

GLOBAL CREDIT PROGRAM FOR SMALL AND MEDIUM-SIZED ENTERPRISES

(BR-0310)

EXECUTIVE SUMMARY

**BORROWER:** Banco Nacional de Desenvolvimento Econômico e Social

**GUARANTOR:** Federative Republic of Brazil

**EXECUTING AGENCY:** Banco Nacional de Desenvolvimento Econômico e Social

**AMOUNT AND SOURCE:** IDB: US\$1.2 billion under the ordinary-capital emergency lending program

**FINANCIAL TERMS AND CONDITIONS:**

Amortization period:	5 years
Grace period:	3 years
Disbursement period:	18 months
Interest rate:	U.S. dollar 6-month LIBOR + 400 basis points p.a.
Special fee:	1% front-end fee
Credit fee:	0.75%
Currency:	U.S. dollars
Waiver of loan charges:	The waivers that would normally be allowed for regular ordinary-capital loans do not apply.

**OBJECTIVES:**

The program's general objective is to further the development of a modern producing sector in Brazil by making more medium- and long-term finance available, on market terms, to private-sector small and medium-sized enterprises (SMEs) requiring investment funding for projects to restructure, improve, and expand efficient operations. In line with previous operations and with guidelines for IDB action in the finance sector, the proposed program would support Brazilian government efforts to modernize the country's production sectors and make them more competitive, by lowering the so-called 'Brazil cost'.

The specific aim of the program is to maintain, over the coming 18 months, an adequate flow of medium- and long-term financing on market terms, via the formal financial system, for SMEs' investment outlays to restructure, improve, and expand efficient operations.

**DESCRIPTION:**

The proposed program would supply multisector global financing to spur job creation in the productive sectors, so SMEs can modernize and expand their operations to be more competitive as Brazil continues to open up its economy. Banco de Desenvolvimento Econômico e Social (BNDES) would be the vehicle for increasing productive employment, by virtue of its active involvement in medium- and long-term lending to SMEs. The operation proposed here would be concordant with the guidelines for IDB emergency

loans designed to expedite SMEs' access to credit (document GN-2031-4).

The program would take the form of a discount window for medium- and long-term commercial bank loans to SMEs to finance purchases of machinery, equipment, and services, including associated working capital, and for new plant and fixtures to expand, modernize, and diversify the operations of private Brazilian production businesses that satisfy the program's technical, financial-economic, legal, and environmental viability requirements. The program will support loans of up to R\$7 million each to SMEs (companies with annual sales of up to R\$15 million), by way of two commercial bank loan discounting facilities: BNDES-Automático and the Agência Especial de Financiamento Industrial (FINAME-Automático) facility, with terms in accordance with current BNDES operating policies.

All funds for the program will be channeled through BNDES and thence through intermediary financial institutions (IFIs) which qualify according to the program's Credit Regulations; as in previous operations, those regulations will be consistent with rules governing BNDES operations. The IFIs will onlend these monies to SMEs to finance productive investment projects.

**RATIONALE FOR  
THE OPERATION:**

Constraints associated with the current global market climate are making it more difficult than ever for Brazil's SMEs to secure funding now or in the near term, whether from the financial system (which is reluctant to take on medium- and long-term exposure when deposits are at short term) or from the capital market, which in any case supplies very little medium- to long-term finance, and is a viable option only for large corporations.

Against the present sluggish economic backdrop, the profile of SMEs' financing needs is changing dramatically. The combination of dwindling external-funding inflows and tight monetary policy has slashed the amount available for credit, and SMEs are being crowded out by larger corporations. As their sales figures slip, many smaller businesses are unable to come up with money of their own to fund their operations (working capital) and capital outlays. What SMEs need in these circumstances are lengthier bank-loan repayment terms and more working-capital finance.

The foregoing developments will be heightening the demand for BNDES's lending programs: the only significant source of such finance for SMEs precisely at a time when it is exceedingly difficult to secure more funds to fill this need, as was noted above.

The fresh funds that BNDES would obtain through the proposed line of credit would keep it from having to cut back on its lending, and equip it to address

problems ensuing from the macroeconomic adjustment.

