

GLOBAL SMALL BUSINESS AND MICROENTERPRISE CREDIT PROGRAM II

(AR-0127)

EXECUTIVE SUMMARY

Borrower:	The Argentine Republic
Executing agencies:	The Secretariat for Small and Medium-sized Business, Office of the President of the Republic (SEPyME). The Central Bank of Argentina (BCRA) will act as financial agent.
Amount and source:	<ol style="list-style-type: none">1. Ordinary capital (foreign exchange) – credit component IDB: US\$ 98,000,000 (OC/for ex) Local counterpart funding: US\$ 98,000,000 Total: US\$196,000,000 The IDB funding will be in US dollars from the Single Currency facility.2. Ordinary capital (local currency) – technical assistance component IDB: US\$2,000,000 (OC/lc) Local counterpart funding: US\$2,000,000 Total: US\$4,000,000
Terms and conditions:	<ol style="list-style-type: none">1. Ordinary capital (foreign exchange) Amortization period: 20 years Commitment period: 3 years Disbursement period: 4 years Interest rate: Variable Inspection and supervision: 1% Credit fee: 0.75%

2. Ordinary capital (local currency)

Amortization period:	20 years
Commitment period:	3 years and 6 months
Disbursement period:	4 years
Interest rate:	4%
Inspection and supervision:	1%
Credit fee:	N/A

Objectives:

The principal objective of the program is to continue providing credit support to enhance the productive capacity of small businesses and microenterprises (SBMs), and thereby help them to become more competitive and to reduce unemployment.

A supplementary objective of this operation, which draws upon the lessons learned from execution of the first SBM Program (Loan Contracts 643/OC-AR and 867/SF-AR), is to serve as a catalyst in encouraging participating intermediary financial institutions (IFIs) to respond more fully to SBM credit demands, on a self-sustaining basis from their own resources.

Description:

The proposed program consists of two components: (i) a credit component (US\$196,000,000), to be channeled through regulated IFIs that meet the eligibility criteria of the program and are willing to provide financing at market terms and conditions and to make increasing use of their own resources in support of the target group; and (ii) technical assistance (US\$4,000,000), which will include activities to promote the transfer of appropriate lending technology to eligible IFIs and to provide institutional strengthening for the executing agency.

Environmental and social impact review:

The Committee on Environment and Social Impact reviewed and approved the program. Its recommendations focus on continuing and strengthening the activities launched under the first program using Bank guidelines for this type of operation. These recommendations have been incorporated into the Loan Proposal (see paragraphs 2.22 to 2.27 and 3.44 to 3.47) and the Credit Regulations.

Benefits:

1. Benefits to small business and microenterprise:

The planned program is intended to support an expanded supply of credit to SBMs, on market terms and conditions, so that they can take advantage of investment opportunities that were hitherto beyond their reach. As well, it will serve to foster greater competition in the supply of such financing, to the benefit of borrowers.

The program will encourage commercial banks to pay more attention to the SBM sector by demonstrating that this is a segment that offers real possibilities for developing a permanent financing relationship. Achieving this objective will mean incorporating this type of financing as part of the commercial banks' business strategy so that in the future they will devote increasing amounts of their own resources to such lending, rather than relying solely on funding from international agencies. Having permanent access to credit will make these productive units more viable and help to increase their revenues.

2. Benefits for the IFIs

Bringing new SBMs into the bank lending market will mean a more diversified client base for financial institutions and hence a better distribution of risk. As well, it may be expected that over time SBMs will require other kinds of banking services, offering new business opportunities for the IFIs. The program will also make it possible to attract institutions that have traditionally shied away from lending to SBMs, thus making the market more competitive.

On the other hand, the program will foster rapid growth in IFI loan portfolios and will help them to improve their lending methodology and to achieve economies of scale. This will allow participating institutions to become more efficient in working with SBMs.

Risks:

1. Macroeconomic context

Social pressures arising from a deterioration in macroeconomic conditions could lead the government to change the course of its economic policy to the detriment of the current environment of price stability. The impact of such a shift on investment, credit demand and the willingness of the IFIs to provide credit is unpredictable. Nevertheless, the measures undertaken by the government (for example, fiscal control) suggest that the country will maintain its present course despite an unfavorable international economic setting.

2. IFI solvency

Experience during execution of SBM I showed the need to ensure that IFIs participating in the program are financially sound and in compliance with the demanding regulatory requirements of the BCRA, in particular with respect to the smaller banks. Strict observance of the program's eligibility criteria will ensure that all participating entities are solvent and capable of operating competitively.

3. The situation of the SBMs

Despite the economic reforms that have been undertaken in Argentina, SBMs still face a number of limitations flowing essentially from the high fixed costs inherent in their lack of economies of scale. In addition, the relatively few support services to which SBMs have access are inadequate, and this fact, combined with market failures (asymmetries of information and externalities), has limited their response to structural reform. In this respect, the government, through the SEPyME, has taken a series of initiatives which, together with this proposed program, will make it easier for SBMs to gain access to financial and nonfinancial services that will improve their competitive positioning. The Bank is supporting several of these initiatives, as mentioned in the project report.

Project role in the Bank's country and sector strategy:

The Bank's activity in Argentina is concentrated in three basic areas: (i) strengthening and consolidating the **modernization of the State** at the central level and extending this to the provincial and municipal governments; (ii) **reducing poverty and raising living standards** through efforts to increase the quality and coverage of social programs; and (iii) **enhancing the productivity and competitiveness** of the commodity-producing sectors of the economy, with a focus on environmental protection, through the provision of support infrastructure, upgrading the productive apparatus and promoting regional integration.

This program will help to enhance the productive capacity and competitiveness of SBMs through the supply of credit, and will seek to institutionalize a financial services mechanism targeted at this sector. In addition, it will contribute to reducing poverty and raising living standards in the SBM sector.

Exceptions to Bank policy:

None.

**Special
contractual
conditions:**

Conditions precedent to the first disbursement: (i) the borrower and the BCRA will sign an agreement setting out the obligations of each party in executing the program (see paragraph 3.2); (ii) the Director of the PCU and the operational and administrative coordinators will be selected and hired on terms agreed with the Bank (see paragraph 3.5 (a), (b) and (c)); and (iii) the Credit Regulations must be in effect (see paragraph 3.8).

Conditions during the life of the financing: two special evaluations of the program will be performed during execution, after funds have been committed to the extent of 25% and 75%, respectively (see paragraphs 2.17, 3.50 and 3.56).

**Poverty
targeting and
social sector
classification:**

This operation does not qualify as a social equity enhancing project, as described in the indicative targets mandated by the Bank's Eighth General Increase in Resources (document AB-1704).

Furthermore, this operation does not qualify as a poverty targeted investment (see paragraph 4.6). The borrower will not be using the 10 percentage points in additional financing.

**Procurement of
goods and
services:**

For the procurement of goods and services, where required, the Bank's standard procedures will be used.

I. FRAME OF REFERENCE

A. Macroeconomic context

- 1.1 The economic program pursued by the national government since 1991 has served to revive the economy and to produce growth both in GDP and in real incomes. The government has instituted a program of monetary and fiscal policy reform that has succeeded in stabilizing the national currency. The success of the "convertibility law," together with increasingly determined efforts to reduce federal government expenditure and improve tax collection, has been reflected in a dramatic drop in the inflation rate. The principal result of this measure has been to strengthen confidence in the system.
- 1.2 The "currency board" system prevents devaluation of the currency, which is pegged to the US dollar at a ratio of 1:1, and requires that every peso in circulation be backed by one dollar in the reserves of the Central Bank of Argentina (BCRA) (a smaller percentage may be held in dollarized securities). The Argentine economy at the present time is in fact heavily "dollarized": 55% of deposits and 50% of loans are denominated in dollars, indicating in effect a dual-currency economy.
- 1.3 While the existence of a fixed exchange rate has had the undoubted benefit of stabilizing prices, it has also forced the export sector to become more competitive. Increasing the competitiveness of small and medium-sized enterprises has become vital to their survival.
- 1.4 The external sector has seen a sharp increase in its trade balance deficit, primarily because of falling commodity prices, but external financing has been sufficient to cover this deficit and at the same time to increase the BCRA reserves.
- 1.5 GDP is expected to fall by about 1% in 1999, reflecting the change in Brazil's exchange rate and the impact this has had on the Argentine economy, particularly on the industrial sector. The need to support GDP growth, to reduce unemployment and to stimulate activity in the private sector, calls for a program, such as the one proposed here, that will help to strengthen private production units and ensure the steady flow of funding to the microenterprise and small-business (SBM) sector, which continues to experience difficulty in gaining access to credit.

