
Summary of the Working Group Report on MIF STRATEGY

The Multilateral Investment Fund (MIF)

was established in 1993 to encourage the growing role of the private sector in Latin America and the Caribbean. Equipped with funding of US \$1.3 billion, MIF was given a broad and flexible mandate to address rapidly changing private sector development needs. Using both grants and investment mechanisms, MIF supports small-scale targeted interventions that pilot new approaches and act as a catalyst for larger reforms. MIF is now the major source of technical assistance grants for private sector development in Latin America and the Caribbean.

Over the past decade, nearly all countries of the region have implemented comprehensive macroeconomic reforms that have strengthened the business framework, including financial and trade liberalization, deregulation, tax reform and privatization programs. Through its almost 400 projects, MIF has promoted and assisted in these reforms, strengthening the environment for business, building the capabilities and skills standards of the workforce, and broadening the economic participation of smaller enterprises.

As the world becomes more interconnected and interdependent, it is increasingly important to ensure that those less equipped to benefit from these changes are not left further and further behind. A strong, competitive, and broadly based private sector is key to equitable growth.



It is now critical to complete the reform process and broaden economic growth to include micro and small business. While larger companies usually benefit from the early stages of reform, smaller firms often cannot take full advantage of new opportunities until the reform process is completed.

Much has been accomplished over the past decade. However, while the economic and political advances are impressive, they are less compelling for the vast constituencies in Latin American and Caribbean countries that have yet to see corresponding improvements in living standards. There is much yet to be achieved in social, policy and economic reform.

Private sector development plays an essential role in poverty reduction. The region needs six million new jobs every year just to maintain the existing employment rate. However, companies are increasingly facing competition from international firms producing from more developed business environments, with better access to the latest information and technology. It is crucial to complete the reform process in Latin America and the Caribbean so as to broaden participation and ensure that institutional, legislative and regulatory frameworks provide a sound environment for the growth of businesses of all sizes.

MIF has a special role to play in supporting these changes, piloting new ideas and acting as a catalyst to broader reform. Over the next few years, MIF will intensify its focus on micro and small business to help all businesses in the region not only cope with but prosper from the forces of globalization and technology change.

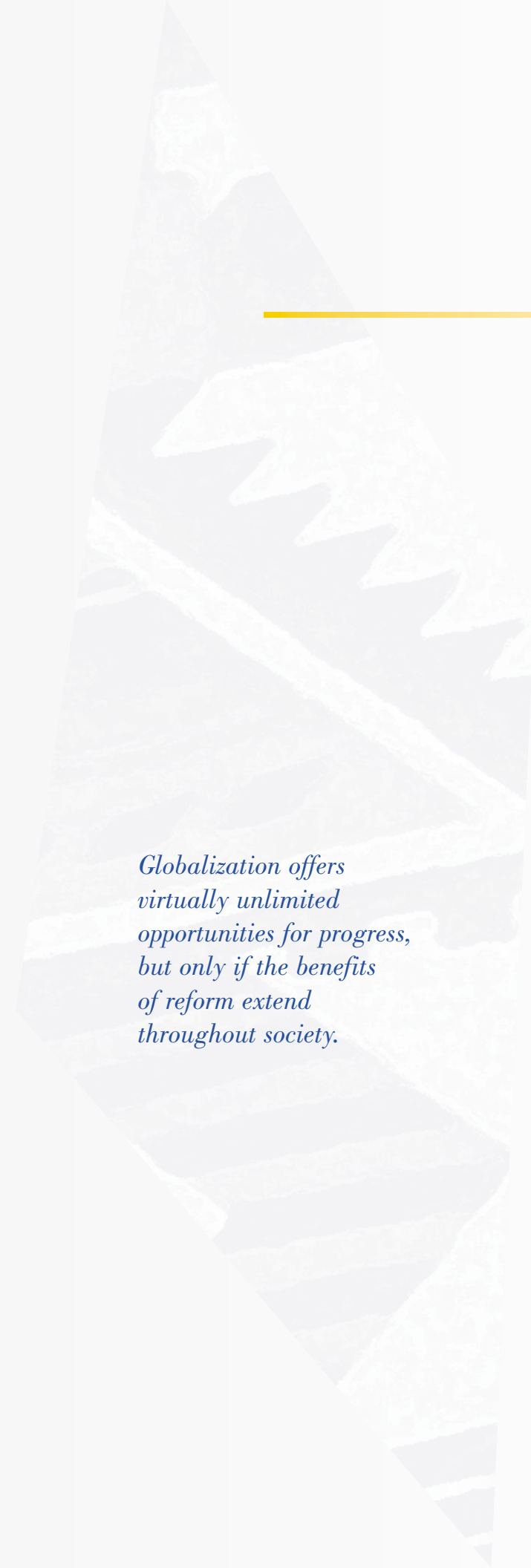
MIF was established to assist countries of Latin America and the Caribbean bridge the gap between the theory and the realities of transition to a global market economy. As experience over the past decade has shown, this is a difficult process, with no firm blueprint for success. Effective change requires successful macro-level reform, as well as the active participation of private sector business groups, NGOs, and others working at a local level to translate the benefits of national reform into daily business life.

