MULTISECTOR GLOBAL CREDIT PROGRAM

(ME-0117)

EXECUTIVE SUMMARY

Borrower:	Nacional Financiera, S.N.C. (NAFIN)	
Guarantor:	United Mexican States	
Executing agency:	Nacional Financiera, S.N.C. (NAFIN)	
Amount and source:	IDB (dollar window):	US$300 million
	Local counterpart:	US$300 million
	Total:	US$600 million
Financial terms and conditions:	Amortization period:	12 years
	Disbursement period:	3 years
	Interest rate:	variable
	Inspection and supervision:	1 %
	Credit fee:	0.75%
	Currency:	U.S. dollar

Objectives: The objective of the program is to assist with the development of micro-, small-, and medium-sized enterprises (MSME) by expanding the supply of formal credit services geared to this sector. To accomplish its objective, the program will make resources available to NAFIN to fund loans that financial intermediaries make to MSME. It will also provide resources for developing specialized lending technologies tailored to meet this sector's needs efficiently.

Description: The proposed program will have two components: a **multisector credit component (US$586.75 million)** that will provide resources to expand NAFIN's roll-over programs for loans that eligible financial intermediaries make to MSME. This component will be instrumental in funneling medium- and long-term resources through auction and rediscount programs and, on a short-term, more limited scale under a supplier credit program. A **technical assistance component (US$8 million)** whose specific objective is to expand the institutional capacity of the financial intermediaries and of NAFIN to serve the MSME sector and make the products offered more competitive. This component will have three subcomponents: (1) technology transfer and competitiveness; (2) upgrading specialized providers and developing new distribution channels, and (3) improving MSME competitiveness.

The Bank's country and sector strategy:

The Bank's strategy for the financial sector has focused on support for the government in its efforts to reform and modernize the system of existing public development banks in Mexico. The Bank has financed modernization programs for NAFIN and Banobras (two of the leading development banks) and has at the same time has kept up an ongoing dialogue with authorities on the future role that development banks will play as tools of government economic policy.

The Bank's strategy is fully consistent with the country's strategy for the sector, which is why the present operation was included in the country paper that the Bank's Programming Committee approved last October. Support to the private sector is one of the priorities of the Bank's strategy for Mexico. The Bank's strategy for the private sector would consist of the following: (i) modernizing laws and regulations; (ii) financing private investment projects; (iii) financing public projects associated with private investment, and (iv) financing and supporting micro-, small- and medium-sized enterprise. The Bank currently has two other operations in the pipeline for the financial sector: one with the bank savings protection institute [Instituto de Protección del Ahorro Bancario] (IPAB) (ME-0227) to assist with the reforms now being introduced in the financial sector, and another to help the housing sector through the mortgage bank operating and financing fund [Fondo de Operación y Financiamiento Bancario de la Vivienda] (FOVI) (ME-0137).

NAFIN's experience in the MSME sector and its command of the products to serve them makes it the best intermediary through which to channel the proposed operation's resources. The program would capitalize on NAFIN's role as a catalyst in the growth of the financial market, in other words its ability to attract and establish partnerships with financial intermediaries, and to leverage its position as a catalyst to supply stable, long-term resources for lending, which will be an important inducement to financial intermediaries to increase their lending to the MSME. The program is expected to benefit some 3,900 businesses.

The support this operation will provide to NAFIN will come just as it is completing its financial restructuring and implementing an in-depth institutional reform through a strategic program designed to make it an efficient provider of second-tier financial services. The operation will enable NAFIN to consolidate and expand the delivery of financial services to the MSME, with more emphasis on the smaller businesses within this sector.

Environmental and social review: The Committee on Environment and Social Impact (CESI) approved the program last May 19 and its recommendations were built into the design of the strategy for the present operation.

Benefits: Under the present operation, a number of benefits will accrue to the target population, the principal one being greater access to financial services for micro-, small- and medium-sized enterprise, thereby helping to create jobs for the Mexican people. IFIs will be able to participate provided they meet sufficiently stringent eligibility criteria, the effect of which will be to upgrade the intermediaries participating in NAFIN's lending programs. The program will also be pivotal in getting NAFIN's restructuring process fully in place, which will give the institution the operating efficiency that the reforms were intended to achieve. The program's technical assistance component will further the development and introduction of new products, thus enabling NAFIN to be more instrumental in deepening Mexico's financial market.

Risks: **The macroeconomic climate and financial system.** The program's success will largely depend on whether the macroeconomic situation remains stable, with fiscal and monetary policies conducive to growth and expansion of credit to the private sector. The structural reforms instituted within the financial system have to be continued to ensure that it recovers and functions normally. The government is determined to follow through with those reforms and to maintain monetary and fiscal discipline, thus minimizing the risk of both these variables.

Operating risk. NAFIN has made significant progress with its reform and institution building. However, the improvement NAFIN has made to upgrade its capacity to analyze and manage risk assets will have to be sustained if the institution is to lend more without jeopardizing its financial position. The operating risk is also mitigated as more and more risk analysis procedures are automated and because the eligibility criteria being introduced are program-specific.

Timing of the operation. The proximity of Mexico's elections and the possibility of a change of administration could be regarded as potentially detrimental to execution of this operation. However, inasmuch as NAFIN's activities under this program are among the services that the institution provides to the private sector, the political process is not expected to have any effect whatever on those services. Moreover, the election process does not appear to have had any ill effect on NAFIN's lending during the first quarter of 2000.

Special contractual clauses:

1. Prior to the first disbursement from the credit component, the borrower must show the following, to the Bank's satisfaction:

   a. evidence of having put into force the credit regulations that will govern the program, as previously agreed with the Bank;

   b. the draft contracts to be entered into with the IFIs, as previously agreed with the Bank;

   c. a report establishing the procedures that will be used to put into practice the environment-related provisions of the credit regulations and the NAFIN departments responsible for implementation.

2. Prior to disbursement of the resources from the technical assistance component, NAFIN must submit, to the Bank's satisfaction, a plan of operation for the component, outlining the activities to be performed and the work schedule, as previously agreed with the Bank.

Poverty-targeting and social sector classification:

This operation qualifies as a project that promotes social equity, as described in the key objectives for the Bank's activities in the report on the eighth general increase in resources (documents AB-1704). It does not qualify as a poverty-targeted investment (PTI).

Exceptions to Bank policy:

N/A

Procurement:

The Bank's normal procurement rules will apply.

Revolving Fund:

The Bank normally allows the borrower to request up to 5% of ~~–~~the financing under a revolving fund. ~~. this ceiling was raised at NAFIN's request to 10% for loan 911/OC-ME so that the auction mechanism for program lending could be used for efficiently~~However, the borrower is requesting that the revolving fund be increased to 10% for this operation to make program lending more efficient, especially under the auction mechanism. The same percentage was requested ~~Based on this experience, it is felt that the same ceiling of 10% be continued for the present loan~~for loan 911/OC-ME.~~.~~