

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

## **COLOMBIA**

### **BANCÓLDEX: THIRD PROGRAM FOR THE FINANCING OF INVESTMENT PROJECTS, PRODUCTIVE RESTRUCTURING, AND EXPORT DEVELOPMENT (CO-L1132)**

### **UNDER THE CCLIP FOR FINANCING OF INVESTMENT PROJECTS, PRODUCTIVE RESTRUCTURING, AND EXPORT DEVELOPMENT (CO-X1007)**

## **LOAN PROPOSAL**

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ELECTRONIC LINKS	
<b>REQUIRED</b>	
1.	Monitoring and evaluation arrangements <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=37692886">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=37692886</a>
2.	Environmental and social management report (ESMR) <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=37692893">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=37692893</a>
<b>OPTIONAL</b>	
1.	Economic analysis <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=37692731">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=37692731</a>
2.	Assessment of the Colombian financial system <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=37692744">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=37692744</a>
3.	Financial assessment of Bancóldex <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=37692849">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=37692849</a>
4.	Analysis of investment credit demand <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=37692754">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=37692754</a>
5.	Institutional presentation: Bancóldex <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=37692759">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=37692759</a>
6.	Allocation of credit quotas to IFIs <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=37692766">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=37692766</a>
7.	Program deal flow <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=37692772">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=37692772</a>
8.	Credit Regulations for the Second Program under the CCLIP <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=37692721">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=37692721</a>
9.	Results of impact assessments of the Bancóldex investment financing lines <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=37692781">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=37692781</a>
10.	Safeguard policy filter <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=37693018">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=37693018</a>

## ABBREVIATIONS

CCLIP	Conditional credit line for investment projects
CE	Credit establishment
CONPES	Consejo Nacional de Política Económica y Social [National Economic and Social Policy Council]
DTF	Weighted average of interest rates
ESMR	Environmental and social management report
FNG	Fondo Nacional de Garantías [National Guarantee Fund]
FOMIPYME	Fondo Colombiano de Modernización y Desarrollo Tecnológico de las Micro, Pequeñas y Medianas Empresas [Colombian Fund for Modernization and Technological Development of Micro, Small, and Medium-sized Enterprises]
IBR	Benchmark short-term interest rate
MCIT	Ministry of Trade, Industry and Tourism
MCP	Multisector credit program
MSMEs	Micro, small, and medium-sized enterprises
PCR	Project completion report
PRM	Project risk management
SGFP	Sistema de Gestión Financiera Pública [Public Financial Management System]
SMLV	Salario mínimo legal vigente [current legal minimum wage]

**PROJECT SUMMARY**  
**COLOMBIA**  
**BANCÓLDEX: THIRD PROGRAM FOR THE FINANCING OF INVESTMENT PROJECTS,**  
**PRODUCTIVE RESTRUCTURING, AND EXPORT DEVELOPMENT (CO-L1132)**

**UNDER THE CCLIP FOR FINANCING OF INVESTMENT PROJECTS, PRODUCTIVE RESTRUCTURING,**  
**AND EXPORT DEVELOPMENT (CO-X1007)**

Financial Terms and Conditions			
<b>Borrower and executing agency:</b> Banco de Comercio Exterior de Colombia S.A. ("Bancóldex") <b>Guarantor:</b> Republic of Colombia		<b>Flexible Financing Facility</b> *	
		<b>Amortization period:</b>	25 years
		<b>Weighted average life:</b>	15.25 years
<b>Source</b>	<b>Amount (US\$)</b>	<b>Disbursement period:</b>	48 months
<b>IDB (Ordinary Capital)</b>	US\$200 million	<b>Grace period:</b>	5.5 years
<b>Local counterpart</b>	US\$200 million	<b>Inspection and supervision fee:</b>	**
		<b>Interest rate:</b>	LIBOR-based option in U.S. dollars
		<b>Credit fee:</b>	**
<b>Total</b>	<b>US\$400 million</b>	<b>Currency of approval:</b>	U.S. dollars from the Bank's Ordinary Capital
Project at a Glance			
<b>Project objective/description:</b> The objective of the third program under the conditional credit line for investment projects CO-X1007 is to continue supporting the government's efforts to strengthen productive sector competitiveness through the financing of investment projects, productive restructuring, and business and export development (see paragraph 1.33). To this end, credit resources to finance MSME investment projects will be channeled through Bancóldex's network of intermediary credit establishments (CEs). <sup>1</sup>			
<b>Special contractual clauses:</b> The approval of the program's Credit Regulations by Bancóldex, with the Bank's prior no objection, will be a condition precedent to the first disbursement of resources for the proposed program (see paragraph 3.4b).			
<b>Exceptions to Bank policies:</b> As in the two previous CCLIP programs, this program requires a partial waiver of the policy on Guarantees Required from the Borrower (Operational Policy OP-303), given that the Republic of Colombia will guarantee only the financial obligations arising from the loan contract (see paragraph 3.2).			
<b>Project qualifies as:</b> SEQ <input type="checkbox"/> PTI <input type="checkbox"/> Sector <input type="checkbox"/> Geographic <input type="checkbox"/> Headcount <input type="checkbox"/>			

\* Under the terms of the Flexible Financing Facility (document FN-655-1), the borrower has the option of requesting changes to the amortization schedule, as well as currency and interest rate conversions. The Bank will take operational and risk management considerations into account when weighing such requests.

\*\* The credit fee and inspection and supervision fee will be established periodically by the Board of Executive Directors as part of its review of the Bank's lending charges, in accordance with the applicable policies.

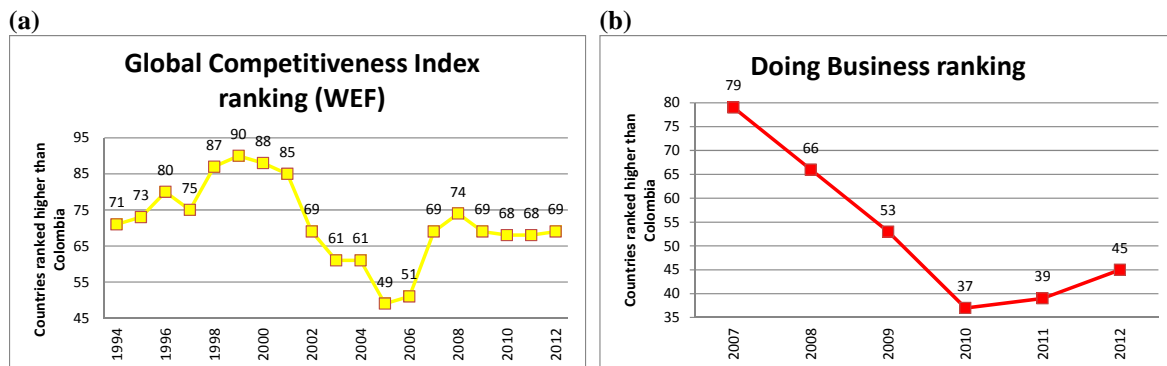
<sup>1</sup> For purposes of this program, intermediary financial institutions (IFIs) will be referred to as "credit establishments" (CEs), in order to match the terminology used in the borrowing member country.

