

PROJECT SUMMARY

INNOVATIVE FINANCING FOR SMEs: REVENUE-BASED BANK LOANS

(RG-Q0039, RG-T2929)

In spite of substantial advancements in bank financing and fund investments in recent years, small and medium enterprises (SMEs) that are based on human resources (talent), such as ventures in the knowledge economy, continue to face difficulties in accessing capital. The challenges have significant implications since they create the jobs that are a central part of economic growth and stability. Lending to this segment continues to be heavily dependent on collateral (often a mortgage or personal guarantee) due to the lack of innovative tools that make it easier to assess the true credit risk of this customer segment. And while several institutions are innovating to better serve talent-driven SMEs, commercial banks are lagging behind.

As the innovation lab of the Inter-American Development Bank Group, the MIF is mobilizing strategic partners to test new financial tools that are better fit for the needs of entrepreneurs. And as part of its strategy to develop the knowledge economy in the region, the MIF has been supporting the development of alternative funding structures as a way to provide more right-sized financing, especially to talent-driven SMEs in the region. One financial product in which the MIF has been particularly interested are loans with repayment schedules tied to top-line business indicators, such as revenues. These types of loans are referred to as **revenue-based loans**.

This project's main objective is to unlock the growth of talent-driven SMEs that will access revenue-based loans. The project will engage directly with local commercial banks so they can offer these unprecedented products. The SMEs receiving these loans will also benefit from **business development services**, which will not only impart technical assistance to the entrepreneurs, but will also prepare SMEs for capital infusion, accelerate their growth, augment loan monitoring, reduce risk of default, and thus increase their impact and sustainability.

To further reduce the risk borne by participating local banks and to quickly scale this pilot, the project will also create a **special purpose vehicle** through which other investors can participate in the loans. This mechanism will make it easier for international impact investors (such as the MIF) to contribute to the project and make it grow throughout the region.

The MIF's financial contributions will include an investment of up to US\$ 3 million to the special purpose vehicle as well as a non-reimbursable technical assistance funds of US\$250,000 to kick start replication across countries in Central America. The technical assistance will be crucial to transfer the know-how to target local banks across participating countries and to extract lessons about this innovation.

As key results, the project will yield a growing number of SMEs in the knowledge economy accessing right-sized financial products to help them thrive. It will also support commercial banks to innovate while lending to talent-driven SMEs. Furthermore, a mechanism will be tested that facilitates replication, scalability, and economies of scale for commercial banks and impact investors.