

NAFINSA: Mexico's modernization of development bank lights and shadows

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• *** Comisión Nacional Bancaria y de Valores

Washington, DC, April 19, 2017,

1. The modernization of development banks “Mexican style”



Washington DC, April 19-20, 2017

A LONG TRADITION OF DEVELOPMENT BANKS IN MEXICO

Seven development banks were created in 1933-63:

Development Banks, date of origin in Mexico

Bank	Creation Date
Banco Nacional de Obras y Servicios Públicos (BANOBRAS)	Feb - 1933
Nacional Financiera (NAFINSA)	Apr - 1934
Banco de Comercio Exterior (BANCOMEXT)	Jul - 1937
Banco Nacional del Ejercito, Fuerza Aérea y la Armada (BANJERCITO)	Jul-1947
Banco del Ahorro Nacional y Servicios Financieros (BANSEFI)	Dec - 1949
Sociedad Hipotecaria Federal	Apr - 1963
Financiera Nacional de Desarrollo Agropecuario, Rural, Forestal y Pesquero (FND) ¹ /	1926*

¹ FND was consolidated with the financial reform of 2014; however, this institutions performs the functions previously performed by "Financiera Rural", the institutional development bank for the agricultural sector in Mexico which replaced in 2002 the National Bank of Rural Credit, same that was formed by three institutions that preceded until 1965, which were: "Banco Nacional de Crédito Ejidatl"; "Banco Nacional Agropecuario"; "Banco Nacional de Crédito Agrícola". Of these institutions, the longest origin dates from 1926.

Source: Prepared with the information of each *web site the institution*; 2016

1.2. Development Banks and their objectives

- Traditionally development banks in Mexico had three objectives:
 - Act as financial agents of the federal government;
 - Strengthen the financial market: stocks, government and corporate bonds and inclusion,
 - Develop key sectors and activities
- NAFINSA, from 1940 until the 1980s, helped to regulate the stock market, provided long-term loans and gave financial support to promote key industries and infrastructure (directly or indirectly by subsidized loans) It was the financial agent of the Federal Government.
- But by the 1990s, the radical neoliberal shift in the development agenda restricted its actions to correct market failures, complement the commercial banking system. Its role as policy bank as market creator was shunned away

1.3. Modernizing development banks: from policy banks to back seat actors vs market failures

The Old Model

Development Banks: a key tool to promote capital accumulation in strategic productive sectors and regions with national impact on development

Main actors in a state-led strategy for structural transformation to achieve robust economic growth, reduce poverty incidence and help to keep tolerable inflation.

The New Model

- Development Banks have a subordinate role relative to commercial banks.
- Complement commercial banks, thru major changes in organic law, mission, scope and tools.
- This implied that their goal or rationale was to correct for market failures that commercial banks, could not solve for profitability reasons.

MEXICO'S NEOLIBERAL SHIFT IN DEVELOPMENT BANKING, MID 1980S TO 1990S

	Traditional view	"Modern" view post 1998
Perspective and criteria	Industrialization, market creation for development	Complement commercial system. Profitability
Priorities	Key sectors/regions to create comparative advantage	Strengthen current comparative advantage
Tools	Loans/credit, subsidies and even direct action in capital formation	Advise/support to ease access to credit and promote inclusion
Target population	Mega-projects, large firms, mainly SOEs in key sectors	Mainly SMEs & some new technologies. Private sector
Marketing	Supply oriented, create markets	Demand driven, commercial or investment projects
Fund allocation	Direct - first tier	Indirect/ second tier big Banks
Relative competitiveness	Subsidies on interest rates, Access and amounts	Products, guarantees, factoring advisory services
Resources	Public funds/ State supported	Private and external/foreign

