INTER-AMERICAN DEVELOPMENT BANK -MULTILATERAL INVESTMENT FUND- 2008 IADB ANNUAL MEETING

"MAKING PEOPLE COUNT – TRANSFORMING THE FINANCIAL SYSTEM TO REACH THE POOR"- MIAMI – APRIL 5, 2008
ROUNDTABLE DIALOGUE – LENDING TO SMALL BUSINESSES – CHALLENGES AND NEW MODELS
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LET ME DIVIDE MY THOUGHTS IN FOUR CHAPTERS. FIRST AN OVERVIEW OF THE ARGENTINE FINANCIAL SYSTEM, FOLLOWED BY AN EXPLANATION OF THE SME SEGMENT IN PARTICULAR. THEN, THE VARIOUS INSTRUMENTS AVAILABLE ARE BRIEFLY DESCRIBED. FINALLY, I CONCLUDE WITH SOME DETAILS ON THE AGENDA AND MAIN CHALLENGES FOR THE REGION.

DRIVEN BY THE CENTRAL BANK'S FINANCIAL POLICIES, IN THE LAST 3 YEARS THE SYSTEM HAS MADE PROGRESS IN ALL AREAS, LEAVING BEHIND THE NEGATIVE EFFECTS OF THE 2001-2002 CRISIS. TODAY ALL THE INDICATORS ARE IN LINE WITH FINANCIAL SYSTEMS IN THE REGION.

ONE OF THE MAIN ACHIEVEMENTS HAS BEEN THE NORMALIZATION OF BANK ASSETS, WITH A SHARP REDUCTION IN EXPOSURE TO THE PUBLIC SECTOR AND AN EXPANSION OF LENDING TO THE PRIVATE SECTOR AT AN ANNUAL RATE OF CLOSE TO 40% IN 2007. THE SHARE OF LENDING TO THE PRIVATE SECTOR IN BANK ASSETS PORTFOLIOS (38.2%) IS NOW MORE THAN TWICE THAT OF LENDING TO THE PUBLIC SECTOR (16.1%), THE LATTER HAVING DROPPED 25 PERCENTAGE POINTS (P.P.) IN THE LAST THREE YEARS. THIS RECOVERY BY BANK FINANCING FOR THE PRIVATE SECTOR TOOK PLACE SIMULTANEOUSLY WITH AN IMPROVEMENT IN THE QUALITY OF THE PRIVATE SECTOR PORTFOLIO, FROM VERY HIGH LEVELS OF NON-PERFORMANCE TO HISTORICALLY LOW RECORDS (NON-PERFORMANCE IS CURRENTLY 3.2% OF LENDING TO THE PRIVATE SECTOR).

ALTHOUGH THERE IS STILL A NEED FOR THE DEEPENING OF THE FINANCIAL SYSTEM WITHIN THE ECONOMY, IF ONE CONSIDERS THE LOW LEVEL OF LENDING TO THE PRIVATE SECTOR RECORDED AT THE END OF THE CRISIS, THERE HAS BEEN A SIGNIFICANT IMPROVEMENT OF OVER 5 P.P. OF GDP, RISING FROM A LOW OF 7.4% OF GDP IN MID-2004 TO 12.5% CURRENTLY.

IN LINE WITH THE INCENTIVES ESTABLISHED BY THE CENTRAL BANK, PRIVATE SECTOR DEPOSITS HAVE BECOME CONSOLIDATED AS THE PRINCIPAL SOURCE OF BANK FUNDING. AT THE SAME TIME, THE REDISCOUNTS GRANTED BY THE CENTRAL BANK DURING THE CRISIS HAVE ALMOST BEEN ELIMINATED FROM BANK LIABILITIES.

HAVING OVERCOME THE TURBULENCE ON INTERNATIONAL FINANCIAL MARKETS THAT PARTLY AFFECTED THE RESULTS, BANKS CONCLUDED THEIR THIRD CONSECUTIVE YEAR OF PROFITS. BOTH PROFITABILITY AND NEW CAPITAL CONTRIBUTIONS (US$5.8 BILLION SINCE 2002) CONTINUED TO STRENGTHEN THE SOLVENCY OF THE SECTOR.