## I. DESCRIPTION AND RESULTS MONITORING

### A. Frame of reference, problem to be addressed, and rationale for Bank support

- 1.1 **Background.** Multisector credit programs (MCPs) are the Bank's main financing instrument to support development of the private sector. In order to support the financing of fixed investment business projects, productive restructuring, and export development, in late 2008 the Bank approved a conditional credit line for investment projects (CCLIP) with Bancóldex for US\$650 million (CO-X1007) and a first MCP for US\$100 million (CO-L1078; 2080/OC-CO) to finance investment projects, productive restructuring, and business and export development among micro, small, and medium-sized enterprises (MSMEs). A second MCP for US\$200 million (CO-L1082; 2193/OC-CO) was approved in 2009. The proposed loan will be the third MCP to be approved under this CCLIP.
- 1.2 **Business productivity and competitiveness in Colombia.** On international measures, Colombia has been progressively raising its competitiveness levels since the start of the last decade, but there is still much room for improvement. Thus, according to two widely recognized international competitiveness indicators, Colombia's competitiveness levels are in the middle range (see Figure 1).

Figure 1



Source: “Global Competitiveness Report,” World Economic Forum, several years of data; “Doing Business,” World Bank and International Finance Corporation (IFC), several years of data. The graphs show the country rankings for each of the indexes, relative to the universe of countries analyzed in each of the reports. The lower the value of an index in a particular year, the better the country's relative performance.

- 1.3 For example, the World Economic Forum's 2013 Global Competitiveness Index ranked Colombia 69th out of 144 countries (down one from the previous year). Similarly, the World Bank/IFC “Doing Business 2013” report ranked Colombia 45th out of 185 countries (down five from 2012).<sup>2</sup>

<sup>2</sup> For more information, see the “National Competitiveness and Productivity Policy” [CONPES document 3527](#), June 2008, page 8, section A; and “Situación de la competitividad de las Pymes en Colombia: Elementos actuales y retos” [SME Competitiveness in Colombia: Current factors and challenges], Alexandra Montoya, Iván Montoya, and Oscar Castellanos, *Agronomía Colombiana*, 2010.

- 1.4 These indexes rank countries according to their macroeconomic management, regulatory environment, institutions and development plans, and companies' capacity to innovate, integrate with, and adapt to the markets they serve. Table 1 shows the performance of each of the World Economic Forum's Global Competitiveness Index indicators for Colombia, indicating that the challenges the country faces to improve its competitiveness are directly related to innovation and business sophistication factors, which in this case refer to a firm-level evaluation. Thus, as Table 1 shows, these factors are relatively important for the country's overall competitiveness and have deteriorated markedly over the last year, particularly in the case of innovation.

**Table 1**

<b>Factor</b>	<b>Rank 2012</b>	<b>Rank 2011</b>	<b>Rank 2010</b>	<b>Change in rank 2012-2011</b>
<b>Number of countries</b>	<b>144</b>	<b>142</b>	<b>137</b>	<b>NA</b>
<b>Overall position</b>	<b>69</b>	<b>68</b>	<b>68</b>	<b>-1</b>
<b>Basic requirements</b>	<b>77</b>	<b>73</b>	<b>78</b>	<b>-4</b>
Institutions	109	100	103	-9
Infrastructure	93	85	79	-8
Macroeconomic environment	34	42	50	8
Health and primary education	85	78	79	-7
<b>Efficiency enhancers</b>	<b>63</b>	<b>60</b>	<b>60</b>	<b>-3</b>
Higher education and training	67	60	69	-7
Goods market efficiency	99	99	103	0
Labor market efficiency	88	88	69	0
Financial market development	67	68	79	1
Technological readiness	80	75	63	-5
Market size	31	32	32	1
<b>Innovation and sophistication factors</b>	<b>66</b>	<b>56</b>	<b>61</b>	<b>-10</b>
Business sophistication	63	61	61	-2
Innovation	70	57	65	-13

Source: World Competitiveness Report, World Economic Forum, 2011, 2012, and 2013. The report utilizes statistical data from leading international agencies (such as the United Nations Educational, Scientific and Cultural Organization (UNESCO), the International Monetary Fund (IMF), and the World Health Organization (WHO)) in combination with subjective data from the "World Economic Forum's Annual Executive Opinion Survey" ([http://www3.weforum.org/docs/CSI/2012-13/GCR\\_Chapter1.1\\_2012-13.pdf](http://www3.weforum.org/docs/CSI/2012-13/GCR_Chapter1.1_2012-13.pdf)).

- 1.5 Significantly, Colombian companies have focused their energies on improving productive performance in recent years. This is not only in response to appreciation of the real exchange rate, putting pressure on their cost structures, but also the entry into force of major free trade agreements with the United States and Canada. These agreements have broadened the scope of their activities while also heightening rivalry and competition with other local and foreign companies in productive sectors and the domestic and foreign markets where they operate. Achieving better

performance relative to companies in similar business areas or rivals means raising competitiveness. According to Porter and van der Linde,<sup>3</sup> to do so, they need to either produce at lower cost than rivals or offer higher-value products that can command a higher price. This will only be possible if companies can continually improve and innovate in terms of how they produce, the design of the products and services they offer, the market segments they serve, and how they market their products. To improve on any of these dimensions, companies need to make investments, which will only be possible if they have access to finance on suitable terms and conditions.

- 1.6 **Problems faced by MSMEs.** The situation described in the preceding paragraphs holds particularly true for micro, small, and medium-sized enterprises (MSMEs),<sup>4</sup> which have a series of opportunities for improvement that, if not capitalized upon, will not allow them to grow, become more competitive and profitable, and in some cases, even survive.
- 1.7 MSMEs play a crucial role in Colombia's economic growth, as well as in productive diversification and competitiveness. According to the latest information,<sup>5,6</sup> as a segment they represent 99.9% of Colombia's businesses, and account for 80.8% of jobs and 40% of GDP. By creating jobs and generating income in rural or economically depressed areas, MSMEs help to reduce poverty and eliminate regional and sector imbalances. MSMEs have a stronger presence in the country's less developed departments, with a significantly lower concentration of MSMEs in the country's six economically most important departments<sup>7</sup> than of large companies (62%, vs. 79.2% in the case of large companies).
- 1.8 However, MSMEs face serious challenges limiting their ability to raise their levels of productivity and competitiveness, such as the obsolescence of their technology,

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<sup>3</sup> Porter, Michael E. and Claas van der Linde (1995), "Towards a new conception of the environment competitiveness relationship." *Journal of Economic Perspectives*, vol. 9, issue 4.

<sup>4</sup> Colombia defines MSMEs according to their number of employees and the value of their total assets (Law 905 of 2004). Thus, a microenterprise has fewer than 10 workers and assets worth less than 500 times the current legal minimum wage (known by its Spanish-language acronym, SMLV); a small enterprise has between 11 and 50 workers and assets worth between 501 and 5,000 times the SMLV, and a medium-sized enterprise has between 51 and 200 workers and assets worth between 5,001 and 30,000 times the SMLV. The SMLV in Colombia is 589,500 pesos for 2013, equivalent to US\$323 at an exchange rate of 1,825 pesos to the dollar.

<sup>5</sup> See: (i) National policy for the productive transformation and promotion of micro, small, and medium-sized enterprises: A public-private effort, CONPES document 3484, August 2007, page 2; and "Políticas e Instituciones de apoyo a las Pymes en Colombia" [SME-support policies and institutions in Colombia], Luis Alberto Zuleta, in *Apoyando a las Pymes: Políticas de fomento en América Latina y el Caribe* [Supporting SMEs: Promotion policies in LAC], Carlo Ferraro (ed.), ECLAC, December 2011, page 168.

<sup>6</sup> According to the two works cited above, based on the 2005 Economic Census, there were 1,590,982 companies, of which 1,533,704 were microenterprises, 47,729 were small enterprises, 7,955 were medium-sized, and 1,592 were large.

