

## PROJECT SUMMARY

### **LOCFUND NEXT: FINANCIAL INCLUSION AND DIGITAL TRANSFORMATION IN MICROFINANCE INSTITUTIONS IN LATIN AMERICA AND THE CARIBBEAN (RG-Q0063/RG-L1141/RG-T3689)**

To continue bridging the financial inclusion gap, the microfinance industry in the Latin America and Caribbean (LAC) region that IDB helped to initiate, develop, strengthen and consolidate since the early 1980s, and that more recently the other public and private agencies have been taking over the baton from IDB Lab, is expected to continue playing a central role in improving the lives of the poor and vulnerable and small business owners. However, the current COVID-19 crisis has posed an unprecedented challenge to the continuity of microfinance institutions (MFIs), especially small- and medium-sized ones, in a context where liquidity and financial services are needed more than ever for low income households and small businesses. As the effects of COVID-19 crisis impacts the real economy of LAC region, small and medium MFIs face serious liquidity problems and currency mismatches as their loan portfolio quality deteriorates, their funding sources dries up, and volatile currencies enhance their foreign exchange (FX) risks.

To guarantee the continuity of well-managed MFIs, not only to be able to provide vital financial products and services to the poor and vulnerable in the immediate short run, but also to accelerate the post COVID-19 economic recovery process in LAC region, there is a need for a mechanism/vehicle that provides much-needed local currency-denominated financing to MFIs with mid- to long-term vision based on long-standing sector expertise and knowledge.

In addition, the current quarantine/lockdown and social-distancing measures evidenced the importance and urgency of digital transformation across many industries and sectors, both public and private, so they continue operating and serving low income populations and become more agile and resilient for the near future. The financial/banking sector, especially MFIs, is not an exception. In order to face the current crisis as well as maintain continued relevance, including for the period after the crisis, digitization has become a “must have” requirement of doing business at the microfinance level, rather than simply “good to have” as in the past.

Despite the growth of fintech startups who have improved financial inclusion, MFIs, particularly the small- and medium-sized ones, remain as the main channel and point of contact for serving the poor and vulnerable population. For these MFIs to play a key role so that LAC economy withstands the COVID-19 pandemic impact with a greater resilience and shifts to recovery and growth phase smoother once the pandemic subdues, the proposed project, as part of the IDB Group-wide effort to address the effects of the current COVID-19 crisis in the region, will mobilize capital and technical assistance to contribute to the creation and consolidation of Locfund Next.

Locfund Next will build on the successful model adapted to smaller MFIs' needs by its predecessor, the Local Currency Fund (“Locfund”)<sup>1</sup>, and transform this model into a permanent vehicle with a holistic approach, ready to scale up. This will be the first permanent regional vehicle, administered by local managers, dedicated to providing local currency financing and digital transformation support to MFIs.

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<sup>1</sup> Locfund I (RG-Q0029/RG-L1105/RG-M1076), approved in 2006, started operations in 2007 and closed in 2014. Locfund II (RG-Q0031/RG-L1107/RG-M1236), approved in 2013, started operations in 2014 and is scheduled to close in 2022. Locfund I disbursed a total of USD 69 million in local currency loans to 45 MFIs in 13 countries, reaching 1.8 million final beneficiaries of which 59.5% were women and 42.2% living in rural areas. Locfund II has disbursed, so far, a total of USD 179 million in local currency loans to 55 MFIs in 13 countries, benefitting 1.4 million individuals of which 62.3% are women and 48.1% living in rural areas.

IDB Lab proposes to join forces with a suite of public and private investors to create Locfund Next. IDB Lab's contribution of USD 1 million in equity investment, USD 3 million in debt and USD 500,000 in technical cooperation, will allow Locfund Next to start its operations with the initial capitalization of USD 20 million and available debt financing of USD 41 million, as well as USD 1 million technical support facility for MFIs' digital transformation.

Direct beneficiaries of the project will be about 114 small and medium MFIs providing services in 17 countries in LAC, who are expected to reach 380,000 low income households and small businesses (~2.1 million low income individuals).