LOANS GRANTED TO COMPANIES IN THE SMALLEST SEGMENT ARE GROWING AT A HEALTHY RATE, AVERAGING 30% ANNUAL GROWTH IN THE LAST TWO YEARS. NEVERTHELESS, THESE CREDIT LINES STILL ACCOUNT FOR A LOW PROPORTION OF THE TOTAL, SHOWING A SHARE OF 16% OF FINANCIAL SYSTEM LENDING TO COMPANIES. UNLIKE THE SITUATION IN 2006, LARGER CREDIT LINE SEGMENTS POSTED THE LARGEST RELATIVE INCREASE IN 2007.

CENTRAL BANK POLICIES FAVORED THE DEVELOPMENT OF INNOVATIVE INSTRUMENTS THAT HAVE BEEN BOOSTING CREDIT TO SME RECENTLY.

LEASING IS ONE OF THE MOST DYNAMIC FINANCING INSTRUMENTS THAT HAS BEEN ESPECIALLY TARGETED AT SMES IN ARGENTINA. IT HAS GAINED GROUND AS A FUNDING INSTRUMENT COMMONLY USED BY SMES TO ACQUIRE MACHINERY AND TECHNOLOGY. ALMOST 70% OF LEASING LINES CAN BE FOUND IN THE UNDER $1 MILLION SEGMENT.

DEFERRED-PAYMENT CHECKS (CHPD) ALSO CONSTITUTE ANOTHER KEY SME TOOL FOR FINANCING VIA CAPITAL MARKETS, BEING MORE FREQUENTLY USED THAN FINANCIAL TRUSTS AND LESS-COMMON INSTRUMENTS SUCH AS CORPORATE BOND ISSUES OR SHORT-TERM SECURITIES ISSUES. ITS TRADING PROVIDES SMES WITH ACCESS TO FINANCING AT A LOWER INTEREST RATE THAN THAT TRADITIONALLY AVAILABLE IN ALTERNATIVE CHANNELS. DEFERRED-PAYMENT CHECK TRANSACTIONS HAVE GROWN STEADILY SINCE DECEMBER 2003, WHEN THEY BEGAN TO BE TRADED. IN 2007 $612 MILLION OF SUCH CHECKS WERE TRADED ON THE BUENOS AIRES STOCK EXCHANGE, AN INCREASE OF 42% OVER THE PREVIOUS YEAR, AND AN AMOUNT EQUIVALENT TO HALF THE INCREASE IN TOTAL LEASING IN THE PERIOD. THE TOTAL TRADED IN 2006 WAS $400 MILLION (TWICE THE FIGURE FOR 2005).

MUTUAL GUARANTY COMPANIES (SGR) ARE LIMITED LIABILITY COMPANIES CREATED FOR THE PURPOSE OF ISSUING GUARANTEES FOR THE OBTAINING OF FINANCING. IN ADDITION, THEY PROVIDE ACCOUNTING, FINANCIAL AND LEGAL ADVICE TO THEIR MEMBER SMES FOR A FEE, AND THEY POSSESS GOODS AND SERVICES THAT SERVE AS COUNTER-GUARANTEES. CURRENTLY 24 SGRS ARE AUTHORIZED TO OPERATE. OVER 15,000 GUARANTEES WERE ISSUED IN 2007 FOR A TOTAL OF $ 735 MILLION. THE DEVELOPMENT AND CAPITALIZATION OF THESE SGRS HAS BEEN AN ELEMENT THAT HAS FACILITATED CREDIT ENHANCEMENT, REQUIRED SO THAT LENDING TO SMALL BUSINESSES COMPLIES WITH THE RISK LEVEL DEMANDED BY CERTAIN INSTITUTIONAL INVESTORS (SUCH AS THE PENSION FUNDS –AFJPS- AND INSURANCE COMPANIES), WHICH HOLD SIGNIFICANT RESOURCES THAT COULD BE USED TO FINANCE THIS BUSINESS SEGMENT (SEE AGENDA).

FINANCIAL TRUSTS AROSE IN ARGENTINA IN 1996 AND HAVE BECOME THE SECOND LEADING SOURCE OF SMALL BUSINESS FINANCING VIA CAPITAL MARKETS IN THE LAST THREE YEARS. THE AMOUNT PLACED IN THE 2005-2007 PERIOD TOTALED $1.04 BILLION. A SIGNIFICANT PORTION OF THESE ISSUES WAS MADE IN US DOLLARS. THE MAIN ACTIVITIES FINANCED BY MEANS OF FINANCIAL TRUSTS HAVE INCLUDED AGRICULTURE AND EXPORTS.