<sup>7</sup> These departments are: Bogotá, Antioquia, Valle, Cundinamarca, Santander, and Atlántico.



given the prevalence of their use of machinery and equipment based on older technologies, and technical shortcomings in their core production processes.<sup>8</sup> These are compounded by their limited access to more up-to-date technologies, largely due to constraints on their ability to obtain finance in the formal market, particularly for medium- and long-term investments.<sup>9,10</sup> MSMEs therefore have to turn to supplier finance and/or very short-term bank credit, at interest rates and with requirements (collateral, documentation, etc.) often incompatible with the returns on their projects,<sup>11</sup> thus limiting their ability to expand production. The proposed program seeks to help overcome MSMEs' problem of low productivity and competitiveness due to technological obsolescence by promoting lending for productive investment projects and business and technological modernization.

- 1.9 The difficulties in obtaining finance alluded to here have been reported in the latest Colombia Country Profile (2010) by the World Bank/IFC. The findings of these organizations' business surveys reveal that access to finance is the biggest obstacle companies perceive in the country's business climate, and that it is a particularly serious obstacle for micro and small enterprises. Indeed, whereas 25% of medium-sized enterprises and 56% of large enterprises report having accessed bank finance for their investments, only 9.9% of micro and small enterprises said they had done so.
- 1.10 One critical factor on the supply side that has helped bring about to this state of affairs is that credit establishments (CEs) rely on a deposit base with maturities so short that it constrains their ability to offer medium- and long-term credit (see paragraph 1.21). Given that ECs perceive large, well-capitalized companies as carrying lower risk, their limited medium- and long-term funding tends to be channeled towards them.
- 1.11 Increased access to medium- and long-term funding for CE is essential to better align their lending to MSMEs with the maturation periods of MSME investment projects, better enabling the MSMEs to compete and survive in an ever more challenging and competitive economic environment. The government offers two support instruments for such purposes: (i) the second-tier lending facilities of

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<sup>8</sup> See "Análisis empírico de la aplicación del modelo de modernización de la gestión para organizaciones en Pymes colombianas" [Empirical analysis of application of the organizational management modernization model at Colombian SMEs], *Revista Escuela de Administración de Negocios*, issue 65, January-April 2009, pages, 79, 80, and 98.

<sup>9</sup> See Op. Cit. 4, pp. 5-6; and "Colombia Country Profile 2010," *Enterprise Surveys*, World Bank and International Finance Corporation.

<sup>10</sup> See Zuleta J., Luis Alberto, "Política pública e instrumentos de financiamiento a las Pymes en Colombia" [Public policy and financing instruments for SMEs in Colombia] in *Eliminando barreras: El financiamiento a las Pymes en América Latina* [Breaking down barriers: SME finance in Latin America], Carlos Ferraro (ed.), Chapter II, ECLAC, November 2011.

<sup>11</sup> See National policy for the productive transformation and promotion of micro, small, and medium-sized enterprises: A public-private effort, CONPES document 3484, August 2007, pp. 3-4.

Bancóldex, which is the borrower and executing agency for the proposed program; and (ii) the guarantees offered by the National Guarantee Fund (FNG). These two instruments have significantly increased the amount of financing available to the sector.

- a. In the case of Bancóldex, disbursements have been concentrated in: (i) MSME financing, which stood at 51% as of December 2012; (ii) medium- and long-term lending, at 53% as of December 2012; and (iii) financing of business modernization, at 29% of loans disbursed (see [Institutional presentation: Bancóldex](#)).
  - b. Similarly, the amount of credit leveraged with FNG guarantees grew 120% between 2009 and 2012, to US\$5.317 billion, and the number of beneficiary MSMEs rose from 52,000 in 1992 to 527,459 in 2012.
- 1.12 **Positioning of CEs.** The financial system's structure, recent performance, and outlook are described in the [Assessment of the Colombian financial system](#). In brief, CEs remain well capitalized and continue to exhibit comfortable levels of profitability and liquidity.
- 1.13 Specifically, in November 2012, CE indicators showed: (i) improved capital adequacy ratios, surpassing the regulatory minimum of 9% by 7 percentage points; (ii) a ratio of liabilities to assets of 85.5%, 2.5 percentage points lower than at end-2008, suggesting that the generation of value from assets is becoming progressively less reliant on increased short- or long-term debt; (iii) return on assets (ROA) and return on equity (ROE) of over 2% and 1.5%, respectively; (iv) a sustained reduction since 2008 in past-due loans as a percentage of gross portfolio; (v) adequate liquidity levels, given that in November 2012 short-term assets exceeded short-term liabilities; and (vi) a recent trend toward slower real growth of credit.
- 1.14 As mentioned in the preceding paragraph, a reduction in the real value of credit disbursements is currently being observed. Last year, disbursements of almost all forms of lending, with the exception of microcredit, shrank in real terms. Thus, in November 2012 disbursements of business, consumer, and housing loans fell by 34%, 13%, and 14% year-on-year, respectively, for an aggregate drop of 29%. Disbursements of microloans, on the other hand, posted annual growth of 34%, indicating that microcredit continues to trend up in Colombia.<sup>12</sup>
- 1.15 The aggregate deceleration is explained by the combination of macroeconomic and international factors. Firstly, between February 2011 and July 2012 the central bank implemented a contractionary monetary policy, raising the policy interest rate from 3% to 5.25%. According to Romer and Romer,<sup>13</sup> changes in this interest rate take

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<sup>12</sup> This year-on-year growth of microcredit was preceded by a growth rate of 102% in November 2011, and 18% in November 2010.

<sup>13</sup> Romer, Christina D. and David H. Romer, "A new measure of monetary shocks: Derivation and implications," *The American Economic Review*, vol. 94, issue 4, pp. 1055-1084, 2004.

about a year to have an impact on economic activity, such that current trends are partly a response to this monetary contraction.

- 1.16 Another factor that may be affecting current lending activity is the slowdown in output in the second half of 2012. Housing investment slackened in the last quarter of the year. This decline in investments has a direct and immediate impact on lending activity, resulting in the drop observed in the associated credit disbursements.
- 1.17 Lastly, the international economic environment is fairly uncertain. A number of European economies foresee no improvement in the pace of economic activity, and growth of the U.S. economy is still weak and fragile. In view of the adverse impact this may have on the economy, CEs have been tightening their lending standards.
- 1.18 Despite these adverse conditions, it is important to highlight that monetary policy decisions in the near future will probably tend towards a cut in the benchmark interest rate. In this context borrowing rates would come down, allowing CEs to offer lower lending rates, which could stimulate credit demand (see [Analysis of investment credit demand](#)).
- 1.19 Despite the progress seen since the 1999-2000 financial crisis, total lending to the private sector by CEs as a percentage of GDP has only recently returned to pre-crisis levels (around 36%). This is lower than the level for other Latin American countries with an equal or even lesser degree of economic development.
- 1.20 As discussed in the first two programs under the CCLIP, not only is the level of financial deepening low for a country with Colombia's level of economic development, but most of the credit granted by CEs is very short term.<sup>14</sup> This is because the deposits taken by CEs are concentrated in very short-term instruments. At end-November 2012, 71.2% of CE deposits had maturities of less than one year, and 63.5% had maturities of less than 180 days. With this funding structure, CEs have little appetite for offering medium- and long-term loans, thus limiting their potential to fulfill their role of financing growth by extending credit for investments.

## **B. Rationale for the Bank's program**

- 1.21 The proposed program seeks to help overcome MSMEs' problem of low productivity and competitiveness due to technological obsolescence (see paragraph 1.8) by promoting lending for investment projects (medium- and long-term). Although the government has been giving priority to supporting MSME productivity and competitiveness in recent years through its financial and nonfinancial public policy programs, these firms are expected to continue to face major competitiveness challenges in the future due to the increasingly competitive business environment. Promoting investments in projects for the adoption of new technologies, productive restructuring, and business and export development is seen

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<sup>14</sup> According to evidence gathered by Bancóldex, the average term of loans made by CEs is around two years.

