in value chains –as large buyers or sellers to/from MSMEs– is also critical. Anchor companies can leverage their longstanding relationships with MSMEs in their value chains, and in partnership with Fintechs they can increase MSMEs' working capital financing through supply chain finance schemes.
- 2.3 There is no single solution to address the diverse array of challenges impeding MSMEs' ability to improve productivity, performance, and growth across the region. Levels of financial development and specific gaps in MSME support vary across countries, and MSME segments within each country. In some cases, it will be adequate to help large FIs invest in tools that allow them to expand their overall MSME portfolios, while in others it may be more important to help private sector to analyze a specific market or technology or support FCIs to innovate on how to reach specific MSME segments not yet financed.
- 2.4 **Objective.** This TC seeks to increase MSME's growth and productivity by supporting financial intermediaries, Fintechs, and inclusive corporate value chains to adopt practices that seek to increase access to finance and market inclusion of MSME.
- 2.5 This TC is an initiative of the Bank to promote growth through private sector. Through this TC, IDB will work with support from IDB Invest to pilot different demand-driven approaches to benefit MSMEs by increasing their access to finance and non-financial assistance and capture and share lessons learned in order to promote uptake of successful interventions. These approaches include interventions tailored to address the barriers facing local providers of MSME finance, including financial institutions, Fintechs and corporate value chains, which can unlock more sustainable development results at greater scale. In terms of the barriers faced by FCIs, some of them are related to the same barriers highlighted for SMEs, such as having asymmetric information and technical capacity to select the right clients when reaching

³ IDB (2017), "Sector Framework Document on Support to SMEs and Financial Access and Supervision."

⁴ MSME Finance Gap. Bruhn, M. et al., IFC, 2017.

underserved or unserved segments. They are also related to lacking enough market information to design adequate product lines for new segments in their business. Finally, many FCIs need in-depth and evidence-based knowledge that guides them on cost-effective strategies to reach new MSMEs segments and strengthen those they are already working with. Anchor companies, on the other hand, can offer opportunities to MSMEs to integrate the regional or global economy, accelerate scale-up, innovate, strengthen its skillset, and access much needed working capital. Some anchor companies face technology challenges, as well as difficulty to integrate supply chain ESG risk management with supply chain financing schemes.⁵

- 2.6 Addressing financial constraints for MSMEs can play an important role in boosting competitiveness, growth and productivity ultimately benefiting the region's borrowing member countries of the Bank, through adequate financing that allows MSMEs to invest in human and physical capital, thus creating employment, improving their capacity to innovate, fostering changes in production, and expanding their business reaching economies of scale.⁶ Therefore, this TC will aim to facilitate the transfer of technical know-how and qualified experience with the purpose of complementing and strengthening national and regional technical capacities, thereby contributing to the primary purpose of the Bank: accelerating the process of economic and social development of the borrowing member countries, individually and collectively.
- 2.7 **Strategic Alignment.** The activities financed by this TC are consistent with the Update to the IDB's Institutional Strategy 2010-2020 (AB-3008) and is aligned with the development challenge of productivity and innovation, as it seeks to promote adequate knowledge and innovation ecosystems through technology adoption and adaptation to bolster development among MSMEs. It is also aligned with the development challenge of economic integration because it will promote the insertion of MSMEs into value chains through access to working capital (i.e. supply chain finance) and linkages and integration into regional value chains. Moreover, it is also aligned to the cross-cutting issue of gender equality by prioritizing support for women-led MSMEs. This TC is also aligned with the Ordinary Capital Strategic Development Programs (OC SDPs) for Countries (GN-2819-1), because it seeks to contribute to: (i) expand access to intraregional experiences and advance the exchange of cooperative know-how among all borrowing member countries by supporting project origination and financing high-quality inputs during project preparation in small and vulnerable countries; and (ii) taking targeted response measures to facilitate the removal of bottlenecks in project preparation and implementation. It is also consistent with IDB Invest Business Plan's (IIC-BP), and IDB Invest Action Plan for the Micro Small and Medium Enterprises, developed in partnership between IDB and IDB Invest. The TC is also aligned with the Sustainable Development Goals (SDGs) by supporting Goal 8 of "inclusive economic growth, through encouraging MSME employment generation, improve access to financial services and productivity gains", and Goal 5 of "gender equality by generating more inclusion of women-led MSMEs."
- 2.8 The project is in line with IDB's efforts to strategically employ OC resources to contribute to the acceleration of economic growth by supporting key sectors, such as SMEs and growth through the private sector with an emphasis on gender and climate change, among others (GA-269-4 par. 1.23). Particularly, it contributes by:

⁵ McKinsey and Company, McKinsey on Payment – Supply Chain Finance: The Emergence of a New Competitive Landscape, 2015.

⁶ International Trade Centre, "SME Competitiveness Outlook 2019."