THE FINANCIAL POLICIES AND THE PRUDENTIAL FRAMEWORK OF THE CENTRAL BANK ESTABLISHED AFTER THE CRISIS MADE POSSIBLE THE DEVELOPMENT OF THESE KINDS OF INSTRUMENTS. IT IS POSSIBLE TO IDENTIFY BOTH DIRECT MEASURES TO ENCOURAGE LENDING TO SMALL BUSINESSES AND MICRO-CREDIT FOR HOUSEHOLDS, AS WELL AS OTHER MORE INDIRECT MEASURES THAT STILL HELP TO STRENGTHEN FINANCING. A SERIES OF MEASURES HAVE BEEN INTRODUCED TO ENCOURAGE LENDING TO SMALL BUSINESSES:

- FACILITATION OF THE GRANTING OF GUARANTEES BY MUTUAL GUARANTY COMPANIES (SGR).

- IMPROVED OPERATION OF DEFERRED CHECK DISCOUNT MECHANISMS.

- INCENTIVES HAVE BEEN GRANTED TO CERTAIN FINANCING MECHANISMS FOR THE SEGMENT, SUCH AS LEASING.

TO ENCOURAGE THE GRANTING OF MICRO-CREDIT FOR HOUSEHOLDS MEASURES WERE ADOPTED TO:

- INCREASE LOAN INSTALLMENT FREQUENCY (MAKING IT WEEKLY, TWO-WEEKLY OR MONTHLY), AS WELL AS ALLOWING BANKS TO GRANT AN INITIAL GRACE PERIOD FOR THE PAYMENT OF PRINCIPAL SERVICING.

- RAISE THE CAP ON THE AMOUNT OF THE INSTALLMENT PAYABLE FROM $200 TO $300 TO BE ABLE TO INCLUDE A WIDER SEGMENT OF THE POPULATION.

- EXTEND THE MAXIMUM FINANCING TERM FROM 24 TO 36 MONTHS.

- INCREASE THE AMOUNT OF FINANCING AVAILABLE FOR HOME INFRASTRUCTURE WORKS FROM $3,000 TO $6,000.

- ELIMINATE THE MANDATORY 30% RESERVE REQUIREMENT ON CAPITAL INFLOWS INTENDED TO FUND MICRO-CREDIT PROGRAMS.

- ALLOW FINANCIAL INSTITUTIONS TO GRANT SMALL LOANS WITHOUT REQUIRING DOCUMENTATION ON DEBTOR INCOME ON THE BASIS OF “SCORING” AND “SCREENING” TOOLS.

OTHER MEASURES HAVE BEEN ADOPTED TO ENCOURAGE INCREASED USE OF BANKS BY THE POPULATION WITH LIMITED ACCESS TO FINANCIAL SERVICES, WHICH WILL SERVE TO STIMULATE THE GRANTING OF SMALL-SCALE LOANS. IN PARTICULAR, THESE MEASURES INCLUDE:

- ENCOURAGING THE DEVELOPMENT OF SAVINGS AND LOANS AND CREDIT COOPERATIVES, BY GRANTING FACILITIES FOR THEIR SETTING UP, EXPANDING THEIR SERVICE MENU AND INCREASING THEIR OPERATING CAPACITY.
- CHANGING OF CATEGORIES WHEN DETERMINING THE BASIC MINIMUM CAPITAL FOR FINANCIAL INSTITUTIONS ACCORDING TO THE JURISDICTION IN WHICH THEIR HEADQUARTERS ARE LOCATED. THE AIM IS TO FACILITATE THE SETTING UP OF NEW FINANCIAL INSTITUTIONS WITHIN THE FINANCIAL SYSTEM, PARTICULARLY IN AREAS WHERE COVERAGE IS LIMITED.
- ALLOWING FINANCIAL INSTITUTIONS TO OPEN TEMPORARY CUSTOMER ATTENTION OFFICES IN CERTAIN CONDITIONS (FOR EXAMPLE, SUCH OFFICES MUST OPERATE IN LOCATIONS WHERE THERE IS NO BANK BRANCH). THESE OFFICES WILL BE ABLE TO PERFORM ALL TRANSACTIONS ALLOWED IN THE CASE OF BANK BRANCHES, EXCEPT THE PROVIDING OF BANK CURRENT ACCOUNT SERVICES, ALTHOUGH THEY WILL BE ABLE TO RECEIVE DEPOSITS.