B. The financial system

- 1.6 At the end of 1998, the Argentine financial sector was composed of 19 public banks, 90 private banks and 23 non-banking financial entities. Since 1991, the sector has made significant adjustments in response to a series of international financial crises. This process has not only led to the disappearance of many financial entities, but has accelerated the merger of small banks and banking

cooperatives with larger financial institutions, and has prompted the privatization of provincial banks.

- 1.7 The current structure and operating mechanisms of the Argentine financial sector reflect, in large part, the process of structural reform that has been undertaken since 1991, a significant aspect of which has been the changes introduced to banking legislation and to the supervisory role of the BCRA.
- 1.8 Without attempting to list all of these important changes, the following may be noted: a high number of financial institutions were liquidated and disappeared in the wake of the 1995 crisis, leaving behind a more solid financial system; the capital adequacy ratios of the remaining financial institutions are higher than the minimum required by the Basle standards; the convertibility regime placed severe limits on the capacity of the BCRA to act as lender of last resort, but this has been overcome through an agreement with the banks to cover a significant portion of total bank deposits; a private deposit insurance system was created, financed by the financial entities themselves; BCRA superintendents have made progress in strengthening prudential rules and in supervising the financial system; and a new system for classifying financial entities has been agreed with international risk rating firms.
- 1.9 There has been a change in policy with respect to the public banking sector, inspired by the heavy losses experienced by the provincial banks, which required financial support that neither the federal nor the provincial governments were in a position to deliver. This has resulted in establishment of a successful program for liquidating these banks or selling them off. In fact, while the reforms introduced to the financial system have not yet produced an across-the-board improvement in the financial intermediation process, those banks that are still in operation are now going through a period of consolidation and repositioning.
- 1.10 A review of the financial system, to 31 December 1998, shows that total assets of the system reached the equivalent of US\$146,724 million, of which the loan portfolio represented US\$76,547 million. The quality of the portfolio recovered toward the end of the year, after having registered a continuous but slight deterioration beginning in August of that year. The financial default indicator for the system rose slightly from 9.5% in September to 10.1% in December 1998.¹ Capital adequacy in terms of risk weighted assets, according to the Basle criteria, rose to 17%, well above the minimum international standard of 8%.
- 1.11 The average profitability performance of the Argentine financial system is still short of desirable levels. At the end of 1998, the system showed an average return of 6.2% on equity, slightly higher than that recorded for 1997, which was 5.7%. The rate of return on bank assets was 0.66% per year (December 1998),

¹ A transaction is considered to be in irregular status if payments are in arrears by more than 30 days.

against 0.72% for the same month of the previous year. This situation is thought to be due, in large measure, to the set of provisions adopted by the BCRA during the last twelve months, requiring the banks to maintain higher reserves and provisions.

C. Microenterprises and small businesses (SBMs)

1. Characteristics of microenterprises and small businesses

- 1.12 As part of its development strategy, the Argentine government is committed to targeting support to small-scale economic units in all sectors of the economy. This group includes small businesses that are "formalized" and fully integrated into the economy, microenterprises associated with small businesses in the formal market, semi-informal microenterprises such as small manufacturing and craft workshops, retail merchants, repair services, and informal activities such as street vendors, repair services (generally conducted from home) and the many other activities that are considered together under the concept of self-employment. This last group constitutes the target population for government policies and nongovernmental efforts at social development, as an acknowledged strategy for reducing poverty.
- 1.13 It is difficult to quantify microenterprises and small businesses in Argentina in terms of obtaining and updating hard data. Bearing in mind these limitations, data for 1996² suggest that there are 1,200,000 economic units with fewer than five employees in the country's urban areas as a whole.

SBMs as a proportion of all businesses (establishment size by economic sector)

SIZE (employment)	INDUSTRY	TRADE	SERVICES	TOTAL
MICROENTERPRISES (1 TO 5)	71%	95%	89%	91%
SMALL BUSINESSES (6 TO 25)	22%	4%	9%	7%
TOTAL SBMs	93%	99%	98%	98%

SOURCE: NATIONAL ECONOMIC CENSUS 1994, Final Results/Revised Version, INDEC, 1997

- 1.14 SBMs employ a substantial percentage of the country's working population, as can be seen from the above table. Firms employing up to five persons account for 91% of the national total of business establishments in the industry, trade and services sectors. If those employing 6 to 25 persons are included, the SBM sector accounts for 98% of businesses in the country. In the trade sector, the overwhelming majority of establishments are SBMs, and this is true of the services sector as well. In industry, the equivalent figure is 93%.

² Program Information and Evaluation System (SIEMPROS), Ministry of Social Development, based on data from the Permanent Household Survey, INDEC.

- 1.15 The SBM sector generates 60% of Argentina's jobs. In the trade sector they absorb 87% of total employment, in services 53% and in industry 36%. These data show the differing dynamics within each sector of activity.

2. Credit demand by the small-business and microenterprise sector and supply of financing by the banking system

- 1.16 Two trends have been apparent in the Argentine financial system over the last few years. The first has been the gradual but steady remonetization of the economy that has been taking place since the end of high inflation (which normally leads to a drop in the demand for money in real terms). The temporary interruption of the trend that was noticed in 1995 did little to derail its progress. The process of remonetization has led to a significant increase in dual-currency deposits in real terms, to around 20% of GDP, although these levels are still relatively low in comparison with those that were typical of Argentina in the decades preceding the inflation, when they stood at around 60% of GDP. This suggests that remonetization, which brings with it a parallel process of expanding bank credit, will continue for some time, as long as the growth and macroeconomic stability of the last few years continue.
- 1.17 The second trend, which has been highlighted by recent circumstances, is the growing resort that large companies are having to debt and capital markets, both domestic and external (marketable debt, bonds, share issues, etc.), as a substitute for bank borrowing. This process, which is sometimes referred to as disintermediation, means that the banking system's best borrowers (or at least its largest ones) are turning to other sources of finance.
- 1.18 The persistent growth of credit in real terms, and disintermediation by the largest borrowers in the system, are creating pressures and incentives that are leading the commercial banking sector to pay increasing attention to smaller-sized businesses. These two trends hold out good prospects for fostering a greater flow of credit to smaller companies, at interest rates that are falling in response to continued financial stability.
- 1.19 In addition, the rigidity and persistence of interest rate controls in an inflationary atmosphere long had a negative impact on bank financing for small businesses. Interest rate controls effectively shut down the rate structure that allowed banks to offset higher risks with higher interest rates, to the prejudice of small businesses, which are generally considered to be higher-risk borrowers. Currently, with the reestablishment of free interest rates and macroeconomic stability, risk discrimination is again becoming more efficient.
- 1.20 The BCRA has no information on the distribution of bank lending by size of borrowers, and this makes it difficult to provide an accurate quantification of the potential demand for credit by small and micro businesses. Nonetheless, given the number of SBMs in the market, this demand is thought to be significant. The

recent business survey by INDEC shows that only 11% of firms with fewer than 15 employees, surveyed in the metropolitan area of Buenos Aires, had ever obtained a loan from a formal financial institution, while 12% had turned to informal lenders for their funding needs. It is important to note that current banking legislation in Argentina prevents banks from lending to businesses that are not formalized.

