

**BDMG - Innovation in Access to Finance for the Base of the Pyramid
Microentrepreneur and Microenterprise in the state of Minas Gerais, Brazil
BR-L1366**

ENVIRONMENTAL AND SOCIAL STRATEGY (ESS)

I. Transaction Overview

1. The Opportunities for the Majority Initiative (OMJ) seeks to structure a US\$10 million Risk Sharing Facility (RSF) (or its equivalent in *Brazilian Reais*) with the Development Bank of Minas Gerais (*Banco de Desenvolvimento de Minas Gerais* or BDMG) to support the launch of a new financing program of up to 60 million Reais (approximately US \$30 million) for startup Microenterprises (MES)¹ from the state of Minas Gerais (MG) in Brazil, of which the vast majority belongs to the Base of the Pyramid (the “Project”). In order to achieve the proposed objective, OMJ proposes to enter into a Risk Sharing Facility (RSF) with BDMG for up to US\$ 10 million (or its equivalent in *Reais*) to share the risk of the newly formed portfolio of startup microenterprises.
2. In order to reach this underserved market, BDMG will apply an innovative credit methodology developed by the Entrepreneurial Finance Lab (EFL) which helps to overcome the traditional market failure that prevents MES from accessing credit lines in suitable conditions for their businesses: lack of formal credit record in the financial system, lack of business track record and lack of real guarantees to provide as collateral. The new BDMG loan product is for a standardized amount of up to R\$15,000 (approx. US\$7,500) and a tenor of 24 months including a 3 months grace period. The project is designed to reach 4,000 MES during a two year pilot phase. A second three year phase will be conditioned on the Project’s early results, aiming to expand the credit program to serve newly registered Individual Microentrepreneurs², thus providing the potential to significantly scale the project in the state of MG.
3. In recognition of the obstacles which inhibit access to credit for startup Microenterprises, and to serve its mandate as a development bank, BDMG has formed a partnership with EFL to be the first in Brazil to apply EFL’s innovative psychometric-based credit scoring methodology to qualify businesses for loans. The use of psychometric tools for micro entrepreneurs offers promising hope of increasing access since the approach relies on financial risk assessment related to the person rather than prior business track record or availability of real guarantees. The test is structured to overcome traditional barriers of high operating cost and lack of scale to this targeted niche.

¹ Microenterprises are defined by *Lei Complementar n° 123/2006 (Lei Geral da Micro e Pequena Empresa)* as businesses with annual sales of up to R\$360,000 (approx. US\$178,000) and up to 19 employees (construction sector) and 9 employees (retail and service sector).

² According to *Lei Complementar 128/2008* MEI are individual microenterprises with annual sales of up to R\$60,000 (approx. US\$29,000) with up to one employee receiving the minimum wage.

II. Environmental and Social Impacts and Risks

4. The project will allow microentrepreneurs from the Base of the Pyramid in Minas Gerais to increase access to finance for their business operations as formal business entities and at lower interest rates. At present, given the lack of access to credit for MES, entrepreneurs commonly use their personal credit cards to finance their businesses, which is relatively more costly and inadequate to meet productive needs. These enterprises cannot access business credit lines from the financial market due to their lack of previous credit history and business operating data. The lack of suitable access to capital is one of the most cited reasons for companies' bankruptcy, contributing greatly to the 27% mortality rate in Brazil for companies with up to two years of operation³.
5. With the successful implementation of this new credit program, the project is expected to have a positive social impact on the life of microentrepreneurs from the Base of the Pyramid in MG. By allowing that many microentrepreneurs have access to needed capital to overcome this difficult period that immediately follows the start of their business operations, the project will help them to have an improved survival rate and thus maintain a source of income for many families from the Base of the Pyramid.
6. The environmental risks of the project are projected to be minimal to moderate, and will depend on the type of business to be financed. Considering that BDMG will be providing a financial product to fulfill working capital needs of the microentrepreneurs in service businesses, there is a small likelihood that there will be many negative externalities, as it could happen more often for investment loans or for projects that involve manufacturing or construction risk. In any case, the risks are also considered to be low given the small amount of the loans and because all registered businesses must comply with local environmental regulations in Brazil in order to maintain valid business operating licenses. Moreover, since BDMG is a branchless development bank, a local partner will be hired to monitor the loan recipients to check their payment record and use of funds, but also to provide business coaching advice to improve the enterprise management. This will greatly diminish not only the financial risk of the portfolio, but also environmental risk, since any emerging issue can be more immediately identified and addressed accordingly. It is envisioned that the monitoring agents will visit all the 4,000 clients from the pilot phase at least 2-3 times during the life of the loan.

III. Strategy for Environmental and Social Due Diligence

^{3 3} Source: *Taxa de Sobrevivências de Empresas no Brasil*—Sebrae 2011. Available at: [http://www.biblioteca.sebrae.com.br/bds/BDS.nsf/45465B1C66A6772D832579300051816C/\\$File/NT00046582.pdf](http://www.biblioteca.sebrae.com.br/bds/BDS.nsf/45465B1C66A6772D832579300051816C/$File/NT00046582.pdf)

7. Based on Directive B.13 of the Environment and Safeguards Compliance Policy (OP703), and given that this is a risk sharing facility, this operation is not subject to an environmental impact classification.
8. During the due diligence phase, the IDB will assess BDMG's existing environmental and social policies and institutional capacity for social and environmental risk mitigation, in order to establish how environmental risks and impacts will be assessed, monitored and mitigated and thus define the environmental and social requirements of the operation, which will be reflected in the ESMR and the Loan Agreement.
9. The environmental and social due-diligence will focus on the components listed below and will attempt to identify areas where the IDB's participation could result in additionality by promoting better management and good practices:
 - i. An assessment of the client's involvement in projects, companies or activities considered unacceptable to the IDB in case it could represent a reputational issue.
 - ii. An assessment of BDMG's compliance with all ESHS and labor legislation applicable in Brazil.
 - iii. An assessment of BDMG's existing social and environmental policies and capacity for risk management.
 - iv. An assessment of the final criteria used to select beneficiaries, to make sure they are not discriminatory from a social standpoint.