

Multilateral Investment Fund-TC Profile

I. Basic Project Data

Country/Region:	Argentina			
Program Name/Number:	Small Loan Facility of Argentina (SLFA) AR-M 1003.			
Team Leader/Members:	Susana García-Robles (MIF/INV) Team Leader, Hector Castello (MIF), Tatiana Soufen (MIF), and XXXX (LEG)			
Date of Request:	July 2004			
Beneficiaries:	SMEs in the province of Santa Fe, Argentina			
Executing Agency:	<i>Fundación Cuenca</i>			
Financing Plan:	Technical Cooperation:			
	MIF (III-A)	up to	USD	500,000
	<i>Fundación Cuenca</i>	up to	USD	500,000
	Total	up to	USD	1,000,000
	Loan Facility			
	MIF (III-B)	up to	USD	5,000,000
	UNIDOS	up to	USD	5,000,000
	Total	up to	USD	10,000,000
Technical and Basic Responsibility:	MIF Investment Unit			
Tentative Dates:	POC August 6, 2004 Donors October 2004			

II. Background and Problem Statement

- 2.1 **Background.** This project has as background the MIF Network of Business Services Centers Program (ATN/ME-4851-AR). Rafaela was one of the chosen cities where to start one of the Enterprise Development Centers, and was the most successful one. An evaluation conducted in 2000 highlighted the impact of this program¹. Non- financial services to approximately 800 companies were provided through this grant. After three years of the MIF project having finished, the Center is still operating with success. Some years ago, the different actors who had been involved in this program, approached the MIF to create a VC fund. It was concluded that the needs of the SMEs in the region would be better served by a Loan Facility, rather than a VC fund. The financial services that this proposed project contemplates would be complementary to the activities carried out by the Center for Business Development, which will also provide a pipeline of companies that could receive financing from the Facility.
- 2.2 **Problem Statement.** The purpose of the Facility is to meet the urgent medium and long-term financing needs of local businesses in this province, including manufacturers and exporters. Assessments of the capital market indicate an acute lack of medium or long-term debt financing for SMEs from commercial banks or other sources. The Facility is intended to channel resources to viable, growing businesses to fund purchases of equipment, facilities purchases or improvements, permanent working capital, or other longer-term investments. With the recent crisis in the financial sector and the inability of banks to provide long-term financing, the SLFA is expected to have a large pipeline of potential deals.
- 2.3 Even though there are several programs being implemented in the country (*Programa Global de Crédito del BID, Convenio de préstamo BICE con Francia, Fondo de asistencia para la constitución de*

¹ Evaluation of the experience of the Centros de Desarrollo Empresarial: lessons Learned from CDE Rafaela-Esperanza in Argentina, Nexxus Associates, March 2000

consorcios entre PYMES, etc.), small and medium size enterprises continue to face obstacles accessing loans, as well as having to afford higher costs than bigger companies. In general the use of banks as financing sources increases with the size of the company, while the cost of the loan diminishes. According to the *Asociación de Bancos Públicos y Privados de la República Argentina ABAPPRA*, there are 84,875 companies that have loans from banks; with 2,775 big companies accounting for 84% of this total financing, and 82,100 small companies representing only 16%, with loans below USD 300,000.² Currently banks reach only 23% of total SMEs in the country, leaving a gap that can begin to be closed in the province of Santa Fe by the creation of this Facility.