- 1.21 The shortage of credit and the scarcity of financial institutions specializing in the small-business sector have had a significant impact on the competitiveness of small businesses. This fact has been confirmed by the research, surveys and samplings that were conducted by the Bank for the Entrepreneurship Strategy,³ as well as the study on small and medium-sized businesses in Argentina by the Latin American Economic Research Foundation (FIEL) of Argentina (December 1995), and the assessment of experience with SBM I.
- 1.22 The commercial banking system's experience in lending to SBMs is limited to activities under the first Global Microenterprise and Small Business Credit Program (loan contracts 643/OC-AR and 867/SF-AR). The commercial banking system has shown a growing interest in funds available under that program over the last four years, which suggests that they are now including the SBM sector in their "target population". In addition, it is expected that the new single-tax system⁴ will serve to increase the effective demand for credit by microenterprises.
- 1.23 In conclusion, the commercial banks are being driven by greater competition from the recent spate of institutional mergers to change their attitude towards the SBM sector. Some banks have already taken the decision to pay more attention to this market segment, adopting a cautious but progressive approach. Bank managers have indicated that the principle stumbling blocks are now the lack of lending technology systems and the shortage of technically trained personnel for this type of lending transaction.
- 1.24 Access to credit is a key priority for the development of SBMs, since the kind of financing available through suppliers and finance companies carries interest rates many times higher than those offered by the financial market, and places a significant burden on the sector's profitability.

³ This Strategy was prepared on the basis of document GN-1885, Enterprise Development Strategy – Small and Medium-sized Enterprises, and the methodology stipulated for developing these strategies. Its results were incorporated into the country paper (GN-1951) for Argentina and its priority activity areas.

⁴ The "Monotributo" or single-tax system that recently came into effect is intended, as its name implies, to unify the various national taxes and social security contributions into one single payment, which also allows businesses to reduce their VAT (value-added tax) burden. It is hoped that this move towards tax simplification – which requires no special administrative expertise – will have the result of enlisting new taxpayers, articulating the system more closely with the formal economy, and improving access to Bank lending.

- 1.25 To address these problems, the proposed program would continue the steps to broaden access and coverage of credit for SBMs that were initiated by the first Global Microenterprise and Small Business Credit Program.

D. Evaluation of the first Global Microenterprise and Small Business Credit Program.⁵

- 1.26 The first Global Microenterprise and Small Business Credit Program began execution in early 1994, with the objective of expanding access to credit and providing training and technical assistance to SBMs. The program, financed with loans 643/OC-AR (US\$30 million) and 867/SF-AR (US\$15 million plus US\$15 million in local counterpart funding), constituted the first specific measure taken by the national authorities in support of the sector's development.
- 1.27 During the first quarter of 1997, resources of the credit component were fully disbursed, and since that time the program has continued to operate with recoveries under the loan. By May 1998, US\$89.5 million had been allocated (US\$40.7 million from IDB financing, US\$26.2 million from recoveries, and US\$22.6 million from the participating banks), with an average disbursement per loan of US\$9,412. The program provided financing, through 32 banks, for 9,510 microenterprises and small businesses, located in 21 of the country's 25 jurisdictions.
- 1.28 Financing by sector was as follows: services, 31%; trade, 29%; industry, 19%; agriculture, 14%; and transportation, 7%. None of the activities under the program was found to have a negative environmental impact. Some 15.4% of loans were granted to female owners of SBMs, but it should be noted that only in a few cases, primarily family-run firms, is the ownership of a business recorded in the name of a woman.
- 1.29 In the credit area, while the program was successful in awakening the interest of the commercial banking system in the target group, it is recognized that the measures carried out to date have not been sufficient to ensure a permanent and self-sufficient channel of credit to SBMs within the financial system. Experience suggests that to achieve this will require the introduction of appropriate credit technology, since traditional procedures are not adequate for dealing effectively with this target group's demand for financial services.
- 1.30 During the four years of execution of the credit component of SBM I, 32 intermediary financial institutions made use of its resources. In general, banks showing the greatest interest in the first round of bidding were those in the second and third tiers, with the exception of the Banco de la Nación and the Banco de la

⁵ The evaluation of this operation is based on the PCR that was distributed with Memorandum RE1/FI1-299/98, of November 13, 1998.

Provincia de Buenos Aires. It was assumed in the design of SBM I that these two banks would take the largest share of resources.

- 1.31 Some entities that declined to participate pointed to reasons such as their lack of familiarity with the program, reflecting the failure to ensure adequate promotion, information and steady publicity for it; others recognized that there had been an initial promotional effort, but its impact had quickly faded. In general, the factors they suggested for improving its design have been taken into account in preparation of the program currently proposed. These relate to such aspects as the following: there was a lack of continuity in bidding procedures; the program was administratively complex; contradictory instructions emanated from the BCRA, scattered through half a dozen official circulars; the process of deciding on the eligibility of would-be participants was too slow; the complicated process of allocating funds to IFIs created uncertainties, because the amounts actually awarded at each bidding would only be confirmed one or two months later; and the mechanism of guarantees required by the BCRA was cumbersome.
- 1.32 The program also included a training and technical assistance component for final beneficiaries and IFIs, but this component was severely affected by institutional changes within the program executing agency. After a number of revisions, this component has been adjusted and its execution period has been extended, with the expectation that it can be satisfactorily concluded within that time. Fifty-seven technical support entities participated in this component, and through them more than 2,000 entrepreneurs received training or technical assistance. Nonetheless, the component has had a limited impact because of poor promotion and the lack of technical capacity for handling this type of activity.
- 1.33 While SBM I was the country's first experience in providing governmental support to microenterprises, a number of other initiatives have been taken in recent years by both public and private institutions, although on a reduced scale and within a very limited area. They have served, however, to demonstrate that there is an interest in supporting and developing SBMs.

E. Rationale for the new program

- 1.34 It is increasingly clear that providing access for SBMs to credit from the financial system is a key factor for the country's development. This calls for consolidation of the supply of small-scale credit in order to provide the needed economic impetus to growth in the sector. To date, the commercial banking system has been unable to satisfy this need, and has continued to demonstrate its traditional reluctance to become involved with small-scale enterprises. Banks consider operations of this kind to be too risky, and they have faced a lack both of human capital and of suitable credit technology, as well as of refinancing sources that can offer terms appropriate to the credit needs of the sector. Financial institutions regard the investment of resources in developing credit technologies as a risky and expensive undertaking.

- 1.35 The program will contribute to a long-term solution to these problems, by providing a catalyst for financial market initiatives by allocating a steady flow of financial resources and increasing the incentive for the banks to adopt a credit technology appropriate for SBMs.

F. Key elements in the program's design

- 1.36 The program has been designed to allow IFIs to respond promptly and flexibly to the credit demands of the target group, by offering loans on market terms and conditions and using mechanisms to raise market funds as a means of ensuring the sustainability of these financing activities.
- 1.37 Eligibility under the program will be restricted to formally constituted financial intermediaries that give evidence of solvency and low default rates, and can show that their operating policies provide for full cost recovery and that their capital is adequate to cover transaction risks.
- 1.38 In seeking an appropriate response to the credit demand of SBMs, it is essential to ensure that the funds are allocated to IFIs in an expeditious and transparent manner. The BCRA will be responsible for financial administration of the program, in line with Bank classification standards and the rules of the program itself. IFI eligibility will be determined on the basis of the country's prevailing risk classification categories. Funds will be allocated on the basis of bidding, and will be awarded in lots to the best interest rate offers submitted by eligible IFIs.
- 1.39 Technical assistance for IFIs will be directed at: (a) training a new kind of loan officer, specialized in microenterprise lending, (b) introducing a computerized system for monitoring microcredit, and (c) implementing the institutional changes needed to streamline the processing and approval of credit applications. These institutional strengthening measures will help to lay the basis for the sound management of microcredit operations.
- 1.40 The program also includes technical assistance for the executing unit within the Ministry of Small and Medium-sized Enterprise (SEPyME) and the BCRA. In particular, it calls for establishing an information system for coordinating public and private initiatives aimed at the target group, as well as training activities to improve monitoring of the credit component.

G. Program consistency with the Bank's country strategy

- 1.41 The Bank's activity in Argentina is concentrated in three basic areas:
(a) strengthening and consolidating the **modernization of the State** at the central level and extending this to the provincial and municipal governments;
(b) **reducing poverty and raising living standards** through efforts to increase the quality and coverage of social programs; and (c) **enhancing the productivity and competitiveness** of the commodity-producing sectors of the economy, with a focus on environmental protection, through the provision of support

infrastructure, upgrading the productive apparatus and promoting regional integration.