Source: Gurria, (1999)



nacional financiera

Banca de Desarrollo

Banca de Desarrollo

2. NAFINSA: Objectives and scope of action

2.1.NAFINSA'S SPECIFIC ROLE IN MEXICO

- **With broadest mandate of all development banks in Mexico.**

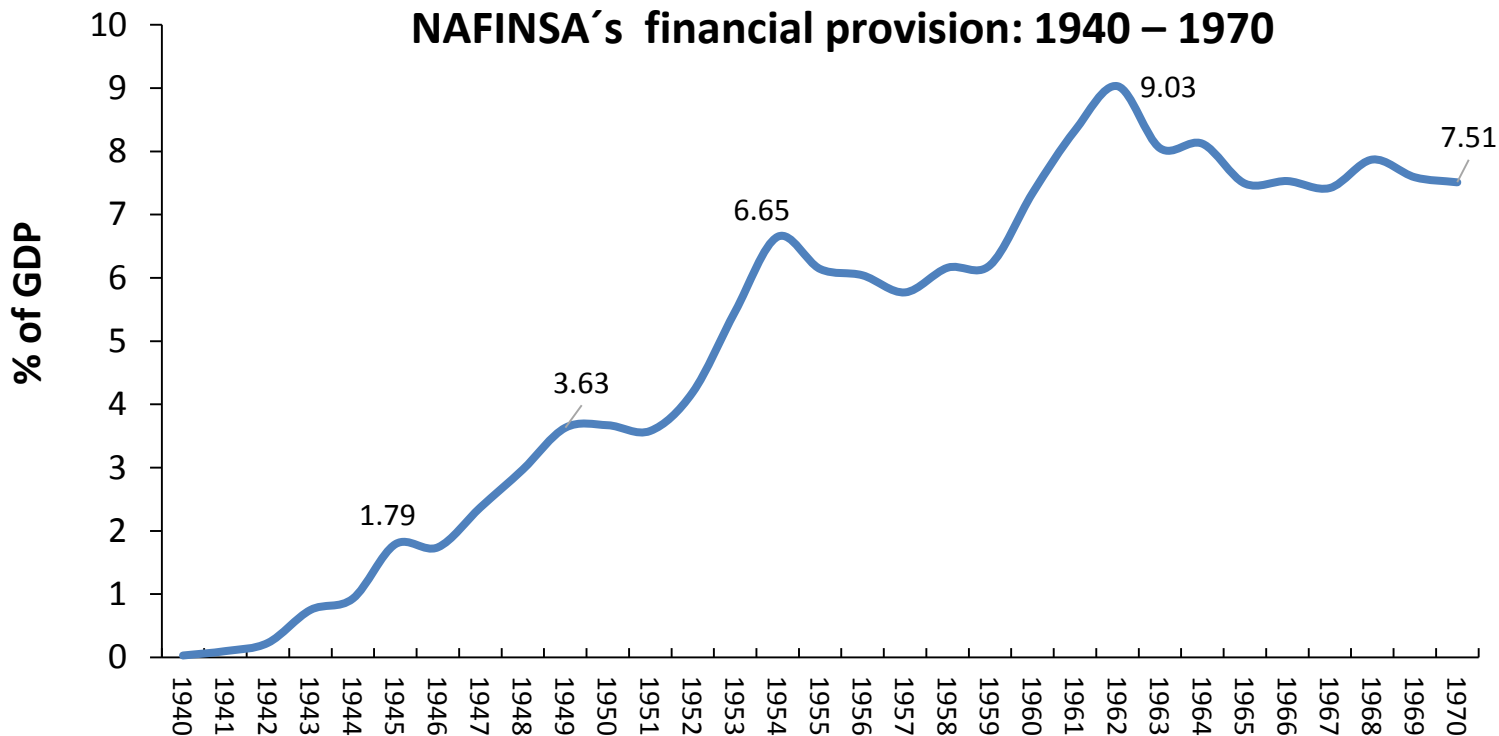
Main Objectives of the Development Banks in Mexico