- 2.4 Other projects in Argentina have focused on equity investment and microfinance (see n. 2.9). While both products are vital to the development of micro and small business, debt finance to small business is needed on a far greater scale to fuel the growing sectors of the economy, particularly the export and import-replacement sectors. With an initial capital of up to USD 10 mm and a structure that will allow for additional investment and replication to other regions in the country, the Facility could begin to address the market gap left by weak and risk-averse commercial banks in Argentina.
- 2.5 Justification and MIF's Additionality. An external independent evaluation conducted by OVE³ on the MIF investments found that VC results in the region were below expectations, and recommended that MIF should continue its efforts on VC in those countries which presented a sound scenario for VC activity, with some incipient signs of interest from private parties in VC investing, and a number of significant non-commercial sources of capital with long-term programs to support the industry. For the other countries, the evaluation recommended that MIF explore other products such as leasing, factoring, supply chain financing, specialized credit trust funds that could be a better fit for SMEs⁴. This project is in line with this recommendation.
- 2.6 The project has attracted the interest of the UNIDOS pension fund, based in Rafaela, Santa Fe. The participation of MIF in this Facility, given its experience investing in the Region, has become a decisive factor of influence on UNIDOS' final decision to be a co- investor in this Facility.
- 2.7 This project, if approved, will be highly innovative in many aspects. It will be: 1) the first public trust the MIF has ever entered into; 2) the first project in which our sole co-investor will be a local pension fund; 3) the first project in Argentina to be designed with the possibility to incorporate a guarantee and further commitments from other pension funds, once the loan facility starts operating; and 4) the first time that a pension fund participates in the technical assistance component of the project.
- 2.8 MIF's Portfolio in Argentina. MIF's financing projects in Argentina have been few, and with an uneven track record. SEGF, a VC fund approved in 1998, ran into difficulties due to the bankruptcy of its only investment. This resulted in suspension of the management company. At the same time, the co-investor in the fund lost interest in further investing in the country, and the highly adverse business environment made it impossible to find a replacement manager. Inverpymes, another VC fund, was set to start when the crisis in 2001 unraveled, and the management company underwent a restructuring process. The management has been now restructured to incorporate a new advisor, and the first investment committee will happen on August 3rd. FIE Gran Poder is a microfinance project, approved in November 2003, which is about to receive the first tranche of the USD 2 mm loan from MIF. FIE is performing very well, but its niche is microfinance, not SME financing.
- 2.9 MIF's current exposure in Argentina is as follows:

² Electronic Bulletin n.22, Asociación Latinoamericana de Instituciones Financieras para el Desarrollo-ALIDE, quote from El Cronista, 6/11/2004.

³ Evaluation of MIF Projects: development of venture capital. Office of Evaluation and Oversight. MIF/GN-78-11.

⁴ Idem, page vii, second paragraph.

		MIF Original	MIF	Amount	MIF	Amount	Revised
	Project	Commitments	Disbursed	Realized	Cancelled	Available	Current
					Commitment		MIF
							Exposure
1998	SEGF	5,000,000	967,412	0	4,000,000	32,588	
1999	Inverpymes	6,000,000	1,285,800	0	0	4,714,200	
	FIE Gran						
2003	Poder (loan)	2,000,000	0	0	0	2,000,000	
	Total	13,000,000	2,253,212	0	4,000,000	6,746,788	9,000,000