- 1.42 This operation will help to strengthen SBMs through the use of mechanisms that have already demonstrated their effectiveness, and it is thus complementary to other operations financed by the Bank and by MIF⁶ that are now in the execution phase. These operations offer nonfinancial services such as training, technical assistance and information in the area of micro, small and medium-scale enterprise.

⁶ The Business Development Support Program (Loan 989/OC-AR); the Network of Business Service Centers (ATN/ME-4851-AR); the Assistance Program for Small Rural Producers (ATN/ME-5441-AR); the Urban Microenterprise Support Services Program (ATN/ME-5489-AR); and the Advisory Center for New Business (ATN/ME-5765-AR).

II. THE PROGRAM

A. Objectives

- 2.1 The principal objective of the program is to continue providing credit support to enhance the productive capacity of small businesses and microenterprises (SBMs), and thereby help them to become more competitive and to reduce unemployment.
- 2.2 A supplementary objective of this operation, which draws upon the lessons learned from execution of the first SBM Program (Loan Contracts 643/OC-AR and 867/SF-AR), is to serve as a catalyst in encouraging participating intermediary financial institutions (IFIs) to respond more fully to SBM credit demands, on a self-sustaining basis from their own resources.

B. Description of the program

- 2.3 The proposed program consists of two components: (a) a credit component, channeled through regulated IFIs that meet the eligibility criteria of the program, and which are willing to provide financing at market terms and conditions and to make increasing use of their own resources in support of the target group; and (b) technical assistance, which will include activities to promote the transfer of appropriate lending technology to eligible IFIs and to provide institutional strengthening for the executing agency.

C. Credit component

- 2.4 This operation constitutes the second stage of the Global Small-Business and Microenterprise Credit Program (loan contracts 643/OC-AR and 867/SF-AR), which was totally disbursed in 1997 and is now continuing with the use of loan recoveries, with the result that a greater number of SBMs in all economic sectors now have permanent access to credit.
- 2.5 The credit component will finance transactions at market terms and conditions, to be negotiated by the target group with the participating IFIs. This line of credit will be managed by the BCRA, applying program eligibility criteria for the selection of IFIs and employing a flexible financing mechanism. Interest rates to

IFIs will be established through a bidding process,⁷ on the basis of rates prevailing in the Argentine financial markets, and IFIs will be free to negotiate the rates they charge to clients on their subloans. As in the case of SBM I, the proposed program will allow financing for working capital, the acquisition of fixed assets, and the contracting of services.

- 2.6 To ensure that resources actually reach the target group, the following selection criteria have been established: (a) the sales volume of each borrowing beneficiary must not exceed US\$500,000 annually (exclusive of VAT); (b) the maximum amount per client and/or subborrower will be US\$50,000; (c) the median size of subloans per IFI must not exceed US\$10,000; and (d) maximum repayment terms will be set at 48 months for working capital and 60 months for fixed assets.
- 2.7 The credit component will provide IFIs with the opportunity to obtain long-term funding. At the present time, the term structure at which the banks fund themselves does not allow them to engage in medium and long-term lending to smaller-scale enterprises.

D. Technical assistance component

1. Strengthening the credit system

- 2.8 The government has made it a priority to support the development and growth of SBMs through the provision of both financial and nonfinancial services. In order to facilitate the supply of credit to SBMs, this component provides for strengthening IFIs by encouraging them to utilize appropriate lending technology. Consistent with this objective, and in line with international practice involving the use of “matching grants,” the government will be prepared to cofinance a portion of the investment (up to 50%) for IFIs that meet the requirements described below (see paragraph 3.29).
- 2.9 The success of any microenterprise credit program will depend on a properly designed lending technology and on adequate technical training for loan officers. In addition, having a proper lending technology will strengthen the financial institution's capacity to obtain, process and analyze information on the applicant and on the security offered. Generally speaking, small businesses are not in a position to provide the information or guarantees that banks require, and for this reason the loan officer must be fully aware of the socioeconomic, domestic and

⁷ Bidding is a process of public auction whereby the PCU/BCRA will offer eligible IFIs a specified amount of funding for credit transactions with SBMs that meet the agreed eligibility criteria. The bidding will involve a “base rate” (the cost of IDB funds plus a percentage for administrative expenses), a “per-bidding floor rate” (interest rates for 90 day certificates of deposit, adjusted for reserve requirements, offered by the three largest banks in the system), and finally a “bidding cut-off rate” derived from the weighted average of rates offered by IFIs that are higher than the floor rate. Funds will be awarded in order, beginning with the best interest rate offer, until the available funds are exhausted. The bidding process is described in the Credit Regulations (see technical files).

labor situation of the entrepreneur in order to be able to assess the business in the context of the family unit.

- 2.10 In addition, a proper lending technology establishes standards with respect to credit analysis, volume of lending, portfolio per loan officer and earnings from that portfolio. The most appropriate tool for managing this portfolio consists of software specially designed for such transactions, which will allow procedures to be standardized and administration costs to be reduced.

2. Strengthening the SBE Secretariat

- 2.11 **Research and studies:** systematic studies will be conducted into the variables required for assessing the structure and evolution of the SBM sector.⁸ To this end, one strategy will be to propose that the National Statistics and Census Institute (INDEC) produce a systematic module designed specifically for microenterprises, for inclusion in its Permanent Household Survey (EPH) and the National Agricultural Surveys (ENA). Ad hoc studies will also be needed in critical areas relating to microenterprises, which should reflect concrete requirements (for example regulations, tax policy, access to social security, unionization in the sector, working conditions for microenterprise employees, design of methodologies for measuring the impact of support programs, etc.). In addition, studies will be undertaken to determine whether certain banking system regulations and operating procedures are making it more difficult for microenterprises to obtain credit.⁹
- 2.12 **Information on SBMs:** with a view to coordinating public and private initiatives, and to target financial and nonfinancial services to microenterprises, a Microenterprises Benchmark Information Module will be developed, for inclusion in the existing information systems managed by the SEPyme, providing timely and readily accessible information on the minimum requirements for access to support programs, benefits etc. Such information should be highly useful for public entities, municipalities, banks, NGOs, chambers of commerce, and in general any entity devoted to supporting microenterprises.

3. Strengthening supervision

- 2.13 The program will facilitate the exchange of experiences with supervisors and executives in similar entities in other countries of the region that have undertaken successful programs for meeting the needs of SBMs.

⁸ The results of this work will be incorporated or will complement the design of the SME Observatory for Latin America and the Caribbean (ATN-EA-5846-RG), which is currently being executed by the Bank (SDS/IFM)

⁹ These studies will involve the exchange of information with the Microfinance Policy and Regulatory Framework Reform Project (ATN/SF-6428-RG) currently being executed by the Bank (SDS/MIC).

- 2.14 Supervision will also be strengthened through the provision of specialized advisory services in specific areas, such as banking regulation, in order to analyze and propose adjustments to existing regulations governing the sector.

4. Environmental advisory services

- 2.15 Advisory services and guidance will be provided to the target group and the participating IFIs with regard to the country's environmental standards and Bank guidelines. This will involve expanding upon the activities initiated during execution of SBM I to raise awareness of environmental protection among SBMs and to strengthen the capacity of IFIs to give due consideration to the environmental aspect of credit management. Activities will focus primarily on providing information, training and guidance.¹⁰

5. Promotion and dissemination

- 2.16 Retrospective reviews suggest that one of the weaknesses of SBM I that could be improved under the proposed program had to do with promoting the program and publicizing its activities. This component will pay for a promotion and publicity campaign, using specialized services and appropriate media, throughout the life of the program. Given the nature and mechanisms of the program, this will have to be a shared responsibility of the SEPyme and the BCRA, working through IFIs.

6. Evaluation

- 2.17 The program will pay for two special evaluations during the course of execution, when financing resources have been 25% and 75% committed, respectively. These evaluations will measure progress to date in light of program objectives and will assess the effectiveness of the execution and monitoring mechanisms. The independent evaluations may lead to recommendations for the review or reformulation of certain aspects of the program, if necessary.

7. Monitoring and audit

- 2.18 The program will pay for the services of an independent auditing agency, acceptable to the Bank, to examine the financial statements for the program and to supervise the use of resources.