While much has been accomplished during the last decade, the kind of assistance MIF was designed to provide is needed now more than ever. The forces of globalization represent a critical challenge for the region, making a sound financial system, competitive markets, an efficient public sector, and effective infrastructure and regulatory frameworks ever more crucial.

Technology change is another driving force, offering both the dangers of a 'digital divide' as well as exciting opportunities to connect to new markets and improve communication and information flow. MIF must focus its efforts on helping the private sector manage these changes. Strengthening the business environment and competitiveness of smaller enterprises is particularly crucial, given their key role in job creation and in attaining growth with equity.

There is great demand for MIF resources to address a wide variety of reform issues. However, experience has shown that attempting to spread funds over too broad a range of activities would lessen MIF's overall development impact. A central challenge for MIF is to ensure that its operations are sufficiently focused to maximize development impact, while continuing to respond to the varied development circumstances among the different countries of the region.

Over 75% of MIF's projects are with private sector partners, testing and demonstrating new approaches and laying the groundwork for fundamental change.



Globalization offers virtually unlimited opportunities for progress, but only if the benefits of reform extend throughout society.

Strategic Orientation and Project Characteristics

MIF's central mission should remain to promote private sector development by funding small, targeted interventions that pilot new approaches or play a critical or catalytic role in improving the environment for private sector growth and investment.

MIF projects should, in general, have these characteristics:

Innovation:

A key MIF role is to introduce effective new approaches to promote private sector development.

Demonstration effect:

Projects should offer the potential to be replicated in other sectors and/or other beneficiary countries.

Sustainability:

Projects should have a credible plan and strong potential for financial sustainability once MIF resources are expended.

Partnership:

MIF projects are done with local partners.

Additionality:

MIF resources must be critical to the outcome, and the most appropriate choice to fund a given initiative.

Once sufficient experience in a given area is gained to generate valid, generic lessons learned, MIF's focus should shift to disseminating those results and maximizing the demonstration effect.

Core Activities

MIF will strategically target its resources on the following **core activities**:

Small Business Development

- Streamlining regulations
- Innovative business relationships
- Eco-efficiency
- Quality management
- Financing options
- Information technologies
- Skills standards and credentialing

Microenterprise

- Innovation partnerships
- Regulatory and supervisory framework
- Strengthening microfinance institutions

Market Functioning

- Regulatory framework
- Facilitation of trade and investment
- Labor market modernization

Financial and Capital Markets

- Market transparency measures
- Regulatory reform and supervision
- Capital market development

*Small businesses,
more than any others,
benefit from regulatory
streamlining
and more efficient
markets.*

Core activities define the central mission of MIF's overall program, but in order to address each country's individual needs, MIF may also fund projects that fall outside of these areas where technical assistance grants or investments activities have a critical or catalytic role to play in promoting private sector development. In these projects, MIF must ensure that they have demonstrable impact.

Small Enterprise Development

MIF should support reforms in the policy, legislative and regulatory framework to help put small business on a more competitive playing field.

A vibrant and growing small business sector plays a key role in attaining economic growth with equity. MIF should promote the establishment of mutually beneficial relationships among small firms, the cost-effective provision of information and advice, and standardization of products and services. Development of worker skills standards and credentialing systems should be encouraged, as well as the introduction of international quality management techniques to enable small firms to better compete.

a) Streamlining regulations:

MIF should support projects to streamline or simplify the regulatory environment, facilitate the formalization of small firms, enhance business start-ups and encourage small business growth. These could include techniques such as 'one-stop shops' to help small firms fulfill regulatory requirements by co-locating access to various government agencies/ministries.