III. Program Objective and Description

- 3.1 Description. The Small Loan Facility of Argentina (SLFA) will initially target small and medium sized companies with a demonstrated ability to repay from the cash flows of the business, and will have an initial focus in the province of Santa Fe, located in Northeastern Argentina. Target companies will typically have annual sales between US\$100,000 - \$5,000,000, and up to 100 employees. Target sectors will be those with strong existing or potential export sales, including agribusiness, automobile parts, tools and machinery. A large number of growing export businesses is located in Santa Fe, and many around the city of Rafaela, which has a strong history of entrepreneurial activity and business support services. It is anticipated that the loan size will range between \$ 50,000 to 300,000 USD equivalent (not all transactions will be made in dollars), totaling approximately 100 total transactions. The Facility will continue to lend the payment reflows, building the total available capital.
- 3.2 The Facility will have the legal figure of a public trust, to accommodate the entrance of Unidos as co-investor. The life of the Facility is currently proposed to be seven years, but could be extended to be a permanent vehicle, if there is demand. If this were to happen, the Multilateral Investment Fund would have to be bought out by the local investors at a pre-negotiated multiple to compensate the MIF's status as an initial investor. MIF will require the inclusion of a clause about its exit in the legal documents, to contemplate for this eventuality.
- 3.3 A local Loan Facility Manager will perform the analysis and monitoring of portfolio companies, in partnership with a local bank-servicing agent to be defined. Since expertise in long term lending to SMEs through loans and quasi-equity instruments (i.e. loans with kickers) is not available in the country, an integral part of the project will be the provision of training on lending methodology to the local Facility Administrator team.
- 3.4 This training will be delivered over the course of eighteen months by a firm selected by the MIF and *Fundación Cuenca* through a competitive bid. The selected firm will have to demonstrate a proven record on SME lending, preferably having developed its methodology in a developed country, and tested it also in emerging economies.
- 3.5 The firm selected to do the training will recruit the team for the Loan Facility, with the approval of the co-investors, MIF and UNIDOS. This firm will train the manager of the Loan Facility in on-lending activities, and will play a central role in every aspect of the design, launch, and implementation of the lending programs of the SLFA for the first eighteen months. It will draw on a cadre of professional staff well versed in the specific needs of SMEs in economies with weak capital markets and volatile exchange rate fluctuations.
- 3.6 The goal is to transfer the selected company's lending methodology to the local administration team, creating a strong team of Argentine professionals, who can in turn train additional staff in other cities

for program expansion. The selected firm will mentor the local Argentine staff in its small business lending technology and build their capacity to work independently at the end of the training. This pool of experts can become the training ground for staff utilized in the replication and expansion of the SLFA in other parts of the country. Following the initial 18 months period, this company could play an advisory and oversight role, if desired by the local administrator team.

- 3.7 The grant component will be used for: 1) the creation, incubation, and development for the first three years of the Loan Facility; 2) the training of local officers in sound lending methodologies; and 3) to perform two evaluations (one at the end of the grant period on the 3rd year, and the other one at the end of the sixth year of the Facility's operations). The evaluations will focus mainly on the quality and results of the training on the lending methodology, the Facility's financial performance, and the quality of the loan portfolio, as well as on the socio-economic impact achieved by the Facility.
- 3.8 The objectives of the project are:
- To fund a vehicle which will provide primarily senior debt and, according to the evolution of the market, some quasi-equity deals; financing approximately 100 SMEs in the province of Santa Fe;
 - To showcase this lending methodology through the creation, incubation, and operation of a new financing vehicle, the Small Loan Facility;
 - To create a permanent pool of expertise in small business finance in Argentina through the training provided to local staff; and
 - To attract other investors' interest to further replicate the model in other parts of the country.
- 3.9 Expected results. SLFA plans to finance companies with strong existing or potential export sales, although it is expected that not all transactions will be for this type of companies. The Facility intends to fill a financing gap for the small and mid-size growing companies in the province of Santa Fe, with a focus initially in Rafaela and its surroundings. The Facility will support financially an area well known by its entrepreneurship spirit, which is in need to have a financial instrument after having successfully developed a network of competitive companies in the Santa Fe corridor.

IV. Cost and Financing

- 4.1 Facility's Capitalization for the provision of SMEs loans. The initial USD 10 mm Loan Facility will channel investment to SMEs from the MIF and the local pension fund Unidos. The MIF will provide 50% of the capital for the Facility, with the local partners providing the other 50%.
- 4.2 Grant. The MIF will provide a grant in the amount of up to USD 500,000 (50% of the total amount) for the first 3 years, to ensure the capacity of the local team in SME finance methods. The remaining 50% will be covered by a cash contribution from the local partners and local government in-kind contributions. After the initial three-year period the Facility will be financed through a fee paid from the interest paid from the loans.
- 4.3 The following summarized budget shows the use of the grant resources, for an estimate amount of USD 828,323, to be provided 50-50 by MIF and *Fundación Cuenca*:

	Year 1	Year 2	Year 3
Staff			
Professional (3)	77,832	81,724	85,810
Administrative (2)	17,388	18,257	19,170
Bonus pool @ 10% of all salaries	9,522	9,998	10,498
Subtotal Local Staff	104,742	109,979	115,478