LOOKING AHEAD, AS AN OVERALL OBJECTIVE THERE IS A NEED TO INCREASE THE DEPTH OF THE FINANCIAL SYSTEM IN THE REGION, DEVELOP NEW FINANCIAL INSTRUMENTS AND COMPLETE EXISTING MARKETS.

IN ADDITION, THE AIM OF ENCOURAGING THE DEVELOPMENT OF INCREASED FINANCIAL MARKET DEPTH WILL EVOLVE ALONG FIVE FUNDAMENTAL DIMENSIONS, WHICH CURRENTLY REPRESENT LIMITATIONS ON THE REGION’S FINANCIAL SYSTEMS:

1. DEEPENING OF MEDIUM AND LONG-TERM FINANCING (FOR INVESTMENT AND HOUSING).
2. INCREASED INCLUSION OF MICRO-ENTERPRISES AND SMES IN THE CREDIT SYSTEM.
3. INCREASED LEVELS OF BANK SERVICE USE (GREATER GEOGRAPHICAL COVERAGE AND ACCESS BY BROADER SOCIAL SECTORS).
4. EXPOSURE TO THE PUBLIC SECTOR AND BALANCE SHEET MISMATCHING.
5. MONITORING OF THE CONSUMER CREDIT BOOM.

IN ORDER TO ACHIEVE GREATER DEVELOPMENT OF CREDIT FOR MICRO-ENTERPRISES AND SMALL BUSINESSES, CERTAIN FINANCIAL MARKET PARTICIPANTS WILL HAVE A KEY ROLE TO PLAY:

THERE ARE SEVERAL REASONS FOR THE EXISTENCE OF OFFICIAL OR PUBLIC SECTOR BANKS IN FINANCIAL SYSTEMS, PARTICULARLY IN DEVELOPING COUNTRIES THAT ENCOUNTER GREATER OBSTACLES TO THE FINANCING OF PRODUCTIVE ACTIVITIES AND LENDING TO HOUSEHOLDS. PUBLIC SECTOR BANKS MAKE POSSIBLE THE GRANTING OF LOANS TO SMALL COMPANIES WITH A LIMITED CREDIT HISTORY ALTHOUGH THEY POSSESS SOUND BUSINESS PROJECTS. FURTHERMORE, THEY HAVE HISTORICALLY PLAYED A ROLE IN THE DEVELOPMENT OF CERTAIN STRATEGIC SECTORS (PARTICULARLY IN EMERGING COUNTRIES), GENERALLY FOCUSING ON INDUSTRY AND AGRICULTURE.

CAPITAL MARKETS PLAY A SIGNIFICANT ROLE IN PROMOTING ECONOMIC GROWTH WITH SOCIAL EQUITY. IN ADDITION TO BANKS, INSTITUTIONAL INVESTORS (MAINLY PENSION FUNDS AND

INSURANCE COMPANIES) HOLD RESOURCES THAT CAN BE UTILIZED FOR THE FINANCING OF PRODUCTION IN GENERAL AND SMES IN PARTICULAR, PLAYING A ROLE IN PROMOTING THE DEVELOPMENT OF PRODUCTIVE ACTIVITIES.

IN ARGENTINA, THE PENSION FUND MANAGERS (AFJPS) HOLD OVER $94 BILLION IN THEIR PORTFOLIOS, WHILE INSURANCE COMPANIES, PARTICULARLY THOSE DEALING WITH LIFE AND RETIREMENT INSURANCE TOGETHER HOLD A PORTFOLIO TOTALING ALMOST $18 BILLION. BOTH THESE INVESTORS RECORD A HIGH LEVEL OF EXPOSURE TO THE PUBLIC SECTOR, A TREND THAT REFLECTS THE IMPACT OF THE 2001-2002 CRISIS. THESE FUNDS TOTAL ALMOST $112 BILLION (NEARLY 13% OF GDP), AND PART COULD BE USED TO HELP FINANCE THE REAL SECTOR OF THE ECONOMY. CURRENTLY DOMESTIC INSTITUTIONAL INVESTORS PLAY A LIMITED ROLE IN THE FINANCING OF SMALL-SCALE PRODUCTIVE INVESTMENTS, AS THEIR FUNDS ARE MAINLY USED TO HELP MEET THE GOVERNMENT'S BORROWING REQUIREMENTS.