BANK	Main Objective
BANOBRAS	Finance projects of public or private investment in infrastructure and public services and contribute to the institutional strengthening of governments.
BANCOMEXT	Trade finance, providing credit directly or indirectly through commercial banks and financial intermediaries.
NAFINSA	Facilitate access of MSMEs, financing priority investment projects and other business development services and contribute to the formation of financial markets and act as trustee and financial agent of the federal government.
SHF	Promote the development of the primary and secondary markets housing loans by providing guarantees for the construction, acquisition and improvement of residential, preferably social interest.
BANSEFI	Promoting savings, financing and investment among members of savings and loan sector. Offer financial instruments and services and channeling financial and technical support.
BANJÉRCITO	Financing members of the Army, Air Force and Navy of Mexico.

Source: Prepared with the Organic Law of each credit institution; 2016

2.2 DYNAMISM OF NAFINSA'S FINANCIAL ROLE

In the beginning, it had the to promote fixed capital investment. Its importance grew steadily as a % of GDP in 1940-60 to reach 9% of GDP, and declined thereafter.

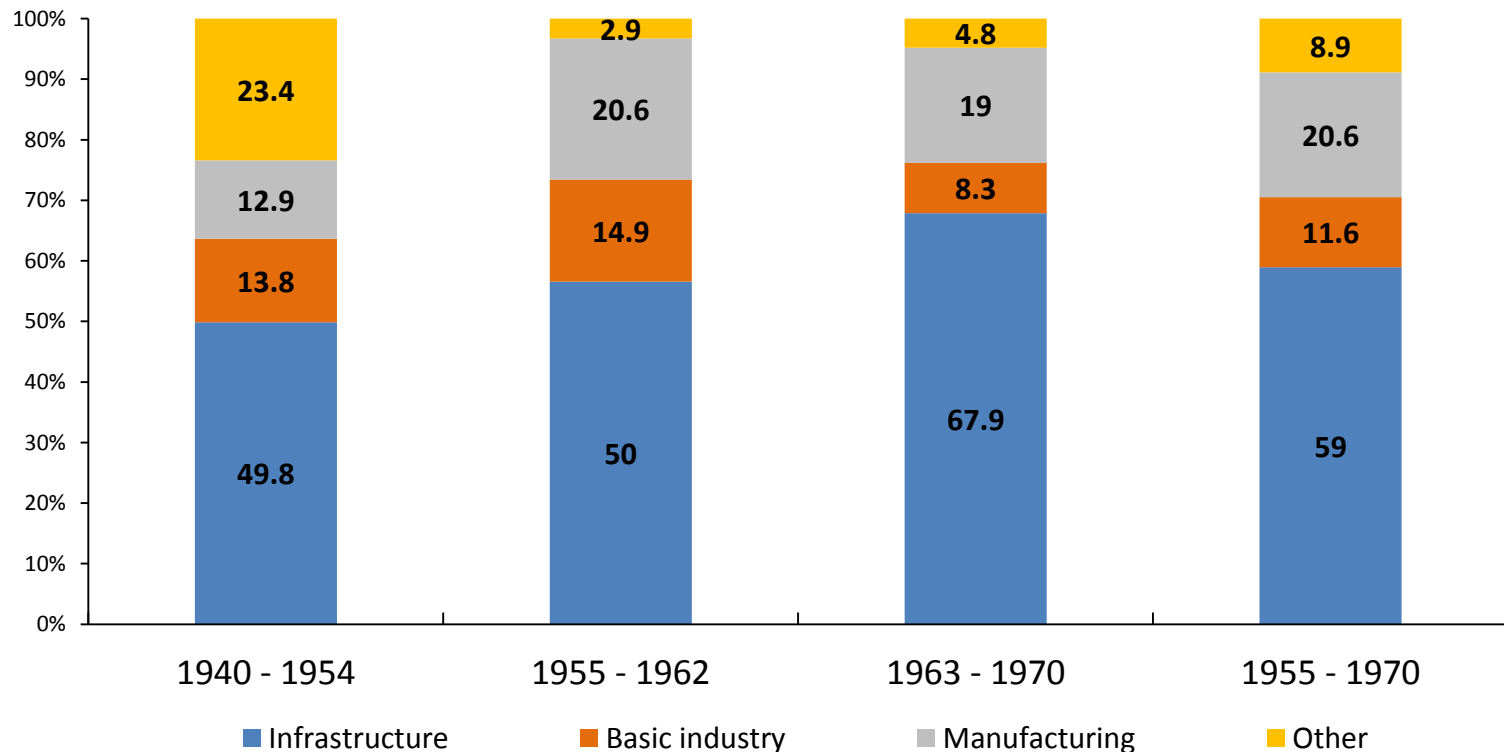


Source: Prepared with data from López (2012); 2016

2.3 NAFINSA'S SCOPE OF ACTION

The funds of NAFINSA were directed mainly to infrastructure, and alternatively to manufacturing or to basic industry.

Sectoral destination of NAFINSA's resources, 1940 – 1970
(Percentage of the Total)



Source: Nafinsa (1978); 2016

2.4 CHANGING SCOPE OF NAFINSA'S ACTIVITIES

1940-47: irrigation, roads, bridges, other public works.

1948-54 : electricity and transport were predominant.

1970-82, Key financial source for industrial projects, actually in charge of several large companies.