- as a critical strategy for MSMEs' sustained future growth in productivity and competitiveness.
- 1.22 The proposed operation will provide Bancóldex with additional medium- and long-term resources to enable it to continue financing MSME investment projects through CEs, expanding its range of finance on suitable terms for MSME investment projects, productive restructuring, and business and export development.
- 1.23 **The country's sector strategy** Colombia's National Productivity and Competitiveness Policy<sup>15</sup> rests on five broad pillars, namely: (i) the development of world-class clusters; (ii) promotion of productivity and jobs; (iii) labor and business formalization; (iv) promotion of science, technology and innovation; and (v) crosscutting strategies. The second of these pillars aims to ensure that all companies, including MSMEs and new startups, are more productive and can generate more quality jobs through specific objectives or plans of action, such as: (i) medium- and long-term financing, through Bancóldex, of modernization and productive transformation projects; (ii) the design of training, awareness, and dissemination programs for technology upgrade measures; and (iii) use and adoption of information and communication technologies.
- 1.24 More recently, Chapter 3 of the National Development Plan 2010-2014: "Prosperity for All" on sustainable growth and competitiveness<sup>16</sup> proposes comprehensive action by public entities concerned with productive development so as to provide companies and/or producers with a wide range of complementary instruments that improve productivity levels when used. The document maintains that companies' productivity growth is multiplied to the extent that there is an adequate competitive environment, as reflected in, among other factors: (i) a developed financial system; and (ii) easy and effective access to local and foreign technologies.
- 1.25 To support firms' business and innovation activities, the government has committed to support a package of modern industrial policy instruments to be mainstreamed through the development banking sector. In the specific case of Bancóldex, it is envisaged that the institution migrate towards a comprehensive development banking model by incorporating development agency functions and offering supplemental services and activities to accompany its loans.<sup>17</sup> To play this new role, Bancóldex is adapting its structure to pursue two lines of action. Firstly, it will continue running activities to reduce market failures in the financial sector, with a view to stimulating the development of products and services and operate

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<sup>15</sup> See "National Competitiveness and Productivity Policy" [CONPES document 3527](#), June 2008.

<sup>16</sup> Plan Nacional de Desarrollo 2010-2014: "Prosperidad para Todos" [National Development Plan 2010-2014: "Prosperity for All"], Chapter 3: "[Sustainable growth and competitiveness](#)," 2011.

<sup>17</sup> This model will be implemented under the institution's current authority, preserving its financial sustainability, with risk management criteria and within the applicable legal and statutory framework.

countercyclically by offering companies rediscount facilities. Secondly, it will create a development unit, the aims of which will include:<sup>18</sup>

- a. Implement a comprehensive program for management of public funds and rediscount resources to support strategic competitiveness projects that promote innovation and productive transformation; and
- b. Administer the Colombian Fund for Modernization and Technological Development of Micro, Small, and Medium-sized Enterprises (FOMIPYME), which aims to develop new financial instruments (for example, seed capital funds) and apply nonfinancial instruments through nonreimbursable cofinancing of MSME development and promotion programs, projects, and activities.

- 1.26 **Alignment with GCI-9 and the Bank's country strategy.** This program is aligned with the IDB's targets under the GCI-9 pillar of Institutions for Growth and Social Welfare. The program is also aligned with the country strategy with Colombia 2011-2014 (document GN-2648-1), which supports promoting lines of credit and developing financial products (insurance, savings, microcredit, microfranchises) and nonfinancial products (technical assistance for MSMEs) through second-tier banks (see paragraphs 3.10 and 3.11 of the strategy).
- 1.27 The proposed loan operation also ties in with another Bank loan involving Bancóldex to support the financing of clean technology investment projects. Part of the proceeds of the proposed loan (up to US\$10 million) will be used to supplement the financing of another Bank loan operation with Bancóldex (loan CO-L1124), now in preparation, to support the financing of investment projects energy efficiency investment projects at hotels and clinics, which will have US\$10 million in concessional resources from the Clean Technology Fund.
- 1.28 Significantly, the Bank has been providing extensive support to Colombia in the form of interventions to further deepen the financial system and strengthen competitiveness. These include: (i) the Financial Sector Reform Program (loan CO-0232, 1231/OC-CO) and the Competitiveness Enhancement Program (with two loans: CO-L1007, 1758/OC-CO; and CO-L1027, 1930/OC-CO); (ii) Colombian peso-denominated loans from the IIC for financial leasing companies; (iii) the admission of Bancóldex as a confirming bank in the Bank's Trade Finance Facilitation Program (TFFP); (iv) a mechanism of "green" guarantees for Bancolombia funded with resources from the Clean Technology Fund (loan CO-L1104, 2533/OC-CO) to support energy efficiency projects; and (v) over 40 MIF operations aimed at: (a) strengthening microcredit institutions; (b) expanding coverage of lending from unregulated institutions to micro and small enterprises; and (c) mobilizing remittances and bringing them into the formal

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<sup>18</sup> The development unit is being financed from national government's share of Bancóldex's profits, and with budget allocations to Bancóldex by the national government or subnational entities through agreements.

banking system. In addition to this set of operations are this CCLIP (CO-X1007) and its first two loans (CO-L1078, 2080/OC-CO; and CO-L1082, 2193/OC-CO).

- 1.29 In relation to the second loan under the CCLIP CO-X1007, as of year-end 2012 almost all resources had been disbursed (99.95%), and the executing agency's performance has remained highly satisfactory (see paragraph 3.1). The outcomes of the first loans are worth noting:
- a. From the quantitative standpoint: (i) with the recoveries from the first two subloans made with resources disbursed under the two loans (and counterpart resources of US\$210 million), an additional US\$163 million in eligible subloans were financed, for total financing of US\$673 million; (ii) 19,065 subloans for MSMEs were financed, with 47% for microenterprises, 38% for small enterprises, and 15% for medium-sized enterprises; (iii) the subloans were focused on the target groups; (iv) the average term of the resources disbursed was 4.3 years, considerably longer than the system average of 1.5 years for the period 2008-2012; and (v) the average spread applied by the CEs for onlending funds was 9.6% with a downward trend over the period.
  - b. From the development standpoint, two [impact assessments on the Bancóldex investment financing lines](#) reveal that, compared to their nonbeneficiary peers, beneficiary MSMEs have: (i) accessed lower interest rates, larger loans, and longer maturities; and (ii) seen increases in output (24%), employment (11%), investments (70%), and productivity (10%).
- 1.30 In light of these outcomes, a third program is proposed so as to continue mitigation of the structural problems identified and expand its scope. Thus, the program will: (i) continue supporting the government's efforts to expand the supply of term financing to MSMEs, enabling them to enhance their productivity and competitiveness; (ii) continue promoting the Bank's country strategy; and (iii) be dimensioned correctly to support Bancóldex's efforts to meet [MSME demand for investment credit](#).
- 1.31 Given its MCP structure, the proposed program will allow: (i) access to a broad spectrum of the target population, in terms of sectors and regions; (ii) relatively small loans to be made in local currency; and (iii) resources to be allocated efficiently and transparently in line with market criteria; all at relatively low cost to the Bank.
- 1.32 It is worth highlighting that the economic analysis of the operation yielded an expected internal rate of return (IRR) of 46%, well in excess of the discount rate of 12%. The corresponding net present value (NPV) exceeds US\$560 million. Upper and lower limits have also been set for the IRR and NPV, showing that, even in the least favorable scenario, the program has a positive NPV of close to US\$63 million. The upper limit suggests an NPV for the program of slightly over US\$1 billion (see [Economic analysis](#)).