(i) supporting the development and dissemination of innovative approaches, tools, methodologies, data, and practices that have a potential for replication or scaling-up in a country or subregion; and (ii) knowledge sharing and dissemination activities, including inputs and support to the policy dialogue, forums, online platforms, exchanges, and other instruments/activities to enhance dialogue and cooperation, with participation of public and/or private sector representatives. (GN-2819-1, paragraph 2.29). In addition, when applicable, the TC team will ensure ongoing communication and synergies with the TC “Facility to Boost Private Sector Growth in Small and Island Countries” (RG-T3502, under preparation), which – although its only focus in Small and Island Countries, it complements well the efforts of this TC, by developing capacities of SMEs to comply with international standards, access financing and other markets. As later explained in the Execution Structure section, the Advisory Services Team at IDB Invest (INO/NFP) will support IDB during the implementation of this TC and will ensure synergies and information coordination with TC RG-T3502.

III. Description of activities/components and budget

- 3.1 To achieve the stated objective, the TC will be structured in three mutually reinforcing components that will provide public and private stakeholders with tools to address the barriers facing providers of MSME finance, including financial institutions, fintech and corporate value chains:
- 3.2 **Component 1 – Market information and product feasibility.** Under this component, the TC will allocate resources to finance consultant services to: develop market information and product feasibility studies directed to FCIs or anchor companies which would allow them to better respond to MSME financing needs; improve or increase access to finance for MSMEs; assess new technologies to improve accessibility and affordability; and assess new market segments currently underserved. To this end, the TC will fund consultant services to perform market assessments, evaluate options and build roadmaps for adoption of technology, and support development of new products and/or internal processes to better serve MSME segments competitively. The allocation of resources on this component will be demand driven and will reflect opportunities that would allow testing effective approaches to support MSMEs by lowering barriers to access financing and through interventions that generate large-scale impact and replicable knowledge. Examples may include shared value assessments, cost-benefit analysis on the adoption of new technologies/digital platforms for affordable MSMEs service delivery, and regulatory and market assessments for sustainable supply chain finance schemes benefitting MSMEs, etc. The beneficiaries selection criteria will include scalability and potential for replicability and will be done in accordance with the approved IDB Invest MSME Action Plan,⁷ which two of its key pillars target gaps in MSME finance through financial intermediaries, as well as increase access to markets, finance and innovation to MSMEs through value chains. Potential beneficiaries include but are not limited to: (i) FI's developing this component and expanding products, programs, and geographic reach to address needs of underserved and unserved MSMEs; (ii) specialized financial

⁷ The MSME Action Plan is the result of a reflective process and considers relevant OVE's recommendations of IDB's support to MSMEs in the past. The Plan presents an opportunity to expand impact and reach more MSMEs in the region through financial institutions and value chains, to generate more knowledge, and to leverage synergies within the IDB Group.

service providers in need of strengthening their operations; and (iii) anchor companies promoting supply finance schemes and other financing opportunities in their value chains for MSMEs.

- 3.3 **Component 2 – Financial innovation.** This component will support financial intermediaries (banks and specialized financial service suppliers) and anchor companies inside value chains to develop adequate and competitive MSME financing solutions –including innovative financial products, instruments, methodologies and other financial services that enable access to finance for MSME and increase MSME integration in regional value chains. The component will focus on financial solutions that allow FCI and anchor companies to finance new sectors or segments, enabling financial inclusion and scale. Consultancy services will be used to develop financial schemes; improving risk management systems; design new delivery channels, products and services; structure partnerships with Fintechs and other relevant digital providers; and recommend/design trainings accordingly. Similar to Component 1, the beneficiaries selection criteria will be done in accordance with the approved IDB Invest MSME Action Plan. Moreover, selection criteria will prioritize scalability and potential for replicability of identified innovations, as well as readiness of FCIs/Anchor companies to implement such innovations.
- 3.4 **Component 3 - Knowledge, causal impact measurement, and dissemination.** Impact measurement is at the core of IDB's mandate, as it ensures the generation and diffusion of knowledge from operations.⁸ This approach helps to ensure that the focus is on delivering results and that project design and scale-up is evidence-based. In addition, it ensures a timely and transparent reporting on development impact to stakeholders. Given the importance of generating rigorous evidence on key innovations that are being carried out by IDB, this component will build on the other two components and will go beyond traditional monitoring mechanisms. The main objective will be to produce in-depth evaluations that are based on experimental or quasi-experimental methodologies and that will allow to measure the causal impacts of financial innovations. This is relevant to understand what would have been the situation of beneficiaries in the absence of the support and what value added is brought and can be attributed to the program of the IDB. Key findings from these evaluations will generate needed evidence to promote the adoption and scale-up of new technologies, products and business models across clients and the broader ecosystem in the region, to reduce market failures and better address the needs of MSMEs.
- 3.5 Detailed impact evaluation plans will be designed prior to the implementation of selected financial solutions.⁹ In certain cases, whenever retrospective data is available and credible evaluation methodologies can be implemented, retrospective studies could be implemented to measure the impacts of innovative financial solutions that already happened and that can serve to extract lessons to design future operations. The definition of key evaluation questions will be guided by financial innovations that are relevant for Components 1 and 2. For example, some questions that could be answered are: what are the most cost-effective interventions to provide non-financial assistance to MSMEs? How well do new credit scoring methods perform to provide

⁸ <https://publications.iadb.org/en/development-effectiveness-overview-deo-2019>.