Professional Services			
Legal Fees	5,000	5,000	5,150
Loan tracking maintenance	5,000	5,000	5,150
Local accounting services	2,400	2,400	2,472
Accounting services for Fund	5,000	5,000	5,150
Sector experts and staff training	0	10,000	10,300
Subtotal Professional Services	17,400	27,400	28,222
Start-up costs	61,500	0	0
Other Operating Costs	44,137	43,924	45,241
In-Country Travel	10,000	10,000	10,300
Training on Lending Methodology	150,000	50,000	
Total Operating Costs	387,779	241,303	199,241
Total Costs Year 1-3	828,323		

V. Executing Agency and Execution Structure

- 5.1 The Executing Agency for the grant will be *Fundación Cuenca*. This Foundation was created by UNIDOS with the mandate to promote and develop activities that improve the quality of life of citizens, their education and their economic development. Its by-laws state, among others, the following objectives: 1) to grant technical assistance money for projects supporting the foundation's goals; 2) to promote agreements with other public and private institutions that have common goals with the foundation; and 3) to provide financing along with multilaterals and NGOs to promote technological development for SMEs training in obtaining financing, and financing for issues related to the SMEs sector's growth.
- 5.2 An institutional assessment on *Fundación Cuenca* is not available at the time, given that this foundation was created during this year as the result of MIF's ongoing conversations with UNIDOS pension fund, designing this project. UNIDOS, under the pension fund legal figure, couldn't provide technical assistance money. Given that the success of this project lies in the provision of training on lending methodology for SMEs, and the creation and incubation for three years of the start-up that will operate as the Loan Facility, UNIDOS decided to create *Fundación Cuenca*, with a small P\$ 20,000 capitalization through another one of its foundations, CAPCODE, to be the counterpart for the technical assistance grant.
- 5.3 CAPCODE is a *sociedad anónima*, and as founder of *Fundación Cuenca*, CAPCODE will provide subsequent capitalization rounds to the new foundation, according to its needs. Executives from UNIDOS compose *Fundación Cuenca*'s board. During the due diligence, the team will request more information, if available, on *Fundación Cuenca*. The fact that UNIDOS is the institution behind this young foundation provides enough comfort to the team with regards to *Fundación Cuenca* sustainability.
- 5.4 Unidos S.A. AFJP 's founding members were SanCor Cooperativas Unidas Limitada (98%), and the Asociación Mutual SanCor (2%). SANCOR is an association of cooperatives from the agribusiness sector and the food industry, with great relevance in Argentina's economy. To date, other entities have been incorporated as shareholders. These entities are: AMPS (Asociación Mutual Personal SanCor), Asociación Mutual Social y Deportiva Atlético de Rafaela, ATILRA (Asociación de Trabajadores de la Industria Lechera de la República Argentina), Uncoga Federación de Cooperativas Agropecuarias Cooperativa Limitada, and Sancor Cooperativa de Seguros Limitada, PROBENEFIT S.A.

