

BANCO DAVIVIENDA MSME FINANCING PARTNERSHIP (ES-L1094)
PROJECT ABSTRACT

Overview

In El Salvador, the Micro, Small and Medium Size Enterprises (“MSMEs”) account for 99.6% of all companies¹, contribute to approximately 43% of the Gross Domestic Product (“GDP”) and employ 65% of the active workforce². Given its large participation in the economic activity of the country, they are considered an important contributor for growth. For the next couple of years, the demand for financing for the MSME sector is expected to increase and is projected at US\$1.6 billion for 2015, US\$1.7 billion for 2016 and US\$1.9 billion for 2017³. Despite their major economic importance, MSMEs face important challenges accessing the formal financial system, which harms their capacity to modernize, increase productivity and reach scale. Financial Intermediaries (“FIs”) have stayed away from the MSME sector due to high informality, lack of documented transactions, inadequate credit risk methodologies, and lack of collateral. Also after the 2008 financial crisis, Salvadorian FIs reduced their risk appetite for MSMEs generating a declining trend of doing business in this segment and focusing more on corporate clients. This situation is slowly changing, given the size of the Salvadorian market and higher competition in the corporate segment and banks are now looking back at this segment as an opportunity to increase revenues and market share. Salvadorian FIs are in the initial phases of both a) developing tailored made financial products and services to cater the segment and b) adjusting their business approach towards MSMEs. This is especially important for women-led MSMEs as most Salvadorian banks have not yet identified them as a profitable and sustainable market.

Project Description

The objective of the project is to support Banco Davivienda Salvadoreño, S.A. (“DAV”) to increase its MSME lending activities in El Salvador. The project would involve an IDB participation in DAV’s Diversified Payment Rights (“DPR”) Program providing a senior US Dollar denominated financing in an amount up to US\$70 million with a tenor of up to 8 years and with up to 3 years grace period (the “Financing”) consisting of: i) an up to US\$60 million financing funded by the IDB (“IDB Financing”); and ii) an up to US\$20 million Co-Loan from the China Co-Financing Fund for Latin America and the Caribbean⁴ (“IDB Fund Financing”). The project contemplates that at least 25% of the financing proceeds will be earmarked to support women-led MSMEs⁵ as part of the women-entrepreneurshipBanking (“weB”) initiative⁶.

¹ Cámara de Comercio e Industria de El Salvador:

http://camarasal.com/index.php?option=com_content&view=article&id=22&Itemid=32

² Chorro, M. (2010). “Financiamiento a la inversión de las pequeñas y medianas empresas: el caso de El Salvador”. CEPAL.

³ Puig and Carrión (2014). “República de El Salvador: Análisis de Demanda de Crédito de inversión para MIPYMES”. IDB.

⁴ The Transaction Consultation Document was approved by non-objection of the China Co-Financing Fund or Latin America and the Caribbean on May 11th, 2015.

⁵ Women-led SMEs defined as an enterprise (a) that is controlled at least fifty one percent (51%) by women, and/or (b) the chief executive officer (CEO) and/or Chief Operations Officer (COO) of which is a woman.

The Financing seeks to increase DAV's MSME lending activities specifically by: i) addressing the lack of availability of long term funding by providing DAV with an up to 8-year tenor financing vs its current weighted average tenor for borrowings of 3.2 years and 5.8 for local issuances of corporate bonds; and ii) providing technical assistance ("TA") to improve DAV's channels to reach women-led MSMEs.

Expected Development Benefits

DAV's MSME outstanding loan portfolio amounted to US\$134 million in 2014, serving a total of 3,038 clients. With IDB support, DAV's portfolio is expected to increase to US\$176 million and 5,264 clients by 2019, an increase of 31% in lending and 73% in clients. In terms of women-led MSMEs, in 2014, DAV has a women-led MSME loan portfolio of US\$17 million serving a total of 693 enterprises. By 2019, it is expected that the loan portfolio will increase to US\$32 million (increase of 88%) serving a total of 1,464 enterprises (increase of 111%).

Bank's Additionality

Financial Additionality. Financial additionality will focus on: i) the positive signaling effect that both IDB's support in the revamping process of DAV's DPR Program and the participation from different International Financial Intermediaries ("IFIs") gives to private institutional investors, motivating them to participate in these types of structured transactions. Also, IDB support to DAV's DPR Program contributes to the development of a stronger Financial System as it supports funding diversification towards more stable sources; ii) the mobilization of additional funds from the China Co-Financing Fund for Latin America and the Caribbean, and the participation of FMO and Prudential for an expected total amount of approximately US\$110 million, equivalent to a mobilization ratio of 1.8x; and iii) the 8 year tenor that will be offered to DAV. This tenor is not widely available in the market and will allow DAV to manage its balance sheet in a prudent manner and the flexibility to continue providing medium to long term funding to the MSME market, building sector knowledge, awareness, and skill. In addition, the 3 year grace period will provide additional flexibility to deploy the resources with time and discretion.

Non-Financial Additionality. IDB's non-financial additionality comes from: i) a TA as part of the weB initiative that MIF is processing. The purpose of the TA is to support the development of product and services for women entrepreneurs to provide training to credit officers, client officers and managers to better understand, attract, attend and assess the segment; or to improve information management systems. Conversations with the client have started and DAV is preparing the information required for the TA application process; and ii) the active role of IDB coordinating the due diligence process of the different participants in the issuance bringing additional efficiency to the process and the client.

Alignment with Bank and NSG Strategy

The Project is aligned with the strategic priorities of the IDB because:

- It serves the purposes of the Ninth General Capital Increase of the IDB ("GCI-9") which states that, to foster "Institutions for Growth and Social Welfare", one of the Bank's

⁶ weB is a joint effort between SCF's beyondBanking Program and MIF's LASEF. weB resulted from research and on-the-ground experience demonstrating that women-owned SMEs make up a high-growth yet underserved segment of Latin American and the Caribbean (LAC) economic activity.

objectives is “strengthening MSME lending through second-tier vehicles and financial services”. It is also aligned with GCI-9 objectives as to it contributes to “Development through the private sector”. The project is also consistent with the IDB’s *Operational Policy on Gender Equality in Development*⁷ (GN-2531) by actively promoting gender equality and empowerment of women through IDB’s direct intervention.

- The project is in line with the Bank’s Country Strategy for El Salvador (GN-2575), paragraph 3.3 states: “...the NSG windows will help to address market defects that limit access to financing by El Salvador’s entrepreneurs, particularly MSMEs”. Also, the new Country Strategy for El Salvador 2015-2019, currently under approval, includes MSME financing projects as part of NSG interventions in El Salvador.
- It contributes to SCF’s vision targets⁸, between 2011 and 2014 SCF has supported a total of 618,462 MSMEs. It also supports two pillars of SCF’s beyondBanking⁹ program: the accessBanking pillar that promotes financial and social inclusion through the access2SMEs products lines; and the equalBanking pillar that promotes gender equality¹⁰.

⁷ <http://www.iadb.org/document.cfm?id=35428399>.

⁸ Vision targets are to improve the living standards for 20 million people, make climate friendly investments of US\$12 billion and meet the funding needs of 700,000 SMEs by 2015.

⁹ For more information, please refer to www.iadb.org/beyondbanking.

¹⁰ Report on the Ninth General Increase in the resources of the Inter-American Development Bank, May 21, 2010. SCF Strategy 2011-2015, November 10, 2010.