E. Cost and financing

- 2.19 The estimated cost and financing for executing the program are shown below:

¹⁰ Examples of such activities would be: preparing handbooks, specific loss reduction guidelines, discussions about preventive measures, discussions and brochures on occupational health and safety, sensitizing IFIs to the environmental variable, identifying activities that have a negative environmental impact, and measures to mitigate them, etc.

Program cost by source of financing (in US\$000)

CATEGORIES	FINANCING		TOTAL
	IDB	LOCAL COUNTERPART	
1. CREDIT COMPONENT			
1.1 Credit operations	97,020	98,000	195,020
1.2 Inspection and supervision	980	0	980
TOTAL	98,000	98,000	196,000
PERCENTAGE	50%	50%	100%
2. TECHNICAL ASSISTANCE COMPONENT			
2.1 Strengthening the credit system	600	600	1,200
2.2 Strengthening the executing unit	390	400	790
2.3 Strengthening supervision	100	100	200
2.4 Environmental advisory services	290	300	590
2.5 Promotion and dissemination	300	300	600
2.6 Evaluation	100	100	200
2.7 Monitoring and audit	200	200	400
2.8 Inspection and supervision	20	0	20
TOTAL	2,000	2,000	4,000
PERCENTAGE	50%	50%	100%

- 2.20 An additional amount of up to US\$900,000 is planned as supplementary financing to the technical assistance component (category 2.1, Strengthening the credit system), to be drawn from the MIF facility for strengthening microenterprise financing institutions (document MIF/GN-47 of June 10, 1998). Consistent with the guidelines for that facility, technical assistance would be provided from non-reimbursable resources (see paragraph 2.8) to three selected financial institutions (up to US\$300,000 each). Local counterpart funding would be provided for each of these transactions in an amount equal to the MIF contribution.
- 2.21 Local counterpart funding for the credit component will be the responsibility of the participating IFIs. As well, up to 15% of subborrowers' input into their respective credit transactions would be counted as local counterpart funding. Local counterpart funding for the credit system strengthening activity of the technical assistance component will again be provided by the participating IFIs, while that for the other activities in this component will come from the SEPyme.

F. Environment

- 2.22 In order to make full use in this operation of the lessons learned from the first program, the Bank contracted independent consulting services to conduct an evaluation of SBM I, with respect to environmental protection. The general conclusion was that the strategies employed to incorporate the environmental dimension were appropriate. In addition, this operation was reviewed from the viewpoint of Bank environmental standards on two occasions: first, by the

Environment Committee (CMA), during preparation of Profile II, and second, by the Committee on Environment and Social Impact (CESI). This second presentation was required because of changes that were made in that Committee's procedures during the processing of this operation. The resulting recommendations focus on continuing and strengthening the activities launched under the first program using Bank guidelines for this type of operation. All of these recommendations have been incorporated into the Loan Proposal and the Credit Regulations.

- 2.23 The system of environmental classification will continue to be used for SBM activities that might have a negative environmental impact. The program provides for training and technical assistance funding to mitigate or eliminate these impacts.
- 2.24 The classification instrument will be combined with the Environmental Declaration Form (FODA) in this operation, in order to develop and implement an information and control system for automatic classification, based on a weighting of the data provided.
- 2.25 The Program Coordination Unit will supply copies of the FODA to the participating IFIs, along with a summary version of manuals containing the ISO-14000 recommendations. As well, the software used for automatic classification of loan applications will be installed at the headquarters and selected branches of the participating IFIs.
- 2.26 For newly classified undertakings where the negative environmental risk is high, the PCU will ask for a statement outlining how this risk is to be addressed, and containing an express commitment to take the recommended mitigation measures, consistent with the rules of the local environmental authority. When specifically requested, the credit will include a component for implementing measures or installing equipment to reduce pollution and environmental nuisances.
- 2.27 Training workshops will continue to be offered to SBM entrepreneurs, as will the practice of holding awareness and discussion sessions with IFI officials. In addition, the technical assistance component will be used to upgrade the manuals of general environmental and occupational health recommendations aimed at SBMs in the various sectors.

III. EXECUTION

A. Program execution scheme

1. Borrower

- 3.1 The borrower of the Bank's financing will be the Argentine Republic, represented by the Ministry of Economy and Public Works and Services (MEyOSP).

2. Secretariat for Small and Medium-Sized Enterprise

- 3.2 The Secretariat for Small and Medium-Sized Enterprise (SEPyME) will be responsible for program execution. From an operational viewpoint, the Secretariat will act through the Program Coordination Unit (PCU). The BCRA will act as financial agent for the program. As a condition precedent to the first disbursement, the borrower and the BCRA will sign an agreement establishing the program execution responsibilities of each party, following the model used for SBM I.
- 3.3 The PCU will be responsible for executing and administering the resources devoted to the program's objectives and will be expected to respect and enforce the agreements and regulations established for the use and application of those resources.
- 3.4 With respect to the credit component, the PCU will essentially be responsible for disseminating the program and monitoring use of its resources. With respect to the technical assistance component, it will be responsible for execution, on the basis of the rules agreed with the Bank regarding services, service contracts and expected results.
- 3.5 The PCU will maintain the operating mechanisms that were applied during execution of SBM I. Given the focus of this new operation, however, the program management personnel profile will have to be amended. In order to fulfil its functions, the PCU will be structured as follows:
- a. A Director, who will be responsible for program management pursuant to the established rules, and for supervising the work of the coordinators and the consultants selected for the various tasks. The Director, with the help of specialized advisors, will be directly responsible for activities relating to program promotion, studies, information and the environment. The position will require a graduate of a respected university, with post-graduate studies and at least eight years of work experience with responsibility in various fields related to credit promotion. The selection and contracting of the PCU

Director, on terms and conditions agreed with the Bank, will be a condition precedent to the first disbursement.

- b. An Operations Coordinator, who will be responsible for coordinating the credit component and execution of the technical assistance component for IFIs, which will require maintaining close links with the Credit Department of the BCRA. The coordinator's activities will focus on promotion and coordination of institutional strengthening measures for IFIs, preparing appropriate assistance packages for them and supervising the consultants hired to carry out the activities. This position will require a graduate of a respected university, with post-graduate studies and at least five years of work experience with responsibility in various fields related to the commercial banking business, preferably in the area of lending to microenterprises. The selection and contracting of this Coordinator, on terms and conditions agreed with the Bank, will be a condition precedent to the first disbursement.
 - c. An Administrative Coordinator, who will be responsible for keeping records on execution of the PCU budget and maintaining consolidated files drawn from the program database, working closely with the appropriate authorities of the Secretariat and the Ministry of Economy. This position will require a graduate of a respected university, with specialized studies and at least eight years of work experience with responsibility in various fields related to the administration of capital project execution. The selection and contracting of this Coordinator, on terms and conditions agreed with the Bank, will be a condition precedent to the first disbursement.
- 3.6 Consistent with the mechanism established for execution of SBM I, the administrative expenses of the PCU and technical assistance will be covered by a portion of the spread between the interest rate paid to the IDB by the borrower and the rate that the BCRA will charge participating IFIs.

3. Central Bank of Argentina (BCRA)

- 3.7 The BCRA, as financial agent for the program, will be responsible, among other things, for: (a) receiving IDB funds and passing them on to IFIs; (b) through the Superintendency of Banks, verifying that IFIs have complied, fully and on time, with the prevailing regulations, and controlling the eligibility of IFIs to participate in the program, in light of the provisions in the Credit Regulations agreed with the Bank; (c) establishing and providing information to the PCU on the maximum US dollar limit to which each IFI will be allowed to borrow program funds; and (d) serving as depository for any security that IFIs are required to provide.
- 3.8 In fulfilling its functions, the BCRA will work closely with the executing agency (PCU). For execution of the credit component, it will use the program Credit Regulations. Entry into force of the Credit Regulations, agreed with the Bank,

will be a condition precedent to the first disbursement of Bank financing. The provisions of the Credit Regulations will be applied, once they enter into force, to the use of recoveries under SBM I, financed under loan contracts 643/OC-AR and 867/SF-AR.

