

PROJECT SUMMARY
CONNECTING THE EQUITY MARKET WITH MICRO, SMALL, AND MEDIUM-SIZED ENTERPRISES.
PERU MICROFINANCE INVESTMENT FUND
(PE-M1111 AND PE-Q0003)

Although Peru was recognized in 2016, for the ninth consecutive year, as having one of the world's most favorable environments for financial inclusion, the level of financial inclusion remains low. The Peruvian financial system is in a transition phase, characterized by greater competitiveness, stricter regulation, the entry of new actors, interventions in financial entities, and mergers and acquisitions of microfinance institutions (MFIs). In this context, the Peruvian microfinance market is expected to continue to grow steadily over time, and accordingly the MFIs will have to strengthen their levels of capitalization if they are to expand their loan portfolios and satisfy the growing demand for financing.

An effective way of increasing the equity of MFIs is through subordinated debt (quasi-equity) operations. A significant number of MFIs with very good track records and solid earnings have been identified that would be interested in obtaining subordinated loans to strengthen their equity position and in financing themselves with senior debt that will help support their growth in this phase of transition and consolidation.

In a context of latent demand on the part of the microfinance sector for subordinated and senior debt resources, combined with high levels of liquidity and an appetite for profitable long-term investments shown by institutional investors in the capital market, this project will support the creation of a private investment fund to provide subordinated debt and senior debt to MFIs.

The investment fund (Peru Microfinance Fund) will be endowed with resources from the capital to be invested by the Multilateral Investment Fund (MIF) and other anchor investors, as well as the proceeds from the issuance of debt instruments that will be acquired by local institutional investors, in this way channeling resources from those investors into the microfinance sector. As a result, the Fund will help to fill an important gap in the capital structure of MFIs, allowing them to meet their financial challenges and improve their positioning so as to expand the scope and penetration of financial inclusion for micro, small and medium-sized enterprises (MSMEs).

The key actors in the Fund will be: (i) anchor investors, including the MIF, which together will contribute up to US\$20 million in equity (20% of the Fund); (ii) local institutional investors (pension funds, insurance companies, etc.), which will contribute up to US\$80 million by purchasing long-term bonds issued by the Fund (80% of the Fund); (iii) Fund Managers—Bolivian Investment Management Ltd. (BIM) and AC Capiales; and (iv) the Inter-American Investment Corporation (IIC), which would provide the Fund with a partial credit guarantee that would improve the risk profile of the bonds it issues.

The innovative strength of the project lies in the creation of what will be the first private investment fund for MFIs in Peru. The Fund will: (i) facilitate connection of local capital market with the financing needs of Peruvian MFIs; and (ii) place the bulk of its resources (over 90%) in long-term subordinated debt instruments in local currency, allowing the MFIs to count the resources as supplementary capital, which they can use to leverage other senior financing.

As the principal outcome expected for this operation, at least 200,000 MSMEs and low-income people—at least 50% of them women—will receive local currency loans from the beneficiary MFIs. The experience gained from the Fund will lay the foundation for promoting similar instruments elsewhere in the region, as a key element for scaling the model. To achieve this outcome: (i) at least 10 MFIs will strengthen their capital through subordinated debt instruments and, to a lesser extent, will gain access to long-term senior loans, which will allow them to leverage and expand their loan portfolios; (ii) the Fund will generate a gross portfolio of at least US\$92 million; and (iii) the Fund is expected to generate an investment return of 8% to 10% for the MIF.

The financial additionality that the MIF will bring to this Fund is considered essential to achieving its capitalization and attracting the institutional investors needed to round out the total amount of the Fund. The MIF was the first institution to declare its commitment as an anchor investor in the Fund, and this was a key factor in recruiting other anchor investors. The MIF and the IIC have worked together closely on structuring the Fund, and the IIC is expected to offer the Fund a partial credit guarantee, which will improve the risk profile of the bonds to be issued for purchase by institutional investors.