b) Innovative business

relationships: MIF should fund projects that offer small businesses new ways to adapt to quickly changing market realities without creating market distortions or long-term dependencies on subsidized services. Techniques such as supply chains connect producers of each stage of a process, allowing small firms to benefit from significant transfers of know-how and to share in the pooled success of the chain. Another approach is to use strategic alliances to help small firms attain goals otherwise beyond their individual reach.

c) Eco-efficiency:

Improvements in environmental performance often translate into increased profitability for the firm through better utilization of inputs, as well as improved sales opportunities as a result of meeting environmental quality standards specified by buyers or achieving positive brand association among environmentally aware customers. MIF should promote joint private-public sector approaches to developing effective regulatory frameworks, and introduce eco-production as a means of improving competitiveness.

d) Quality Management

Systems: As goods and services are increasingly measured against international standards, certification of compliance has become a key factor in both market access and in strengthening the capacity of individual firms. MIF should promote the strengthening of regional quality management capacity, working at both the firm level as well as with the regulatory and institutional frameworks. A particular focus should be to help ensure that smaller firms also benefit from the productivity enhancements that can be realized through quality management techniques.

e) Widening financing

options: The shortage of external financing and limits in the range of available financing products mean that small firms must usually rely on internally generated funds for start-ups and expansion. MIF should focus on broadening the range of financing options through reform in regulatory and legislative frameworks, and through its own strategic investments. MIF should build on its pioneering 'market-maker' role in using investment funds to direct equity to smaller firms, and help remove barriers to small-business financing in such

areas as security interests (moveable property rights) and new financial products. Availability of leasing mechanisms, channeling remittances to productive investments, and discounting receivables are among the areas to be explored.

f) Use of information

technologies (IT): Information technologies hold both the promise of increased competitiveness and access to global markets, as well as the threat that a 'digital divide' may leave the region's small businesses far behind. Some countries of the region are beginning to see an explosive growth in the basic technology platforms, and the major IT providers are expected to extend into most of the region over the next few years. However, the challenge ahead is to maximize the opportunity for all firms to benefit from new information technologies. MIF should assist by promoting the use of information technologies as a means of enhancing productivity, providing access to better information, enabling new forms of distribution and marketing, and opening new markets through e-commerce. MIF should also facilitate increased IT use through reforms to the regulatory framework for telecommunications.

g) Skills standards and credentialing:

The shortage of properly qualified staff and deficiencies in the educational system are frequently cited as being a major constraint to business growth in the region. The private sector market for provision of specialized skills training is comparatively undeveloped, and employers usually train workers in-house. The effectiveness of this approach is significantly enhanced when occupational skills standards exist that allow both workers and employers to train and assess performance against criteria recognized throughout an industry. MIF should fund projects that work with employers and labor in particular industry sectors to develop such standards.

MIF can help transform small business attitudes toward environmental management from a cost to an opportunity.

Microenterprise

Microenterprise accounts for approximately half of the total employment in Latin America and the Caribbean. Expanding opportunities for these very small businesses is therefore critical in efforts to generate more jobs, create economic growth, improve income distribution and promote entrepreneurial spirit. However, microenterprise growth is constrained by a chronic shortage of credit and other financial products. There is also a need to find new ways to deliver practical business guidance to the sector. MIF should build on its leadership role in extending the reach of microfinance institutions, introducing innovative financing mechanisms, and increasing microfinance capacity. It should support the development of new financial products and business development services, and promote a regulatory and supervisory framework that will enhance growth in the sector.

a) Innovation: In June 2000, MIF approved the US \$8-million *Innovation Partnership Fund* to support the initiation of new financial and business development services for the microenterprise sector. Working through private institutions, the program will test new ideas and help expand the range of financial and non-financial services available to microentrepreneurs. Based on an open bidding system, the program will select and support the development of up to ten specific innovations. Selected organizations will typically be provided two years to test and develop these products. In addition, MIF will continue to support a range of projects that pilot or introduce new approaches for microenterprise development.

b) Regulatory and supervisory framework:

At a recent meeting organized by MIF for bank supervisors from countries throughout the region, it was clear that a significant range of approaches exists for microfinance regulation. To assist with development of accepted best practices, MIF should ensure that

the experiences of several leading countries are widely shared throughout the region. MIF should actively pursue progress in this area, promoting development of a regulatory framework that strengthens fiduciary practices, facilitates a wider range of microfinance services, and enables microfinance institutions to achieve better access to capital markets.

c) Strengthening Microfinance Institutions

(Line of Activity): Reliance on donated funds constrains growth and prevents a microfinance institution from offering a more complete range of services to microentrepreneurs. MIF will continue to support NGOs and other institutions as they make the transition to regulated status, where they can begin to attract private sector funds and access capital markets. MIF will also support the downscaling of commercial operations to enable microfinance institutions to extend service to microenterprise clients.