4. Intermediary Financial Institutions (IFIs)

- 3.9 The Intermediary Financial Institutions (IFIs) will be responsible for allocating resources under the credit component. To this end, they must comply with the standards set out in the program's credit regulations.
- 3.10 Public and private financial entities constituted pursuant to the Financial Entities Law 21,526 will be eligible for the program, provided they meet the BCRA standards for the classification of financial entities fully and on time.
- 3.11 In contrast to the system used under SBM I, the current provisions governing the classification of financial entities allow the BCRA to make use of independent risk rating agencies. Under this new system, financial entities must undergo at least a quarterly evaluation by one of the risk rating firms recognized by the BCRA. This evaluation is to be done using an Economic and Financial Index (IEF), which expresses an opinion on the capacity of a financial entity to repay its obligations over the medium and long term. The rating agencies, which are approved for one year at a time, are free to contract with the financial entities for preparation of the IEF. According to current rules in Argentina, the rating agencies must have classified banks in no fewer than ten countries, of which at least five must be in Latin America, and must indicate the countries in question and the date on which they began their classification.
- 3.12 To date, four risk rating agencies have been authorized (Duff & Phelps Credit Rating Co., Fitch IBCA Ltd., Standard & Poor's International Ratings Ltd., and Thomson Bankwatch Inc.). The regulations define 12 risk categories, namely: AAA ("minimal probability of default; extremely strong capacity to repay, even under the most adverse economic scenario foreseeable"), AA ("very low probability of default; very strong capacity to repay; very low risk of default under the most adverse economic scenario foreseeable"), A ("very low probability of default; strong capacity to repay; low risk of default under the most adverse economic scenario foreseeable"), BBB ("low probability of default, if the current economic scenario at time of rating is maintained; repayment capacity is maintained even under more adverse economic and financial conditions, but is reduced under the most adverse scenario"), BB ("low probability of default, if the current economic scenario at time of rating is maintained; repayment capacity is reduced significantly under more adverse economic and financial conditions, and is poor under the most adverse scenario"), B, CCC, CC, C, D ("highly speculative, with high risk of default"), I ("in default status"), and F ("failed to provide the required information"). Initially, it was planned to have financial

entities post their rating in public notices, but the BCRA has recently agreed that ratings should be revealed at the explicit request of clients.

- 3.13 IFIs rated as AAA, AA, A and BBB will be eligible to participate in the program.

B. Execution of the credit component

- 3.14 This component is intended to provide loans to SBMs undertaking productive projects and activities, providing services and engaging in trade in urban and rural areas. Credit will be used for working capital, the acquisition of fixed assets and the contracting of services, according to the criteria and conditions as set out in the Credit Regulations. The term for committing funds under the component will be three years, and the disbursement period will be four years, in each case counting from entry into force of the loan contract with the Bank.
- 3.15 The component would provide support for: (a) increasing the flow of credit to SBMs via IFIs, in accordance with market terms and conditions; (b) the possibility of bringing new clients into the financial system; and (c) the process of establishing a self-standing credit channel for the target group within the financial sector.
- 3.16 The following goals have been set for this component: (a) allocation of US\$196 million on the financial market, of which US\$98 million would be contributed by the participating banks; and (b) the contracting of approximately 30,000 credits to SBMs.
- 3.17 Lending resources will be channeled through IFIs. The BCRA will act as financial agent for the program. IFIs may access program funds through loans from the PCU/BCRA through a bidding process, with funds being allocated in lots to the best rates offered.
- 3.18 Interest rates on transfers to IFIs will be set through the bidding process, as stipulated in the program. The following concepts will be taken into account in their determination: (a) financial viability: rates must not be lower than the cost of the Bank's funds, plus a percentage to cover the program's administrative expenses, so as to ensure the financial viability of the operation and to avoid any implicit subsidy from the National Treasury. This concept will be reflected in the setting of a "base rate" for bids; (b) additionality: rates must not be lower than interest rates on 90-day certificates of deposit, adjusted for reserve requirements, offered by the three largest banks in the system, in order to maintain consistency with the domestic financial cost of raising funds on the national market and to ensure that program resources are additional to, rather a substitute for, internal savings. This concept will be applied by setting a "floor cut-off rate" for each bidding; and (c) market consistency: each round of bidding will result in establishment of a cut-off rate, representing the rates offered by IFIs that are above the "floor cut-off rate" referred to above. It will serve as an indicator of the

additional price that IFIs are willing to pay at any time for long-term funds available through the program.

- 3.19 The interest rate for each SBM will be freely set by the on-lending IFI, in light of its costs and its perception of the transaction risk. Nonetheless, the additionality of the program lies in expanding the term of lending, which must be consistent with the needs of the target group. At present, the existing mismatch between long-term financing needs and short-term fund raising possibilities means that IFIs are severely limited in their ability to lend to SBMs.
- 3.20 In addition, the program will ensure that the lending rates reported by the various participating banks are publicized, in order to ensure transparency in the offer of credit to SBMs.
- 3.21 IFIs will assume the credit and exchange risks on the transaction and must undertake to make available counterpart funding to the extent of at least 100% of the loanable funds contributed by the Bank.
- 3.22 Program funds may not be used to finance: (a) the purchase or improvement of real estate assets not intended for the company's own use; (b) payment of financial debts, capital recuperations, dividends or personal loans; (c) the purchase of shares, bonds or other securities. Program funds may not be used to pay tax or social security obligations, or to purchase goods and services originating in countries that are not members of the Bank.
- 3.23 Eligibility for subloans under the program will be limited to SBMs with an annual volume of sales or invoices that does not exceed US\$500,000 (exclusive of VAT). Subborrowers and/or clients will be limited to a maximum loan of US\$50,000. The median of subloans granted with program resources by each IFI must not exceed the equivalent of US\$10,000. Finally, the repayment term of the subloans must not exceed 48 months for working capital and 60 months for fixed assets.

C. Execution of the technical assistance component

- 3.24 This component is intended to help strengthen eligible financial entities through the transfer of lending technology, with a view to making the provision of credit to SBMs more efficient. At the same time, it will support: (a) research and studies on the regulatory framework for microenterprise and small business; (b) the systematization and supply of information on the supply of financial and nonfinancial services to the sector, using the Microenterprise Benchmark Information Module; (c) permanent, targeted campaigns to promote and publicize the program; (d) audit and monitoring of the use of program resources; (e) periodic evaluations of the program, so that timely steps can be taken as the situation of supply and demand may indicate, and program operating procedures can be improved as needed; and (f) continuity of efforts to promote environmental

awareness among IFIs and enterprises, consistent with the country's environmental legislation and Bank guidelines.

- 3.25 The executing agency for this component will be the PCU, with the support of specialized advisory services contracted pursuant to rules and procedures stipulated in the loan contract for the selection and contracting of such services.
- 3.26 The execution period of the component will be 42 months, and the disbursement period will be 48 months, in both cases counting from the entry into force of the loan contract signed with the Bank. The principal activities of this component, and their manner of execution, are described below.

1. Strengthening the credit system

- 3.27 Appropriate lending technology will be transferred to eligible and interested IFIs for the financing of SBMs. In this way, financing entities will be able to offer suitable financial products to the target group on a larger scale and to better effect.
- 3.28 The principal activities will focus on: (a) promoting and developing needed organizational changes to enhance the system for lending to SBMs; and (b) training for executives and loan officers in the appropriate financial technology for SBMs.
- 3.29 The goal of these activities is to help at least three formal entities to become specialized in microfinance, through the provision of technical assistance and institutional strengthening. The technical assistance would cover: performance plans, organization and procedures for the unit, training for executives and loan officers in appropriate financial technology for lending to SBMs, and strengthening the information management systems of IFIs, with specific application to managing SBM portfolios.
- 3.30 This activity will be open to all IFIs that are qualified to participate in the program. Preliminary eligibility criteria for IFIs include their dedication to working with the "target population," as measured by the size of their program-related portfolio (including SBM I), the number of their individual transactions with SBMs, and the number of branches they maintain in the interior of the country. A selected group of banks will be invited to participate in events for the exchange of international knowledge and experience in the area of financing for SBMs. These events will have a motivational thrust and will examine the usefulness and profitability of various lending technologies for dealing with the sector.
- 3.31 Interested banks may request the PCU to provide specialized microfinance services to work with their technical staff in drawing up a business plan and preparing a project for investing in specialized lending technology. The program will provide up to 50% of the financing for such projects, with the remainder coming from the participating bank itself.