### C. Objective, components, and features

- 1.33 The objective of this third program under the condition credit line for investment projects (CCLIP) (CO-X1007) is to continue supporting the government's efforts to strengthen productive sector productivity and competitiveness through the financing of investment projects, productive restructuring, and business and export development. To this end, credit resources to finance MSME investment projects will be channeled through Bancóldex's network of intermediary credit establishments (CEs) (see [Program deal flow](#)).
- 1.34 Specifically, the program will have the following features: (i) the operation will be for US\$400 million, of which the Bank will finance US\$200 million and the counterpart contribution will be US\$200 million; (ii) it will have a credit component to provide funding to CEs; (iii) it will provide funding to Bancóldex through loans, i.e., no disbursements will be made for guarantees; and (iv) the credit, in principle, will be disbursed in U.S. dollars.
- 1.35 The financing provided to the CEs under the proposed program will have the following features: (i) denominated in U.S. dollars/Colombian pesos; (ii) fixed/variable rate, determined as the program's financing rate plus Bancóldex's spread; (iii) higher than the market average funding rate (DTF<sup>19</sup> or IBR<sup>20</sup>); (iv) Bancóldex will assume the risks of the CEs; (v) Bancóldex's spread will be set with an objective of sustainability; and (vi) the CEs will assume end subborrower risk.
- 1.36 Given that this third program will also focus on MSMEs, they will be financed according to the following criteria:
- a. **Eligibility:** MSME projects focusing on the following will be eligible: (i) plans to improve competitiveness and/or productivity; (ii) innovation and technological development projects; (iii) plans for international expansion; (iv) programs to monitor and improve environmental impact; and (v) investment in fixed and deferred assets associated with production, sales, and service delivery processes at the beneficiary firms, such as land and buildings, improvements, plant and equipment, software, vehicles, quality certifications, licenses, patents, health ministry permits, and other investments to increase productivity.
  - b. **Financing:** Depending on demand, the program may finance Bancóldex's lending facilities to finance business modernization projects, provided that the discount rates set for the CEs exceed the market average funding rate (DTF or IBR).

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<sup>19</sup> Depósitos a término fijo [fixed-term deposit], the weighted average of interest rates offered on 90-day certificates of deposit by the Colombian financial system.

<sup>20</sup> Inter-bank rate, the benchmark short-term interest rate denominated in Colombian pesos, reflecting the bid and offer prices that banks are prepared to pay on the money market.

- c. **Features of subloans:** (i) denominated in U.S. dollars/Colombian pesos; (ii) rates freely negotiated with the CEs; (iii) medium and long maturities; and (iv) maximum amount to be set in the program's Credit Regulations, with possible additional cofinancing by the CEs or the MSMEs themselves.
- d. Given Bancóldex's interest in creating a critical mass of funding for term financing of fixed investments, funds derived from: (i) recoveries of subloans made with the loan proceeds in excess of the amounts necessary to service the loan; and (ii) recoveries of subloans made with counterpart resources after the end of the program execution period and over the life of the loan; will be used to make new subloans that adhere to the terms and conditions of the Credit Regulations.

#### **D. Key results indicators**

- 1.37 The main impact of the proposed program will be an increase in the real output of the beneficiary firms relative to comparable nonbeneficiary firms. The intermediate outcomes of the program will be beneficiary firms' improved access to finance, measured by the variation in the average tenor of loans made with program resources and the quality of the subloan portfolio. Lastly, the expected output will be the number of eligible firms that obtain medium- and long-term financing for investments through the program (see Annex II, Results Matrix).

## **II. FINANCING STRUCTURE AND MAIN RISKS**

### **A. Financing instruments**

#### **1. Source and use of resources**

- 2.1 The program will be financed with resources from the Bank's Ordinary Capital, in U.S. dollars. Under the criteria of the Flexible Financing Facility (FFF), the borrower may convert balances owed in U.S. dollars into Colombian pesos, if country market and regulatory conditions allow.
- 2.2 Bancóldex will onlend the resources for the program's sole component to the CEs on the terms established in the Credit Regulations for the eligible investment lending facilities and quotas indicated in paragraph 1.36.b. The funds will allow Bancóldex to provide financing to CEs, which, in turn, will be able to make subloans to the productive sector for eligible investment projects. The subloans may be cofinanced with funds from other sources. The costs of the program are shown in the following table.

**Program Costs by Source of Financing (US\$ million)**

<b>Investment component</b>	<b>IDB</b>	<b>Local contribution</b>	<b>Total</b>
Credit	200	200	400
Percentage	50%	50%	100%



**B. Fiduciary risks**

- 2.3 The financial management and procurement risk is low (see Annex III).

**C. Environmental and social safeguard risks**

- 2.4 The program provides Bancóldex with funding for second-tier lending operations. Its environmental and social risks will therefore occur at the level of the subloans and are unforeseeable ex ante. Under directive B.13 of the Environment and Safeguards Compliance Policy (Operational Policy OP-703 and document GN-2208-20), this operation does not require classification. However, for the purposes of the program, Bancóldex will have a negative list of projects ineligible for financing and a positive list of eligible projects/sectors, previously agreed upon with the Bank and established in the Credit Regulations. The management system and other environmental and social conditions are set out in the [environmental and social management report \(ESMR\)](#).

**D. Implementation risks**

- 2.5 Although the demand for investment project finance may be a risk, this risk is considered low given the relatively small scale of the project in relation to the potential demand and the Bank's experience with the two previous loans.

### **III. IMPLEMENTATION AND MANAGEMENT PLAN**

**A. Summary of implementation arrangements**

- 3.1 **Borrower, executing agency, and guarantor.** The borrower and executing agency will be Bancóldex, which has been the executing agency for the previous loans. Bancóldex: (i) is subject to the oversight of the Superintendency of Finance; (ii) has the necessary fiduciary and operational capacity for successful program implementation; (iii) is solvent and has model risk management practices; and (iv) has been an effective executing agency for Bank programs. Bancóldex operates as a second-tier bank using a network of previously authorized credit establishments (CEs) (both unsupervised and supervised by the Superintendency of Finance) to meet the credit needs of all economic sectors (see Annex III and the [Financial assessment of Bancóldex](#) and [Institutional presentation: Bancóldex](#)).
- 3.2 The Republic of Colombia will act as guarantor of the financial obligations arising from the loan.
- 3.3 **Execution and administration.** For purposes of this program, Bancóldex will be responsible for: (i) executing and supervising the proper use of the loan proceeds; (ii) providing the necessary human, technological, and budgetary resources in due time and manner; and (iii) delivering the required documentation to the Bank to satisfy the disbursement and other operating conditions required for execution.
- 3.4 The only requirements for execution are entry into force of Bancóldex's system for accrediting CEs, and entry into force of the Credit Regulations to be agreed upon by the parties. In relation to the proposed program, specifically:

- a. **EC accreditation system.** First-tier intermediaries subject to inspection and oversight by the Superintendency of Finance may participate as CEs (see [Allocation of credit quotas](#)). They will be responsible for: (i) evaluating subborrower risk and making lending decisions in line with the Credit Regulations and Bancóldex's operating regulations; and (ii) assuming responsibility vis-à-vis Bancóldex for the servicing and repayment of subloans, irrespective of whether subborrowers meet their obligations.
  - b. **Credit Regulations.** The Credit Regulations will: (i) be consistent with the operating policies of Bancóldex and the Bank, as well as with the country's financial laws and practices; (ii) reflect the main features of the program; (iii) stipulate that noncompliance with provisions will bar access to financing; (iv) **approval of the Credit Regulations by Bancóldex, with the Bank's prior no objection, will be a special condition precedent to the first disbursement;** and (v) require the Bank's no objection for future amendment. The Credit Regulations will be similar to the [Credit Regulations for the second program](#).
  - c. **Plan of operations.** As this is a financial intermediation program, no annual work plan or procurement plan is required.
- 3.5 **Disbursement conditions and timetable.** With regard to the proposed program: (i) demand from CEs will determine the pace of disbursements; (ii) disbursements, in principle, will be made in U.S. dollars; (iii) the interest rate (fixed or variable) will be chosen by the borrower in accordance with the contractual conditions; and (iv) the program resources will be disbursed in the form of reimbursements, although another disbursement modality may be used by mutual agreement with the Bank; and (v) the execution period and disbursement periods will be 48 months.
- 3.6 **Retroactive financing.** The Bank may recognize against the loan proceeds eligible expenditures incurred up to 18 months prior to the date of the operation's approval by the Bank's Board of Executive Directors, but under no circumstances will expenditures be financed when incurred prior to 3 September 2012. This retroactive financing will be for up to US\$40 million (20% of the Bank financing). Expenditures will be incurred in accordance with the Bank's procurement policies or substantially analogous procedures. Retroactive financing is justified inasmuch as execution of some of the eligible business modernization and restructuring projects of medium-sized enterprises financed by Bancóldex under the program began execution prior to approval after lengthy planning processes. The institution needs the loan proceeds since these projects were started with own funding and have maturities that are less than ideal. It therefore wishes to replace this funding source with loan proceeds.
- 3.7 The financial statements and eligibility of program expenditures will be audited annually by a firm acceptable to the Bank, to be engaged and paid by Bancóldex. The firm will report on the eligibility of expenditures and confirm the existence of promissory notes payable to Bancóldex. The audited financial statements for the

program will be delivered to the Bank no later than four months after the close of the executing agency's fiscal year in accordance with the procedures and terms of reference previously agreed upon with the Bank.

**B. Summary of arrangements for monitoring results**

- 3.8 The program will be monitored using six-monthly reports prepared by the executing agency and delivered to the Bank within 60 days after the end of each six-month period. These will describe the progress of results indicators and fulfillment of subloan eligibility criteria.
- 3.9 The executing agency and the Bank will conduct a midterm evaluation of the program approximately 24 months after the first disbursement, or once 50% of the loan proceeds have been committed, whichever occurs first. Progress towards achievement of the outcomes envisaged in the Results Framework will be evaluated to identify any required corrective action. The executing agency will provide the information necessary for the Bank to prepare a project completion report (PCR) within 90 days after the end of the execution period or after the date of the last disbursement. Regular monitoring meetings will also be scheduled. The [Monitoring and evaluation arrangements](#) also include a strategy for conducting an impact assessment, including the necessary budget. Once 75% of the program's resources have been disbursed, the project team, in the context of the efforts of the Bank's Capital Markets and Financial Institutions Division (IFD/CMF) to assess the impact of multisector credit programs as part of its Public Banking Initiative, will begin identifying technical or administrative resources for the performance of such assessment.
- 3.10 **Information.** Bancóldex will gather and maintain all information, indicators, and any other documentation required to prepare the PCR and/or any other ex post evaluation the Bank may require.

Development Effectiveness Matrix			
Summary			
I. Strategic Alignment			
1. IDB Strategic Development Objectives	Aligned		
Lending Program			
Regional Development Goals	Percent of firms using banks to finance investments.		
Bank Output Contribution (as defined in Results Framework of IDB-9)	Micro/small/medium productive enterprises financed.		
2. Country Strategy Development Objectives	Aligned		
Country Strategy Results Matrix	GN-2648-1	Increasing the availability and variety of financial services by expanding access to credit for small, and medium-sized enterprises.	
Country Program Results Matrix	GN-2696	The intervention is included in the 2013 Country Program Document.	
Relevance of this project to country development challenges (If not aligned to country strategy or country program)			
II. Development Outcomes - Evaluability	Highly Evaluable	Weight	Maximum Score
	8.1		10
3. Evidence-based Assessment & Solution	8.2	33.33%	10
4. Ex ante Economic Analysis	8.5	33.33%	10
5. Monitoring and Evaluation	7.5	33.33%	10
III. Risks & Mitigation Monitoring Matrix			
Overall risks rate = magnitude of risks*likelihood	Low		
Identified risks have been rated for magnitude and likelihood	Yes		
Mitigation measures have been identified for major risks	Yes		
Mitigation measures have indicators for tracking their implementation	Yes		
Environmental & social risk classification	B.13		
IV. IDB's Role - Additionality			
The project relies on the use of country systems (VPC/PDP criteria)			
The project uses another country system different from the ones above for implementing the program	Yes	Bancoldex's own financial management system.	
The IDB's involvement promotes improvements of the intended beneficiaries and/or public sector entity in the following dimensions:			
Gender Equality			
Labor			
Environment			
Additional (to project preparation) technical assistance was provided to the public sector entity prior to approval to increase the likelihood of success of the project	Yes	The Bank has been supporting the institution through a TC (CO-T1198) to design and implement an environmental and social risks management system for all of its credit operations. Through other two technical cooperations (CO-T1153 and RG-T1866) the Bank has supported Bancoldex in developing climate change mitigation financing strategies to support MSMEs investment projects' in this area.	
The ex-post impact evaluation of the project will produce evidence to close knowledge gaps in the sector that were identified in the project document and/or in the evaluation plan	Yes	From the ex-post evaluation lessons about the effects of Bancoldex on MSMEs will be extracted.	

This is the third investment loan program under the CCLIP for financing line for investment projects, productive restructuring, and export development for the government of Colombia. It will be financed with resources from the Bank's ordinary capital by US\$ 200 millions and by US\$ 200 millions of the local counterpart. The objective of the third program under the CCLIP CO-X1007 is to support the government's efforts to strengthen the competitiveness of the productive sector through financing investment projects, business development, and exports. For this purpose, loans will be channeled through the network of Bancoldex credit intermediaries, for the financing of investment projects of MSMEs.

The project has a reasonable diagnostic that identifies the main deficiencies and quantifies with empirical evidence most of them. The justification for the effectiveness of the intervention in other or similar contexts is acceptable. In general, results are adequately defined and indicators are SMART. In most cases the objectives are realistic and outputs are also defined in a clear way. General mechanisms of monitoring have been defined and there is a budget for this activity. The program has an ex-post quasi-experimental design to evaluate the results with an evaluation plan and the main activities to perform. Nevertheless budget has not been allocated for this activity. There is an economic analysis for some of its components with costs and benefits correctly quantified. Almost all assumptions are clearly spelled out and are reasonable.

The program has identified risks, as well as all the required mitigation measures.