⁹ Financial solutions that will be subject to in-depth evaluations will be selected from those implemented in Component 2, based on their potential to generate knowledge and the client's capacity and commitment to accompany the evaluation process.

greater financial inclusion while maintaining the FCIs performance? Studies will maximize as much as possible the use of FCIs own data collection instruments and support them in strengthening these information systems when needed. The lessons learned from these analyses will encourage replication and facilitate the spread of knowledge in MSME support in the region. Thus, activities in this component will finance systematic research, data collection, publications, events and seminars, and other dissemination efforts. Additionally, resources from this component will be used to finance the final evaluation of this TC to ensure this objective.

- 3.6 The total budget for this TC is US\$1,250,000 and is being financed through the CTY - OC Strategic Development Program for Countries. The table below provides an estimated breakdown of the TC budget per Component.

Indicative Budget (US\$)				
Activity/ Component	Description	IDB/Fund Funding	Counterpart Funding	Total Funding
Component 1	Market information and product feasibility	425,000	0	425,000
Component 2	Financial innovation	425,000	0	425,000
Component 3	Knowledge, causal impact measurement and dissemination	400,000	0	400,000
Total		1,250,000	0	1,250,000

IV. Executing agency and execution structure

- 4.1 The execution of this TC will be carried out by the Bank through the Connectivity, Markets and Finance Division (IFD/CMF) with support of the IDB Invest, who will advise the team during the execution of this operation. Based on the criteria mentioned in ¶3.2, the Team Leader of this TC in coordination with the Advisory Services Team of IDB Invest, will prioritize and select projects and update the Procurement Plan as needed. This TC is an initiative of the Bank and under the proposed taxonomy, knowledge and dissemination, the Bank is the Executing Agency and has no counterpart. The Bank has sufficient expertise in the area of access to finance to MSMEs, in order to be able to conduct the selection and hiring of quality consulting services.¹⁰ The Bank's role as Executing Agency of this TC is justified because the activities are intended to reach all countries in the region and there will be economies of scale in the execution and supporting IDB investment transactions. The TC activities will research on the MSME ecosystem, including FCIs and anchor companies who reach a vast number of MSME, as well as other support agencies that play a key role in MSME development and access to finance.
- 4.2 These activities will benefit public¹¹ and private stakeholders with similar characteristics in different LAC countries that can take advantage from the generation of horizontal knowledge and the development of spillovers. The products developed by this cooperation are expected to generate knowledge to inform the development

¹⁰ OP-619-1 Annex 10 – Criteria for Bank Contracting.

¹¹ Public stakeholders include public policy entities such as ministries of industry and trade, public development banks, economic development agencies, central banks, etc.

of public goods that help improve public policies implemented by governments and other local development entities. In this regard, the project team will coordinate with IDB's Country Offices to ensure the identification of opportunities and the dissemination of activities and results in the countries.

- 4.3 All activities to be executed under this TC have been included in the Procurement Plan (see Annex III) and will be contracted in accordance with Bank policies as follows: (i) AM-650 for Individual consultants; (ii) GN-2765-1 and Guidelines OP-1155-4 for Consulting Firms for services of an intellectual nature; and (iii) GN-2303-20 for logistics and other related services.

V. Major issues

- 5.1 The main risks identified are: (i) low demand for the services to be provided, which will be mitigated by working closely with relevant and high-impact private sector entities to ensure market-relevant and demand-driven support, as well as ensuring strong dissemination of knowledge and lessons learned; and (ii) high mortality of SMEs could undermine the expected impact of specific activities financed by this TC, which will be mitigated by providing technical assistance to strengthen FCIs and anchor companies to better identify and implement strategies that seek to strengthen SMEs capacity to reduce their mortality rate.

VI. Exceptions to Bank policy

- 6.1 There are no exceptions to Bank policy.

VII. Environmental and Social Strategy

- 7.1 Given the nature of the program, there are no associated environmental or social risks. Based on the Environment and Safeguards Compliance Policy (OP-703) this operation is classified as "C" (See [Safeguards Policy Filter](#) and [Safeguard Screening Form](#)).

Required Annexes:

[Results Matrix - RG-T3495](#)

[Terms of Reference - RG-T3495](#)

[Procurement Plan - RG-T3495](#)