- 3.32 Once the investment project is underway, the PCU, with the support of specialists, will undertake detailed monitoring of implementation of the banks' lending technology investment plan.
- 3.33 This work is expected to be carried out with the help of specialized services contracted for this purpose. The specific terms of reference and the selection and contracting of these services will require the prior concurrence of the Bank.

2. Strengthening the executing unit

a. Research and studies

- 3.34 Consulting services will be contracted to design specific modules aimed at SBMs, for inclusion in the Permanent Household Survey (EPH) and the National Agricultural Survey (ENA) conducted by INDEC. In addition, the program will cover part of the cost of specific surveys, data compilation and publication of results.
- 3.35 Consulting services will be contracted to conduct studies in response to specific needs in critical areas of microenterprise management such as: regulations, tax policy, access to social security, unionization of the sector, personnel working conditions, methodologies for measuring the impact of support programs, etc. The results of these studies will in all cases include a plan for implementing their recommendations.
- 3.36 Consulting services will be contracted to conduct studies of certain regulations and operating procedures in the banking system that may represent obstacles for microenterprises in gaining access to credit.
- 3.37 The specific terms of reference and procedures for conducting this work, and the selection and contracting of the required services must have the prior concurrence of the Bank.

b. Information for microenterprise

- 3.38 Consulting services will be contracted for the design and implementation of a Microenterprise Benchmark Information Module to provide advice and information to SBMs on how to access financial and nonfinancial service programs. This mechanism will also provide business management information. In addition, the component will finance action by the SEPyME to coordinate public and private initiatives in the area of financial and nonfinancial services for microenterprise, including the establishment of bilateral and multilateral linkages,

with a view to identifying inter-program coordination mechanisms and best practices for meeting the needs of SBMs.¹¹

- 3.39 The minimum information that these consulting services will develop for the Microenterprise Benchmark Information Modules will include: (a) program definition; (b) executing institution; (c) name of the responsible program officer; (d) objectives; (e) beneficiaries; (f) services offered (information, financing, training, technical assistance, export promotion, others); and (g) eligibility criteria for projects and beneficiaries. The system will encourage coordination with other services that now provide advice and information to entrepreneurs. Based on the system, and on information management and dissemination activities designed, interaction between the various business support services in operation will be encouraged in order to identify options for coordinating their activities, and to eliminate any overlap.
- 3.40 The specific terms of reference and the selection and contracting of the services required must have the prior concurrence of the Bank.

3. Strengthening supervision

- 3.41 This component will pay for visits to exchange experience with professional staff at similar entities in countries of the region where successful programs have been implemented in support of SBM credit. Funding under this component will be limited to travel, accommodation and insurance expenses.
- 3.42 Consulting services will be contracted to review and analyze regulations governing credit to SBMs. The studies must in all cases include a plan for implementing the recommendations arising from them.
- 3.43 The respective terms of reference and the form in which the activities will be carried out must have the prior concurrence of the Bank.

4. Environmental advisory services

- 3.44 Continued support will be provided for sensitizing and training SBMs in the issue of environmental protection, in accordance with the country's environmental legislation. The activities initiated during execution of SBM I will be continued to this end.
- 3.45 The PCU will hire a consultant to provide advisory services and will contract for additional services as required to assist with program activities under this item, such as discussion groups, sample evaluations, training, information system and

¹¹ IFIs told the Project Team that having a module that would provide SBMs with the information needed to submit proposals, such as exists in other countries, would do much to overcome the problem of the asymmetry of information.

manuals. The purpose in each case will be to prevent, mitigate or eliminate any negative environmental effects produced by SBM activities.

- 3.46 The principal duties of the environmental consultant in the PCU will relate to:
- (a) designing and implementing a system for the ex-ante classification of credit transactions, using the information normally required for this purpose;
 - (b) reviewing the FODA environmental form and maximizing its usefulness;
 - (c) reviewing or preparing simple handbooks with recommendations (general and specific) relating to environmental issues, for distribution by IFIs to their borrowers;
 - (d) conducting or contracting for training activities with IFIs;
 - (e) training subborrowers in critical areas relating to environmental protection;
 - and (f) contracting or conducting evaluations of activities financed under the program that have a high impact on the environment, in order to formulate recommendations and to monitor their implementation. This position will require a graduate of a respected university, with post-graduate studies and a minimum of five years working experience with responsibility in various fields relating to the administration of environmental protection programs.
- 3.47 The specific terms of reference of these consulting services and the selection and contracting of the services must carry the prior concurrence of the Bank.

5. Promotion and dissemination

- 3.48 The PCU will establish suitable guidelines for a permanent communication and dissemination strategy for the program, in order to promote the services offered. Promotion of the program will be targeted at IFIs and at small businesses and microenterprises throughout the country, highlighting the options available for access to services under the program.
- 3.49 The design and execution of the strategy financed by this component will be carried out by means of specialized services contracted to this effect. The terms of reference and the selection and contracting of the services must carry the prior concurrence of the Bank.

6. Evaluation

- 3.50 Independent consulting services will be contracted to conduct two separate evaluations of the program, when resources have been committed to the extent of 25% and 75% respectively. The terms of reference for these evaluations must be agreed with the Bank, and the selection and contracting of the services must carry the prior concurrence of the Bank.

7. Monitoring and audit

- 3.51 The program will be subject to the normal monitoring that the Bank applies to operations of this kind. This monitoring will be performed through progress reports and external audits of the program. Monitoring and audit activities will be

used to verify the efficiency and effectiveness with which planned activities are being executed. In addition to the audits called for in the loan contract signed with the Bank, the PCU may contract external audit services to perform additional checks or special reviews on the use and application of program funds.

- 3.52 The terms of reference for these activities and the manner in which they are to be conducted must carry the prior concurrence of the Bank.

D. Revolving fund

- 3.53 In light of the program's execution and disbursement schedule, it is recommended that a revolving fund be established for up to 10% of the financing. The proposed percentage is justified in light of the average amount of funding planned for each round of bidding (approximately US\$10 million) and the initial expenses anticipated under the technical assistance component (actions that have already been identified and budgeted for immediate execution).

E. Procurement procedures

1. Acquisition of goods

- 3.54 The program does not call for construction works. The acquisition of goods envisaged under the technical assistance component (strengthening the executing agency), to be financed wholly or in part with resources of the loan, will be subject to normal Bank procedures (Annex B of the loan contract). It is expected that the value of goods purchased with proceeds of the loan (computer equipment) will amount to approximately US\$50,000. Before proceeding to purchase such goods, the PCU will consult the Bank as to their specifications and purpose.

2. Selection and contracting of consulting services

- 3.55 For each of the consulting contracts called for under the technical assistance component, the PCU will submit the respective terms of reference to the Bank. Once the Bank has declared its concurrence, the selection and contracting of consulting services will go ahead in accordance with normal Bank procedures, which will be included in Annex C of the loan contract. The selection and contracting of consulting firm services in amounts of US\$200,000 and more will be done through international competition.

F. Evaluation and monitoring

- 3.56 The program will be monitored during its execution in order to generate information for identifying any needed changes, either to the program's management or to its operating mechanisms, and also to allow the national authorities and the Bank to verify compliance with the various contractual conditions (see paragraphs 2.17 and 3.50). Particular attention will be paid to monitoring and evaluation during the initial phases.

IV. BENEFITS AND RISKS

A. Benefits

1. Benefits for small business and microenterprise

- 4.1 The planned program is intended to support an expanded supply of credit to SBMs, on market terms and conditions, so that they can take advantage of investment opportunities that were hitherto beyond their reach. As well, it will serve to foster greater competition in the offer of such financing, to the benefit of borrowers.
- 4.2 The program will encourage commercial banks to pay more attention to the SBM sector by demonstrating that this is a segment that offers real possibilities for developing a permanent financing relationship. Achieving this objective will mean incorporating this type of financing as part of the commercial banks' business strategy so that in the future they will devote increasing amounts of their own resources to such lending, rather than relying solely on funding from international agencies. Having permanent access to credit will make these productive units more viable and help to increase their revenues.

