

MULTILATERAL INVESTMENT FUND

MEXICO

FUND FOR THE DEVELOPMENT OF PRODUCTIVE PROJECTS IN RURAL AREAS IDB/MIF - Fomento Social BANAMEX (TC-94-08-09-9)

EXECUTIVE SUMMARY

BENEFICIARY: The Fund for the Development of Productive Projects in Rural Areas (the Fund), a trust fund to be established in the Republic of Mexico.

COPARTICIPANT: Fomento Social BANAMEX, A.C., a legally incorporated body established in the Republic of Mexico. The National Bank of Mexico (BANAMEX) will serve as trustee.

ROLE OF THE MIF: The MIF's Small Enterprise Development Facility is able to support local private organizations that normally fall outside the IDB's sphere. The proposed project avails itself of this MIF advantage by establishing, in liaison with a private Mexican financial institution, a mechanism for creating and enhancing opportunities to finance and strengthen rural small businesses and microenterprises. This mechanism offers a considerably broader array of financial products than is available under normal IDB mechanisms for this sector, especially in terms of risk capital, underwriting, and guarantee funds.

AMOUNT AND SOURCE: The total contribution is US\$6.2 million: a US\$5 million contribution to the Fund (Facility III-B), and nonreimbursable technical-cooperation funding (Facility III-A) of US\$1.2 million for project preparation, specialized advisory services, training, studies and other nonreimbursable activities during the first five years of the trust fund's operation.

The Agreement Establishing the MIF has been interpreted to mean that the Small Enterprise Investment Fund (SEIF) allows use of a trust fund, in which the IDB/MIF has an interest akin to that of a capital investment. The project accordingly stipulates that the Fund's assets must be returned to the MIF on expiry of the Trust Agreement, and establishes operating regulations that make for

reasonable expectations of returns on the capital contributed.

OBJECTIVE:

To help with creation of the Fund, which will promote and support productive projects, and boost the economic autonomy and self-sustained development of organizations of low-income rural producers (paragraph 3.4).

DESCRIPTION:

The project consists of creating the aforementioned trust fund (the Fund), in which Fomento Social BANAMEX will participate on a one-to-one disbursement basis with the MIF. The initial contribution from Fomento Social BANAMEX would be US\$5 million, to be added to the MIF's and to other eventual contributions from national and international foundations, business groups, and organizations of civil society. The minimum initial amount of this trust fund would therefore be US\$10 million.

The beneficiaries of the activities to be promoted through this fund will be mainly rural small businessmen and microentrepreneurs, members of indigenous communities, ejidatarios, settlers, landless farm workers and peasants, fishermen, and small-scale miners. The project will be executed through grassroots economic organizations (beneficiary organizations), such as ejidos, farm settlements, rural-production societies, solidarity committees, cooperatives, and workers' associations, as well as other profit-making and nonprofit organizations engaged in productive projects and/or in setting up or expanding services for rural microenterprises and small businesses (a typical project sample is described in paragraphs 3.23 to 3.35).

The project will give the beneficiary organizations access to financial products in amounts, at costs, and of types, currently beyond their reach. The project will thus contribute to capital formation, particularly in productive infrastructure, in zones where real shortfalls exist.

The technical, operational, and financial parameters that will govern the functioning of the trust fund are set out in Annex I (Operating Regulations). These operating regulations define the terms and conditions for the transfer of resources in the form of loans, capital contributions, and/or nonreimbursable resources to the beneficiary organizations, underwriting and guarantee funds, as well as the criteria for the beneficiary organizations'

technical, economic, environmental, and financial eligibility (paragraphs 3.16 to 3.21).

Functions such as project identification, selection, and analysis, as well as overall administration of the trust fund, will be performed by a technical committee, whose membership is described in the Trust Agreement and whose powers and responsibilities are specified in the Trust Fund Operating Regulations (Annex I).

**ENVIRONMENTAL
CLASSIFICATION:**

The Environmental Management Committee, at its meeting of September 1, 1994, classified this as a Category III operation.

**TERMS AND
CONDITIONS:**

The MIF resources will be as follows: (a) US\$5 million from Facility III-B (SEIF), as a contribution to the Fund's equity capital, in the terms stipulated in the Trust Agreement; and (b) US\$1.2 million from Facility III-A, as nonreimbursable technical-cooperation funding for the Fund, in the terms stipulated in the pertinent contract.

RISKS:

The feasibility of this operation is supported by the soundness of the counterpart institution, Fomento Social BANAMEX, and the reputation of the trustee, the Banco Nacional de México (BANAMEX). The risks inherent in the administration of funds of this type are minimized by the adoption of reporting requirements and mechanisms for financial and accounting audits for the Fund. The risks usually associated with operations to be financed by the Fund (loans, guarantees, risk capital) are minimized by the feasibility criteria to be applied to potential projects.

Also, the Fund's long-term sustainability is at risk unless it can find a critical mass of economically viable operations within the target universe. However, it is felt that the demand is sufficient to enable the Fund to operate satisfactorily.

The conditions governing the transfer of reimbursable resources to the beneficiary organizations could result in a partial erosion of the Fund's actual dollar value. The trustors have agreed to assume this exchange risk, which does not preclude setting aside appropriate reserves in the Fund's accounts or additional contributions to supplement the Fund's resources.

Last, it is highly unlikely that the technical committee's activities would entail legal risks that

Executive Summary

Page 4 of 4

could jeopardize the Fund's equity. However, should it be necessary, precautions and suitable insurance against such risks will be included in the Trust Agreement, chargeable to the Fund's administration.

**SUPERVISION AND
EVALUATION:**

The Operating Regulations and the Trust Agreement establish the obligation of the trustee (BANAMEX) to regularly report to the technical committee on the administration of the Fund and the obligation of the technical committee to regularly inform the trustors (IDB/MIF and Fomento Social BANAMEX) about the Fund's operations. This will facilitate normal supervision and evaluation of the operation.

Provision has also been made for detailed annual progress reports on Fund activities, to be charged to the nonreimbursable technical-cooperation component. These evaluations will be performed by an international consulting firm or an applied research institution with an international reputation. Both trustors must expressly approve the terms of reference for these evaluations and the firm or entity selected to perform the evaluations. These terms of reference will include the evaluation criteria described in the Operating Regulations (Annex I) and will cover, *inter alia*: functioning and operation of the Fund, effectiveness of the institution-building activities for beneficiary organizations; and effectiveness of support for the final beneficiaries (paragraphs 8.3 to 8.5 and Annex I).

**PROJECT
ELIGIBILITY:**

The proposed project is consonant with the MIF's general purpose, as set forth in Eligibility Guidelines 3 and 4, in that it would boost the capacity of rural small businessmen and microentrepreneurs to avail themselves of opportunities connected with economic reform and change, promoting expansion of the private sector and its participation in economic growth and development. This operation is also consistent with the specific objectives of the Small Enterprise Development Facility, in that funding will be provided for increasing the capacity of nongovernmental organizations to deliver financial and technical services to the target group.