**RESULTS FRAMEWORK  
MATRIX OF INDICATORS**

<b>Objective:</b>	The objective of the third program under the conditional credit line for investment projects CO-X1007 is to continue supporting the government's efforts to strengthen productive sector productivity and competitiveness through the financing of investment projects, productive restructuring, and business and export development. To this end, credit resources to finance MSME investment projects will be channeled through Bancóldex's network of intermediary credit establishments (CEs).
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Impact indicators	Unit of measure	Baseline	Targets	Remarks
(1) Increase in real output by beneficiary firms relative to comparable nonbeneficiary firms in 2017.	Percentages	0	24	<p>This indicator is equal to average real output of beneficiary firms in 2017 over average real output of comparable nonbeneficiary firms, minus one, multiplied by 100.</p> <p>Note that this percentage increase will be calculated towards the end of the program execution period. The baseline datum has not yet been determined, but when the evaluation is done, it will be clear which firms were beneficiaries and which were comparable nonbeneficiaries.</p> <p>The source of verification will be an ex post impact assessment, using data from the DANE Annual Manufacturing Survey.</p>

Sole component	Unit of measure	Base: 2013	2014	2015	2016	2017	Target	Remarks
<b>Outputs:</b> (1) Number of eligible firms that obtain finance for investments, productive restructuring, and export development through the program.	Number of firms	0	712	712	713	713	2,850	Bancóldex's information system

Sole component	Unit of measure	Base: 2013	2014	2015	2016	2017	Target	Remarks
<b>Outcomes:</b>								
(1) Average tenor of loans made with program resources during the execution period.	Number of years	System 2.18 years	4	4.1	4.2	4.3	4.5	<p>This indicator shows the year-on-year change in the average tenor of the loans made with program resources. This indicator is expected to exceed the system's average tenor for lending for production activities. This is an indicator of the program's success at offering MSMEs better loan maturities.</p> <p>The Bancóldex indicator is constructed using the arithmetic average in 365-day years for the subloans made with the program resources.</p> <p>The financial institutions indicator will be obtained from a direct survey of financial institutions overseen by the Superintendency of Finance regarding lending for production activities.</p>
(2) Quality of the program's subloan portfolio during the execution period.	Percentages	System 2.00	1.70	1.70	1.70	1.70	1.70	<p>This indicator shows the expected behavior of the program's subloan portfolio quality. This indicator is expected to be consistently better than the system's average for lending for production activities.</p> <p>Given that CEs will select the most viable firms and projects, the impact of the financed projects will be as good as market conditions allow. CEs will select the best firms, and as these repay their loans with arrears rates similar to or below the system average, the market itself will ensure the best projects are selected. Therefore, the ratio between the market portfolio quality and the program's portfolio quality is key in determining its success.</p> <p>The Bancóldex indicator is calculated on the basis of total prepayments received by the program requested by the financial institution due to arrears by the subloan beneficiaries divided by the total subloan portfolio financed with program resources multiplied by 100. The financial institutions indicator is obtained from the Superintendency of Finance and relates to lending for productive activities.</p>

## **FIDUCIARY AGREEMENTS AND REQUIREMENTS**

**Country:** Colombia

**Project number:** CO-L1132

**Name:** Third Program for the Financing of Investment Projects, Productive Restructuring, and Export Development

**Executing agency:** Banco Colombiano de Desarrollo Empresarial y Comercio Exterior (“Bancóldex”)

**Prepared by:** Mylenna Cárdenas García, fiduciary specialist in financial management  
Rodolfo Gastaldi, fiduciary specialist in procurement

### **I. EXECUTIVE SUMMARY**

- 1.1 The fiduciary assessment was carried out by Bancóldex, the project’s borrower and executing agency, based on the institutional capacity assessment and fiduciary risk assessment for the project. Bancóldex has experience with IDB loans and has demonstrated its capacity as a borrower and executing agency through two programs under the conditional credit line for investment projects (CCLIP). It is currently satisfactorily executing operation 2193/OC-CO for the “Financing of Investment Projects and Productive Restructuring and for Business and Export Development,” and in December 2012 the Bank approved loan 2886/OC-CO, “Program to Promote Outsourced Services,” slated to begin implementation in 2013. The evaluation concludes that Bancóldex has sufficient capacity for the financial management and administration of the loan proceeds. The fiduciary risk in financial management and in procurement is LOW.
- 1.2 Bancóldex is a second-tier financial institution with separate legal status, administrative autonomy, and its own assets, subject to oversight by the Superintendency of Finance, and associated with the Ministry of Trade, Industry and Tourism (MCIT). As Bancóldex is not included in the national budget, it is not obliged to keep its accounts and budgetary controls within the Public Financial Management Systems (SGFP). Bancóldex uses a reliable, integrated system with online accounting, cash management, and budgetary execution modules.
- 1.3 The total cost of the project is US\$400 million, of which \$200 million will be financed with Bank resources, and US\$200 million with the local contribution. The project does not include financing from other multilaterals.

## **II. FIDUCIARY CONTEXT OF THE EXECUTING AGENCY**

- 2.1 Bancóldex uses a reliable, integrated, AS-400 accounting system known as the Financial and Accounting Information System (SFC), in which the accounting, cash management, portfolio, and budget execution modules are online. The system receives information from the Alfyn investment and payroll applications. It is used to maintain, manage, and monitor independent accounts for recording project resources, thus facilitating their monitoring, and identification.
- 2.2 Bancóldex has well defined policies, procedures, and processes, which were analyzed and confirmed during its institutional capacity assessment and supervision of loans in execution, and its quality management system has ISO-9001 certification. One of Bancóldex's strengths is its qualified personnel, functional information systems, and clear and defined procedures for each of the planned activities; it also has technical personnel who have built up experience and years of service in each of the institution's areas, enabling it to ensure quality in its fiduciary and administrative processes, and responsibility and efficiency in the performance of its tasks.

## **III. FIDUCIARY RISK EVALUATION AND MITIGATION MEASURES**

- 3.1 No fiduciary risks were identified in either financial management or procurement. No procurement by the executing agency is envisaged, as it will operate as a second-tier bank with private-sector subborrowers.

## **IV. CONSIDERATIONS FOR THE SPECIAL PROVISIONS OF THE CONTRACTS**

- 4.1 The approval of the program's Credit Regulations by Bancóldex, with the Bank's no objection, is a condition precedent to the first disbursement of the loan.
- 4.2 The Bank will disburse the project resources in the form of reimbursements, although another disbursement modality may be used by mutual agreement with the Bank. The exchange rate for reimbursement requests will be the rate in effect on the effective date of payment in Colombian pesos.
- 4.3 The program's financial statements must be audited annually.

## **V. AGREEMENTS AND REQUIREMENTS FOR PROCUREMENT EXECUTION**

- 5.1 A global credit program structure was adopted for procurements under this operation. Thus, the lending resources will be disbursed according to the rules established in the Credit Regulations, in the form of subloans made by private-sector intermediary financial institutions. The subborrowers will conduct procurement processes in accordance with private-sector practices. Bancóldex will not conduct procurement processes using the Bank loan proceeds.



## **1. Procurement execution**

- 5.2 In accordance with paragraph 3.12 of document GN-2349-9 of March 2011, procurement in loans to financial intermediaries onlent to beneficiaries under another loan to finance subprojects may employ current private-sector practices, acceptable to the Bank, for the procurement of related goods and services. These procurement procedures request adherence to the principles of quality, economy, efficiency, competition, and transparency.

## **2. Table of threshold amounts (US\$000s)**

- 5.3 Not applicable.

## **3. Main procurements**

No procurements by the executing agency are envisaged, given that it operates as a second-tier bank.

## **4. Procurement supervision**

- 5.4 In light of the nature of the operation, procurements will not be subject to review by the Bank.

## **5. Special provisions**

- 5.5 Not applicable.

## **6. Records and files**

- 5.6 The documentation regarding the subloans financed by the operation will be kept by the intermediary financial institutions that review and approve the loan application. The credit establishments (CEs) therefore assume the entire credit risk and will be solely responsible for the task of portfolio monitoring.
- 5.7 At Bancóldex, the area responsible for maintaining the project files and records will be the International Banking office of the Vice Presidency for Finance and Operations. \*\* The official disbursement request forms must be used for program report preparation and record-keeping, listing the subloans subject to reimbursement of expenditures.