FINALLY, INTERNATIONAL FINANCIAL INSTITUTIONS (IFIS) HAVE A POTENTIALLY IMPORTANT ROLE TO PLAY IN REDUCING THE EXTENT OF CURRENCY MISMATCHES IN THEIR BORROWING COUNTRIES BY ASSISTING IN THE DEVELOPMENT OF THE LOCAL FINANCIAL SECTOR, AND CATALYZING THE MOBILIZATION OF LOCAL CURRENCY FINANCIAL RESOURCES.

WHEN IFIS ENGAGE IN THIS KIND OF OPERATIONS SUCH ACTIVITIES CAN PROVIDE SIGNIFICANT BENEFITS, INCLUDING CAPITAL MARKET DEVELOPMENT (SETTING NEW BENCHMARKS, PROVIDING ROLE MODEL TRANSACTIONS IN TERMS OF DOCUMENTATION AND EXECUTION, STRETCHING THE YIELD CURVE, INTRODUCING INNOVATIONS WITH RESPECT TO AVAILABLE FINANCIAL INSTRUMENTS IN LOCAL CAPITAL MARKETS, AND PROVIDING SIGNIFICANT DIVERSIFICATION OPPORTUNITIES FOR LOCAL INSTITUTIONAL INVESTORS SUCH AS INSURANCE COMPANIES AND PENSION FUNDS), REDUCING THE EXPOSURE TO CURRENCY MISMATCHES, CROWDING-IN IMPLICATIONS (THEY CAN GENERATE ADDITIONAL INVESTOR BASE AND COFINANCING INTEREST IN PROJECTS). SIMILARLY, GUARANTEES PROVIDED BY IFIS CAN MAKE IMPORTANT CONTRIBUTIONS BY MAKING CERTAIN BOND ISSUES FEASIBLE IN THE FIRST PLACE, EXTENDING THEIR TENOR AND BROADENING THEIR DISTRIBUTION. ALSO, IFIS CAN SHIFT FROM MAKING LOANS TO OFFERING GUARANTEES IN GOOD TIMES WHEN ALTERNATIVE SOURCES OF FINANCE ARE ABUNDANT, AND BACK TO MAKING LOANS WHEN FUNDS BECOME SCARCE.

AS AN EXAMPLE, WE ARE DEVELOPING A LOCAL BOND ISSUE IN ARGENTINA WITH THE IIC. IT WOULD BE AN INTERMEDIATION TRANSACTION OF A SUPRANATIONAL THAT BORROWS NATURALLY IN DOMESTIC CURRENCY AND LEND AND INVEST IN VIABLE PROJECTS IN THE DOMESTIC MARKET (THROUGH THE FINANCIAL SYSTEM). THE BENEFITS ARE CLEAR AS IT WILL DIMINISH CURRENCY MISMATCHES, DIMINISH MATURITY MISMATCHES, ENHANCE CREDIT TO THE PRIVATE SECTOR, DEVELOP THE LOCAL CAPITAL MARKET AND PROVIDE AN ADDITIONAL (UNIQUE) INSTRUMENT TO INVESTORS.

IN A NUTSHELL, THE FIRST CONTRIBUTION THAT SHOULD BE MADE BY CENTRAL BANKS TO DEVELOP CREDIT MARKETS, AND LENDING TO SMALL BUSINESSES IN PARTICULAR, IS TO ENSURE A STABLE MONETARY AND FINANCIAL SCENARIO THAT HELPS TO MAINTAIN SUSTAINABLE ECONOMIC GROWTH AND SOCIAL INCLUSION.

NEVERTHELESS, PARTICULARLY IN THE CASE OF ECONOMIES IN TRANSITION TOWARDS ITS LONG-TERM EQUILIBRIUM SUCH AS THAT OF ARGENTINA OR OTHER EMERGING COUNTRIES, CENTRAL BANKS INCLUDE ON THEIR AGENDA OTHER SPECIFIC TASKS THAT THEIR POLICY ACTIONS CANNOT IGNORE: THE DEEPENING OF CREDIT IN THE ECONOMY, THE LENGTHENING OF THE TERM OF CREDIT LINES, THE REDUCTION OF BALANCE SHEET MISMATCHING (DOLLARIZATION), REDUCTION OF EXPOSURE TO THE PUBLIC SECTOR, THE SPREADING OF THE USE OF BANK SERVICES, AND THE FINANCING OF SMALL BUSINESS.