2. Benefits for IFIs

- 4.3 Bringing new SBMs into the bank lending market will mean a more diversified client base for financial institutions and hence a better distribution of risk. As well, it may be expected that over time SBMs will require other kinds of banking services, offering new business opportunities for IFIs. The program will also make it possible to attract institutions that have traditionally shied away from lending to SBMs, thus making the market more competitive.
- 4.4 On the other hand, the program will foster rapid growth in IFI loan portfolios and will help them to improve their lending methodology and to achieve economies of scale. This will allow participating institutions to become more efficient in working with SBMs.

3. Impact on the environment

- 4.5 The program includes elements that will make a significant contribution to preventing SME activities from having a negative impact on environmental protection.

4. Impact on low-income groups

- 4.6 The project does not specify explicit performance indicators to measure poverty reduction and social equity enhancement.

B. Risks

1. Macroeconomic context

- 4.7 Social pressures arising from a deterioration in macroeconomic conditions could lead the government to change the course of its economic policy, to the detriment of the current environment of price stability. The impact of such a shift on investment, credit demand and the willingness of IFIs to provide credit, is unpredictable. Nevertheless, the measures undertaken by the government (for example, fiscal control) suggest that the country will maintain its present course despite an unfavorable international economic setting.

2. IFI solvency

- 4.8 Experience during execution of SBM I showed the need to ensure that IFIs participating in the program are financially sound and in compliance with the demanding regulatory requirements of the BCRA¹², in particular with respect to the smaller banks. Strict observance of the program's eligibility criteria will ensure that all participating entities are solvent and capable of operating competitively.

3. The situation of the SBMs

- 4.9 Despite the economic reforms that have been undertaken in Argentina, SBMs still face a number of limitations flowing essentially from the high fixed costs inherent in their lack of economies of scale. In addition, the relatively few support services to which SBMs have access are inadequate, and this fact, combined with market failures¹³ (asymmetries of information and externalities), has limited their response to structural reform. In this respect, the government, through the SEPyME, has taken a series of initiatives which, together with this proposed program, will make it easier for SBMs to gain access to financial and nonfinancial services that will improve their competitive positioning. The Bank is supporting several of these initiatives, as mentioned in paragraph 1.44 of this report.

¹² In the context of BCRA credit risk standards, the interest rate weighting factor discriminates against projects that present relatively high risk components. In effect, the higher the interest rate, the higher the levels of capital and portfolio provisioning required of IFI.

¹³ Asymmetries in access to information and externalities have been identified by various studies conducted in Argentina and are cited in the Study for the Entrepreneurship Strategy prepared by the Bank.

LOGICAL FRAMEWORK
GLOBAL SMALL BUSINESS AND MICROENTERPRISE CREDIT PROGRAM II (AR0127)

NARRATIVE SUMMARY OF OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<p>Goal:</p> <p>Ensure access for microenterprise and small business (SBM) to credit from the financial system. Intermediary financial institutions (IFIs) providing credit to SBMs on a sustainable, timely, adequate basis, using their own resources.</p>			<p>Macroeconomic conditions will be maintained, so as not to discourage investment and SBM demand for IFI credit.</p>
<p>Objective:</p> <p>Continue broadening access and increasing the coverage of credit needed by all businesses and microenterprises, to improve their competitive market position and help to reduce unemployment.</p> <p>Technical assistance:</p> <p>Encourage participating IFIs to respond to credit demands, on a self-sustaining basis, using local resources.</p> <p>Strengthen the government support for SBMs in its efforts to facilitate access to domestic financial and non-financial services.</p>	<p>(1) Credit:</p> <p>The contracting of approximately 30,000 loans to SBMs through the IFIs.</p> <p>(2) Technical assistance:</p> <p>At least three IFIs operating with specialized microcredit lending technology.</p> <p>A Microenterprise Benchmark Information Module.</p> <p>Up-to-date information on SBMs for use in preparing public and private development and support strategies.</p> <p>Proposals for improving the regulatory framework for SBM credit.</p>	<ul style="list-style-type: none"> • Program progress reports • Inspection reports on projects and activities • Results of the two planned evaluations • Sample surveys • Program PCR 	<p>IFI supervisory and control standards that, within the bounds of prudence, encourage IFIs to work with the SBM sector.</p> <p>Existing service programs for SBMs are able, jointly, to help these businesses improve their status and competitive positioning.</p>

NARRATIVE SUMMARY OF OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<p>COMPONENTS:</p> <p>Credit: • Help for funds and SBMs obtain credit from eligible IFIs.</p> <p>Technical assistance: • Strengthened credit system; • Strengthened executing unit; • Environmental advisory services; • Strengthened supervision; • Promotion and dissemination; • Evaluation; (g) monitoring and audit.</p>	<p>(1) <u>Credit:</u></p> <ul style="list-style-type: none"> • 12 rounds of bidding for funds completed • 30,000 subloans formalized <p>(2) <u>Technical assistance:</u></p> <ul style="list-style-type: none"> • 3 professionals hired to manage the PCU • 3 consulting firms contracted in the microcredit technology area • Agreement with INDEC to implement a microenterprise module in the EPH and ENA. • Study on banking system regulations governing credit to microenterprise (limitations, restrictions, proposals) • 1 environmental expert hired and additional services contracted as needed • 2 evaluations performed by independent consultants • Contracting of a specialized firm to develop and implement a Microenterprise Benchmark Information Module • A specialized firm hired for the promotional campaign • 4 independent audit firms contracted to audit the program's financial statements • Study tours to countries in the region 	<ul style="list-style-type: none"> • Bank concurrence with contracting of consultants • Consultants' reports • Program progress reports • Special evaluation reports • Sample-based review of subloans 	

NARRATIVE SUMMARY OF OBJECTIVES	INDICATORS			MEANS OF VERIFICATION	ASSUMPTIONS
<u>PRINCIPAL ACTIVITIES:</u>	Budget in US\$000				
	<u>IDB</u>	<u>LOCAL COUNTERPART</u>	<u>TOTAL</u>		
Credit:	98,000	98,000	196,000		
Transactions	600	600	1,200	• Program progress reports	
Technical assistance:	400	400	800	• Disbursement requests	
Strengthened credit system	100	100	200	• Program and IFI accounts	
Strengthened SEP/ME/PCU	300	300	600	• Program financial	
Strengthened supervision	300	300	600	statements, as audited by	
Environmental advisory services	100	100	200	external auditors	
Information and dissemination	200	200	400		
Monitoring and audit					

ESTIMATED DISBURSEMENT SCHEDULE AND INDICATOR PERFORMANCE

INDICATORS	PROGRAM EXECUTION PERIOD			
	YEAR 1	YEAR 2	YEAR 3	YEAR 4
CREDIT COMPONENT				
Disbursements (in US\$)	49,000,000	49,000,000	49,000,000	49,000,000
Financing rounds (number)	4	4	4	
Beneficiaries (number)	9,000	10,000	11,000	
TECHNICAL ASSISTANCE COMPONENT				
Disbursements (in US\$)	200,000	800,000	2,000,000	1,000,000
Consultants	3			
Training microcredit methodology (minimum 3)				
Environmental expert contracted and supplementary services as needed (number of experts)	2	1	1	1
Enterprise Benchmark Information Module (consultants, design and operation)			1	
Informational campaign (under way)	1			
Independent auditors (number)	1	1	1	1
Workshops for BCRA personnel (number)		2	4	6
Publications (number)	1		1	
Studies on regulatory framework and sector studies (number)	1	1	1	1
Meetings with INDEC (number)	1			

PROPOSED RESOLUTION

ARGENTINA. Loan /OC-AR to the Republic of Argentina
Global Credit Program for Micro and Small Enterprise II

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 Republic of Argentina, as Borrower, for the purpose of granting it a financing to cooperate in the execution of a Global Credit Program for Micro and Small Enterprise II. Such financing will be for the amount of: (a) up to ninety million dollars (US\$98.000.000) of the United States of America which are part of the Single Currency Facility of the Ordinary Capital resources of the Bank, and (b) up to the equivalent of two million dollars of the United States of America (US\$2.000.000), in Argentine pesos, which are part of the Ordinary Capital resources of the Bank, and will be subject to the "Special Contractual Conditions" and the "Terms and Financial Conditions" of the Executive Summary of the Loan Proposal.