

BANCO DE DESENVOLVIMENTO DE MINAS GERAIS
BDMG: INNOVATION IN ACCESS TO FINANCE FOR THE BASE OF THE PYRAMID
MICROENTREPRENEUR AND MICROENTERPRISE IN THE STATE OF MINAS GERAIS, BRAZIL

The Opportunities for the Majority Initiative (OMJ) seeks to structure a US\$10 million Risk Sharing Facility (RSF) (or its equivalent in *Brazilian Reais*) with the Development Bank of Minas Gerais (*Banco de Desenvolvimento de Minas Gerais* or BDMG) to support the launch of a new financing program of up to 60 million Reais (approximately US \$30 million) for startup Microenterprises (MES)¹ from the state of Minas Gerais (MG) in Brazil, of which the vast majority belongs to the Base of the Pyramid (the “Project”). In order to reach this underserved market, BDMG will apply an innovative credit methodology developed by the Entrepreneurial Finance Lab (EFL) which helps to overcome the traditional market failure that prevents MES from accessing credit lines for their businesses: lack of formal credit record as a business in the financial system, lack of business track record and lack of real guarantees to provide lenders as collateral. The new BDMG loan product is for a standardized amount of up to R\$15,000 (approx. US\$7,500) and a tenor of 24 months including a 3 months grace period. The project is designed to reach 4,000 MES during a two year pilot phase. A second three-year phase will be conditioned on the Project’s early results, aiming to expand the credit program to serve newly registered Individual Microentrepreneurs² (MEI), thus providing the potential to significantly scale the project in the state of MG.

BDMG was founded in 1962 by the *Lei Estadual 2.067* to foster sustainable development and social inclusion. BDMG is a closed *Sociedade Anonima* wholly-owned by the government of MG and governed by the Brazilian Corporations Act, as well as by applicable national and state financial system regulations.

In recognition of the obstacles which inhibit access to credit for startup MES, and to serve its mandate as a development bank, BDMG has formed a partnership with EFL to be the first bank in Brazil to apply EFL’s innovative psychometric-based credit scoring methodology to qualify businesses for loans. The use of psychometric tools for micro entrepreneurs offers promising hope of increasing access to credit since the approach relies on financial risk assessment related largely to the character, intelligence and ethics of person rather than on prior business track record or availability of real guarantees. In addition to the advantages of expanding prospective access to credit for a new segment of entrepreneurs, the EFL test also seeks to overcome the traditional barriers of high operating cost and lack of scale to reach this targeted niche.

This project will establish a partnership between BDMG and JUCEMG (*Junta Comercial do Estado de Minas Gerais*), the State Board of Trade, responsible for the registration of all new companies. The partnership with JUCEMG will allow BDMG, which is a branchless development bank, to leverage a powerful large scale platform to target all new MES in the state and to offer the new BDMG product by taking the necessary application tests – both those of

¹ Microenterprises are defined by *Lei Complementar n° 123/2006 (Lei Geral da Micro e Pequena Empresa)* as businesses with annual sales of up to R\$360,000 (approx. US\$178,000) and up to 19 employees (construction sector) and 9 employees (retail and service sector).

² According to *Lei Complementar 128/2008* MEI are individual microenterprises with annual sales of up to R\$60,000 (approx. US\$29,000) with up to one employee receiving the minimum wage.

BDMG and EFL -, in computers located within JUCEMG's facilities. As a state governed agency, JUCEMG's mission is very aligned with that of BDMG to support the development of private enterprises in the state, as it aims "to contribute to the job creation and wealth generation in Minas Gerais".³

With the establishment of this RSF, the IDB will be supporting an innovative project by sharing the risk of the underlying portfolio of loans to start-up MES as selected by a hybrid combination of BDMG and EFL methodologies. BDMG will be fully responsible for any portfolio losses up to a pre-defined threshold to be established during commercial negotiations. Beyond this "first loss" level, the IDB will share the risk of the portfolio with BDMG, up to an agreed upon limit of losses.

The project will be also strengthened by the provision of visits to the selected new clients to provide advice and "coaching" on businesses management and performance, and to monitor the use of funds. The monitoring and coaching visits to clients will also serve to provide inputs for an Impact Evaluation being designed as an additional component of the BDMG project, and whose primary objectives are to: i) determine causality of the use of the new EFL methodology in increasing access to finance; ii) assess the effectiveness of the tool in identifying good clients for BDMG which would have been-previously excluded due to the lack of appropriate assessment tools, and iii) measure the impact of the company's business performance on the final beneficiaries' living standards.

The proposed project is consistent with the OMJ mandate since: (i) it will help address a market failure by providing otherwise unavailable access to financing to start-ups microenterprises from the Base of the Pyramid; (ii) the model is inherently innovative through the first time application of the EFL methodology in Brazil; and (iii) the model is likely to reach scale in MG to serve the Base of the Pyramid population, and provides a model which can be replicated elsewhere in Brazil or in Latin America.

³ <http://www.jucemg.mg.gov.br/ibr/institucional+missao>