## **7. Retroactive financing**

- 5.8 The Bank may recognize against the loan proceeds eligible expenditures incurred up to 18 months prior to the date of the operation's approval by the Bank's Board of Executive Directors, but under no circumstances will expenditures be financed when incurred prior to 3 September 2012. This retroactive financing will be for up to US\$40 million (20% of the loan). Expenditures will be incurred in accordance with the Bank's procurement policies or substantially analogous procedures.

## **VI. FINANCIAL MANAGEMENT**

### **1. Programming and budget**

- 6.1 Bancóldex is not included in the National Budget. Consequently, its expenses are not defrayed with resources from the Public Treasury. Instead, it meets its expenses from the resources generated by its operations as a credit establishment, and is therefore not subject to budgetary control within the Public Financial Management Systems (SGFP). The institution's budget is structured according to the strategic action plan, which is used to plan the course of action on the business fronts for the year, with subsequent definition of investments per line (loan disbursement requirements) and operating expenses. These are met from internally generated cash flows, deposits taken, and obligations acquired with financial institutions. It is worth noting that Bancóldex has clear policies for both budget preparation and monitoring, defined in the budgetary planning and management processes established within the Bancóldex value chain and approved by senior management. The budgets are approved by the bank's Board of Directors for each fiscal year. Business forecasting (COGNOS PLANNING) and expenditure management tools (COGNOS FINANCE) are used to monitor budget management. These tools also allow monitoring of the various investment lines and business units (DWH-Data warehouse). Budgetary execution is monitored by the bank's president's committees and Board of Directors. The resources for the project will be included in Bancóldex's budget.

### **2. Accounting and information systems**

- 6.2 Bancóldex will be responsible for project accounting, which will be on an accrual basis, using a reliable, integrated system with online accounting and cash management modules. In recording its operations and preparing its financial statements, the institution follows the rules prescribed by Colombia's Superintendency of Finance and, for matters not addressed by those rules, Colombia's generally accepted accounting standards established by Decree 2649 of 1993. The audited financial statements for this program will be prepared on a cash basis using information generated by the portfolio application, which identifies the operations financed with the loan. In addition, Bancóldex has internal accounting policies, which are part of the Integrated Management System, and uses the financial sector's chart of accounts. Notwithstanding this, pursuant to Law 1314 of 2009 and Decree 2784 of December 2012, Bancóldex is in the process of implementing International Financial Reporting Standards (IFRS), which must be reported in parallel with Colombian GAAP in 2014 and will enter fully into effect in 2015. Importantly, although the core of the system will initially follow Colombian GAAP, adjustments will be made gradually to the systems, so that they can enter full operation in 2015 with separate accounting based on IFRS.

### **3. Disbursements and cash flow**

- 6.3 The Bank will disburse the project resources in the form of reimbursements, although another disbursement modality may be used by mutual agreement with the

Bank. Disbursement requests must be accompanied by the list of eligible loans according to the conditions established in the Credit Regulations. The system of unified cash balances will be used for the monitoring of resources obtained (deposits taken, portfolio recovery, and loans). Income from the loan is received in a single account corresponding to the recognition of loans previously made. The exchange rate for reimbursement requests will be the rate in effect on the effective date of payment in Colombian pesos.

#### **4. Internal control and internal audit**

- 6.4 Bancóldex has an internal audit unit that reports to the Audit Committee of the Board of Directors, and administratively to the office of the President of Bancóldex. The institution has implemented the Standard Model of Internal Control (MECI 1000:2005) for State entities, based on the global COSO standard, which is aligned and coordinated with the internal control system established by the Superintendency of Finance in its Basic Legal Circular. Bancóldex has a code of corporate good governance, an Audit Committee made up of three members of the Board of Directors, a policy on controls, a set of audit regulations, an audit manual, and an operations and quality manual. It also applies the standards of the Institute of Internal Auditors (IIA) in the performance of its work. As subject to the oversight and control of the Superintendency of Finance, Bancóldex has the risk management methodologies and manuals required by law (market, liquidity, and operations risk, money laundering and financing of terrorism, as well as information security). Bancóldex delivers an annual report on evaluation management of the internal control system to the Board of Directors and the General Meeting of Shareholders, in compliance with the legal requirement of the Superintendency of Finance's external circulars 14 and 38 of 2009, incorporated into Title I, Chapter IX, number 7, of the Basic Legal Circular.
- 6.5 Based on the principles of self-regulation, self-management, self-control, and continuous improvement, Bancóldex conducted an independent evaluation of its internal control system in 2011, which yielded a satisfactory result. The report for fiscal 2012 is now in preparation, and will be delivered to the Board of Directors and the General Meeting of Shareholders in late March 2013. One of the institution's strengths is its commitment to maintain and continuously improve its Internal Control System. This demonstrates Bancóldex's responsibility in relation to the plans and directives proposed by the national government with regard to internal control and quality management, supplemented by the institution's risk management systems.

#### **5. External control and reports**

- 6.6 The project financial statements and eligibility of expenditures will be audited annually by an independent audit firm acceptable to the Bank, to be engaged by Bancóldex. The program auditor may be the same firm as audits Bancóldex's financial statements and those of the other projects in execution, which would optimize costs and give the firm a comprehensive view for control of the executing agency and program management. The auditor will report on the eligibility of

project expenditures and confirm the existence of the promissory notes payable to Bancóldex and that the resources are channeled through the CEs to the end beneficiaries under the terms of the program's Credit Regulations. Inspection visits will also be made to both the CEs and the end beneficiaries. Audit services are budgeted at approximately US\$28,000 annually, and will be financed with Bancóldex's resources. The audited financial statements for the program will be delivered to the Bank no later than four months after the close of the executing agency's fiscal year in accordance with the procedures and terms of reference previously agreed upon with the Bank.

- 6.7 The Bank will request the borrower's audited financial statements and supplemental financial information related to them during the project execution period, until all the project resources have been disbursed. Such will be delivered to the Bank no later than four months after the close of the borrower's fiscal year, beginning with the fiscal year in which the project commences execution.

## **6. Financial supervision plan**

- 6.8 Based on the results of the institutional capacity assessment, the results of financial management supervision for the first and second loans under the CCLIP, and the project risks assessment, the financial specialist will conduct at least one onsite review per year, in addition to desk reviews of the annual and final audited financial statements. The auditor will confirm the existence of the promissory notes payable to Bancóldex, and that the resources are channeled through the CEs to the end beneficiaries under the terms of the program's Credit Regulations. Inspection visits will also be made to both the CEs and the end beneficiaries. Visits for fiduciary supervision in financial management will include verification of the financial and accounting arrangements employed for project administration, tracking of implementation of any recommendations issued by this program's independent auditor, and other tasks.

## **7. Execution mechanism**

- 6.9 The borrower and executing agency will be Bancóldex, which will be legally responsible to the Bank for payment of the debt, with the guarantee of the national government, and will conduct the program's technical and financial activities. Bancóldex will onlend the Bank loan proceeds to the CEs through the usual rediscount facility employed by the institution, or other mechanism agreed upon with the Bank, at a market rate reflecting its financial costs of funds plus a spread to cover its operating costs. Bancóldex will be responsible for the identification and selection of eligible CEs to participate in the program, as stipulated in the Credit Regulations and its own policies and processes. The CEs will freely establish the amount of the subloans, the nature of disbursements, the interest rate and fees, maturities, repayment frequency, and grace periods, based on a credit analysis of the subloan and the project's useful life. Bancóldex will be responsible for financial management.

## **8. Other financial management agreements and requirements**

- 6.10 There are no agreements in addition to those described above. However, the fiduciary agreements and requirements included in this annex may be altered as the project progresses, based on risk analysis updates and the institutional capacity assessment performed during project execution.