- 5.5 The Executing Agency for the Loan Facility will be a *sociedad anónima* created by *Fundación Cuenca* to manage the trust. The trust will be a public trust, ruled and supervised by the *Comisión Nacional de Valores/CNV*.
- 5.6 Loan Facility Execution Structure. The Loan Facility will be legally conformed as a *public* trust, to accommodate the entrance of UNIDOS as co-investor. The Trust Facility will be denominated in US dollars, with its core lending activities also denominated in US dollars (this will be done in two ways: some loans will be in dollars, and others in pesos, indexed to the dollar). Thus the primary currency risk will be on the ultimate borrowers. In the credit analysis process, the manager will evaluate the currency exposure of each borrower and initially focus lending activities on those firms with a major portion of revenue from exports. However, the allocation of loans will be driven by demand, so there is no guarantee that the majority of companies will export. Borrowers will need to maintain higher cash reserves given the currency exposure.
- 5.7 Compensation of the Loan Facility Manager. After the initial three years of start up operations, training period, and first tranches of lending, the Facility Administrator will become self-sustainable by charging the companies with administration fees to cover operating costs, and those will be charged against interest earnings in the Facility. It is expected that the overall funding level of the Facility will increase with new investments as the program expands, and interest earned on the portfolio will cover the costs of the Facility Administrator. The Facility Administrator budget will be determined at the end of year three based on the scope and scale of activities and reviewed annually going forward.
- 5.8 Following on what is customary in the Argentinean banking system, the Facility will charge fees for services to the companies providing the loans. These fees will offset some of the Facility's costs and will go towards a loan reserve fund.
- 5.9 Pre-operating expenses for the establishment of the Facility will be considered up to 1% of the Facility's committed capital.
- 5.10 Initial financial projections forecast that each investor will receive at the end of the Facility's life an approximate return of the original USD 5 mm, plus approximately between USD 2 to 2.5 mm (this estimation incorporates a deduction for the cost of incubating the Facility through the grant, and the partial interest earnings taken to finance the Facility manager from years 3 to 7). Given the high additionality of the project, the team considers this a very good return.

VI. Major issues

- 6.1 Given the high level of innovation of this project (See n. 2.7), there are several issues that are still being studied and discussed, which the team will analyze during the due diligence, in order to define the final structure of this project. Some of these issues are:
- *Creation of a public trust*: The team will discuss with UNIDOS lawyers specifics of creating a public trust, since UNIDOS has a legal team in place, and expert on establishing this type of trust. The team would like to request that the due diligence mission include an IDB lawyer, for him to become familiar with the Argentine legislation of a public trust from the beginning;
 - *Governance of the Facility*: The team will meet with UNIDOS and *Fundación Cuenca* to better understand the roles institutions play in the governance of a public trust. The governance structure may be different from other private trusts the MIF has entered into, which have a Shareholder's Assembly and an Investment Committee, since public trusts have an oversight body.
 - *Pipeline and Market*: Given the evolution of the Argentine economy over the last year, the team will visit different companies that have been already selected as pre-pipeline, to better understand their needs (exports vs. domestic companies), and fashion the terms of the loans

after these. Since interest rates will be set at market price, the team will analyze what the banks are offering, and adjust it for long-term lending.

- *Cost and Financing of the Project:* after the team reviews the market and the pipeline, the financial projections will be reviewed also, in order to set the final amounts of the project, for both the technical assistance program grant and the Loan Facility. (This is the reason why the team is requesting up to USD 500,000 in T.A. sources, although there is a possibility that this amount will be lowered, once the team has performed the due diligence). The project may be extended to nine years, if the team appraises a need for longer financing.
- *Definition of a Bank-servicing Agent:* the mission will meet with potential banks in the area interested to work with the Facility.

VII. Environment & Social Issues

- 7.1 Given that this is a loan facility, the team does not foresee any negative environmental impact. However, the trust manager will ensure that the companies being financed practice sound labor and hiring practices, and will take into account the IDB/MIF environmental and social guidelines for MIF-supported financial intermediaries⁵. As part of fulfilling the requirements of these guidelines, the trust managers will participate in a MIF/IDB-approved training course on environmental and social review for financial intermediaries. In addition, MIF recently commissioned the development of a specific manual for social and environmental monitoring and due diligence for financial intermediaries that will be soon distributed for use by our managers. *Fundación Cuenca* has as one of its mandates to promote care for the environment, as well as activities that foster a better quality of life; therefore, the Facility will abide by these by-laws, as well as the laws of the country in this respect.

VIII. Action Plan

- 8.1 The following is a preliminary schedule for the project's approval process:

POC	August 6th
CESI	1 st week in August 2004
Due diligence	August 16-20 2004
Donors	October 27, 2004

⁵ MIF/IDB Environmental and Social Guidelines for MIF Financial Intermediary Operations. <http://www.iadb.org/mif/>