Improving Market Functioning

Many countries of the region have already achieved major structural reform and are now addressing the details of market functioning, removing bottlenecks, broadening participation by small enterprise, and promoting transparent and fair practices that meet international norms. To provide a cost-effective mechanism to support smaller-scale initiatives, MIF management should prepare a Line of Activity for Regulatory Reform.

Efficient, transparent and open markets are essential to consolidate macroeconomic reforms and encourage broad-based private sector growth.

a) Regulatory framework:

Measures to ensure better-informed consumers, clear rules governing product claims, enforceable public health and safety standards, and transparent competition regulation are all important goals for market functioning. Strengthening public procurement and laying the groundwork for private sector investment in infrastructure are also areas where MIF can play a catalytic role for broader reform programs. Commercial activity can be strengthened by adopting international accounting and audit standards and by modernizing bankruptcy provisions, minority shareholder rights, contract enforcement and corporate governance regulations. A sound framework for intellectual property rights, copyright, trademarks and patents is also particularly important with respect to nurturing regional technology and innovation.

b) Facilitation of Trade and Investment:

Growth in trade and investment levels is primarily dependent on macro-level factors. However, these basic goals can also be effectively supported by targeted measures designed to simplify procedures and attain international norms. Efficient and standardized custom procedures and transparent, equal treatment of investors are also key areas to ensure the competitiveness of the region. MIF should also support the streamlining and standardization of export regulations as well as the building of export skills.

c) Labor market

modernization: Efficient labor markets are essential to decreasing income inequality and improving business competitiveness throughout the region. However, changes in the regulatory framework are difficult to make. MIF has a special role to play in testing new models of collaboration between workers, management and the public sector, which can lead to building support for reform.

Financial Sector Reform and Capital Market Development

Regulatory frameworks sometimes have unintended negative effects on small firms. MIF will be working with regulators to develop new approaches to improve the environment for small business creation and finance.

A sound and prudent financial system that offers a full range of services is key to private sector development. Despite significant reforms in the area of building financial markets and strengthening system safety and soundness, much remains to be achieved. MIF should focus on those areas where it brings clear additionality such as market transparency measures, regulatory reform and supervision, and the removal of barriers to capital market development. MIF should also fund specific reforms not large enough to warrant an IDB loan program, but where interventions would significantly accelerate market development.

a) Market transparency

measures: MIF should promote the adoption of international accounting, audit and disclosure standards and encourage the development of independent credit bureaus and rating agencies. A sound financial system depends on the availability of reliable and complete information for all decision makers in the system.

Independent ratings, a framework of standardized performance measures, good central registries of credit histories, and regulations governing the quality and reliability of information provided to creditors and investors are all components of this important information exchange.

b) Regulatory Reform and Supervision:

A great deal of work is being done throughout the region to improve financial sector supervision capacity. MIF's role in this effort will be focused on supporting innovative approaches for effective training of supervisory personnel and promoting consolidated supervision for the financial market.

c) Enable Capital Market Development:

MIF will focus on removing barriers to the development of capital market instruments such as special-purpose firms for securitizations, collective investment vehicles and fixed-income securities. Closely related to regulatory reforms to improve market function, capital markets will also benefit from initiatives to address minority shareholders' rights and implement international accounting and audit standards.

Project Clusters

Project Clusters offer an effective mechanism to maximize the development impact of MIF resources. Wherever possible, core activity projects should be designed as part of a cluster.

To help ensure that strategic focus is effectively realized in an operational sense, MIF should introduce the use of **project clusters** for promising development approaches. These would be a group of several projects in the specific area that would be developed, supported and reviewed as a cluster, according to a strategy that would be presented to the Donors Committee.

Clusters would be supported by a technical expert who would regularly visit projects, foster the sharing of experiences, and facilitate project implementation.

Use of project clusters will address many of the issues identified by the Working Group:

- Clusters will strengthen project design and implementation, giving project teams, executing agencies and Country Offices access to ongoing technical expertise.
- They will promote communication among executing agencies facing similar challenges and help build regional networks.
- Clustering will also better focus new approvals on core activities, maximize generic lessons learned and substantially improve the identification and dissemination of best practices.

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