Moreover, BNDES is the only institution in Brazil with a network of IFIs large enough to ensure that funds could be dispersed throughout the country. Likewise, its rules, procedures, and institutional capacity for evaluation and supervision afford assurances of successful administration of a program of this scale.

**ENVIRONMENTAL AND  
SOCIAL CONSIDERA-  
TIONS:**

The proposed program would be subject to the same environmental requirements that applied in previous operations. One design element in those earlier programs was a comprehensive environmental quality-control mechanism for subprojects, based on National Environment Commission standards. BNDES's Environmental Advisory Unit, situated in its planning area, has expertise in this area. The quality-assurance mechanism which was ultimately expanded to take in all BNDES loans has worked satisfactorily, and thus would be used for this program as well, with no significant adjustments. BNDES has environmental policies and procedures in place for IFI classification, approval authority, and compliance monitoring, including on-site supervision of IFI subloans to end-borrowers, for example by reviewing files for each operation to check that official environmental permits were obtained.

**POVERTY-TARGETING  
AND SOCIAL-SECTOR  
CLASSIFICATION:**

The operation does not qualify as poverty-targeted. However, because there would be no minimum on subloans, it is expected that many microenterprises will be able to access the program.

**EXCEPTIONS TO  
BANK POLICY:**

None

**PROCUREMENT:**

Not applicable

**BENEFITS:**

The government proposes to make more medium- and long-term finance available to Brazilian SMEs, which account for a huge share of Brazil's industrial apparatus and offer prospects for production restructuring and modernization. The financing proposed here for small and mid-sized businesses will bolster the medium- and long-term finance available to SMEs engaged in any efficient private-sector activity, including social-sector ventures, during the most critical chapter of the current adjustment program.

**RISKS:**

The success of the proposed program will depend on there being a macroeconomic and financial climate conducive to private investment and export growth. Significant results have already been achieved under the "Real" Plan in terms of reforms and economic stabilization; the package of measures that the government is implementing is expected to build upon these results. The program's macroeconomic risk is significantly lessened in these circumstances.

There is little risk of financial-system dislocations

such as would affect the program: adjustments brought in since the "Real" Plan was launched have strengthened the financial system, including regulation and oversight, and have advanced State bank reorganization and privatization processes. The proceeds of the proposed program thus can be expected to be properly channeled. The program also would allay the aforementioned risk by acting as a catalyst for sound practices, demanding more rigorous loan-selection and portfolio-monitoring in IFIs, and closer BNDES monitoring of IFI credit-line operations. By providing IFIs with long-term funds, the operation described here would also help those institutions put together more balanced loan portfolios.

The experience with BNDES in previous operations and that agency's proven effectiveness in dispersing credit for SMEs nationwide, as well as the significantly lower delinquency rate of the IFIs using BNDES resources as opposed to other resources, will substantially allay any risk of the program's not reaching the entire target group or falling short of its objectives.

**ROLE OF THE  
PROJECT IN THE  
BANK'S COUNTRY AND  
SECTOR STRATEGY:**

The proposed program fits with the Bank's lending strategy for Brazil and pursues the Brazilian authorities' priorities, and would satisfy BNDES's request to the Ministry of Planning. The object of all the foregoing is to make more medium- and long-term finance available to the country's SMEs, as a key avenue for deepening, with stability, the process of Brazil's economic integration with the global marketplace.

**SPECIAL  
CONTRACTUAL  
CONDITIONS:**

The global credit program for SMEs will be considered eligible for disbursement when the borrower has demonstrated that the Credit Regulations have been put into effect (paragraph 4.31 of the proposal which follows) and that, on the date that the credit amounts were committed by BNDES, the guarantor was maintaining a macroeconomic environment consistent with what was agreed with the IMF (paragraph 4.23).

The borrower has asked the Bank to recognize amounts expended (actual and anticipated) up to the date of approval of the loan. According to project team estimates, the Bank might recognize up to 40% of the loan proceeds for such expenses incurred since October 7, 1998 (paragraph 4.47).