

Bush Initiative Banks on Small Business Growth in Latin America

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WASHINGTON -- Come June, the U.S. Treasury Department will launch a lending initiative aimed at small businesses in Latin America. The objective, as outlined by President Bush before his visit to the region this spring, is to encourage U.S. and Latin American banks to provide loans for a clientele they would normally consider as not creditworthy.

According to the Inter-American Development Bank, Latin America ranks among the worst in private-sector access to formal credit, averaging 28 percent of gross domestic product in the 1990s compared with 84 percent in developed markets worldwide and 72 percent in Asia. This deficiency is consistently named the top impediment to growth faced by small- and medium-sized enterprises (SMEs) in surveys.

As in the developed world, SMEs along with micro enterprises -- usually consisting of one or two people involved in such work as sewing or food vending -- outpace large companies by far in job creation. According to the World Bank, they generate more than 80 percent of jobs in Argentina, Bolivia and Colombia. That percentage would be much higher if SMEs had as easy a route to credit as micro enterprises have had in recent years. In Chile, for instance, SMEs generate 11 jobs for every two created by micro enterprises.

In Latin America, however, lenders believe that SMEs interested in loans below \$100,000 are neither worth their time nor the risk. Only 10 percent of the SMEs in the region that have applied for loans from the formal financial sector have received them. And while micro businesses have been proving that small borrowers do pay back, SMEs continue to struggle to borrow money in a collateral-based lending environment that favors large companies.

"The challenge for regulatory authorities (in Latin America) is to find prudentially sound lending practices beyond traditional, collateral-based lending," a U.S. Treasury official working on the new initiative said in an interview this week. Some of those alternatives might include loans against their inventory or their accounts receivable.

Tweaking the requirements would be a start, but the rules and regulations that small businesses face overall have been incredibly cumbersome. Nine out of every 10 business owners in Latin America choose to stay in the informal, non-legal sector rather than attempt to comply with labyrinthine, costly and time-consuming requirements.

In recent years some governments have revamped regulations in order to make it significantly faster and easier to open a business. Those reforms are crucial for improving access to credit, according to Jacques Rogozinski, general manager of the IDB's Inter-American Investment Corporation, which works exclusively on SMEs. Unless governments help create an "enabling environment" where it becomes easier for companies to formalize their existence, the majority of small businesses -- and their practices -- will remain outside the purview of government. In such an environment, banks simply will remain "reluctant to lend them money."

To succeed, the Bush initiative depends on such regulatory reforms. "We are trying to reinforce the benefits of that kind of improved regulations," said the Treasury official, who asked not to be named because the initiative has not been launched.

The initiative includes two main components: One follows the model created by the Overseas Private Investment Corporation, an independent U.S. government agency that offers funds to banks in order to share lending risks; the other would use IDB funds to train banks in assessing clients' creditworthiness when they lack the collateral and credit history normally required from larger borrowers. "If banks are willing to lend to the small business sector, we are committed to helping them with the risks and to do this in a profitable way," the official said.

The hope is to get about 15 to 20 banks to participate, and once the initiative proves successful, other banks will get on board, said Don Terry, manager of the IDB's Multilateral Investment Fund, which will provide the training grants. "A big opportunity of economic growth in Latin America ... will be lost," he noted, "if we can't figure out how to do this."

Some critics remain skeptical that the lending culture and regulatory environment will change sufficiently in order for SMEs to flourish. They point to state-owned institutions -- rather than commercial banks -- as the best hope for financing small businesses.

The new Bush initiative recognizes the need for some public funds to help "catalyze a large amount of private money," the Treasury official noted. But administration officials are betting that even those funds -- already scarce in some of the smaller Latin American countries -- will become unnecessary once the banks realize that SMEs are worth the investment.