In the mid-1980s, its mission changed radically. It ceased to promote industrialization. Its trust funds devoted to such objectives were dwarfed or ended. The new Organic Law of 1986 limited its activities and goals, stopped its promotion of special sectors and limited that its direct participation in enterprises to be a minority and temporary one. Firms under its direct control went from 88 in 1982 to 32 in 1991.

2.5 IN THE 1990S NAFINSA'S LOVE FOR INDUSTRY WAS FORCEFULLY OVER

NAFINSA: Credit and beneficiaries by economic sector

(1989 - 1994, percentages of total credit granted by it)

Total credit by sector	1989	1990	1991	1992	1993	1994
Industry	100.0	82.0	82.0	44.8	40.5	41.1
Commerce	0.0	9.7	9.7	33.9	36.2	32.4
Services	0.0	8.3	8.3	21.4	23.4	26.6
Total beneficiaries by sector						
Industry	100.0	79.6	79.6	30.2	33.7	32.3
Commerce	0.0	14.5	14.5	43.7	44.6	41.9
Services	0.0	5.9	5.9	26.1	21.7	25.8

Source: Nafin, 1995.

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2.6 NAFINSA'S MAIN INSTRUMENTS TO PROMOTE ECONOMIC ACTIVITY

Main instruments: guarantees and induced/factoring, direct credit (2nd tier) via Productive (supply) Chains /factoring

NAFINSA's total financing by program. 2000-2015. In billions of pesos and as a percentage of the total

Financing programs	2000	2002	2005	2010	2012	2013	2014	2015
	In billions of pesos							
Productive chains	...	13.9	79.9	250.3	250.4	230.9	228.1	211.8
Fixed asset financing	...	9.1	10.8	4.1	4.7	26.7
Micro-businesses	...	0.8	3.4	11.3	18.5	20.7	33.5 a/	19.7
Traditional programs	16.8	21.3	19.3	32.0	32.1	36.9	62.4	68.6
Second Tier Credit (A)	16.8	45.1	113.4	297.7	305.7	315.2	324.0	300.1
First Tier Credit (B)	1.2	1.0	0.7	7.1	3.8	7.2	12.1	21.4
Total direct credit to the private sector (C = A+B)	18.0	46.1	114.1	304.8	309.5	322.4	336.1	321.5
Guarantees and induced credit (D)	1.5	4.0	26.2	200.0	342.9	375.6	296.3	270.1
Total financing to the private sector (E = C+D)	19.5	50.1	140.3	504.8	652.4	698.0	632.3	591.7
Public Sector Financing (F)	9.5	36.8	11.3	0.4	2.0	0.5	4.5	3.5
Other (G)	13.9	6.2	0.4					
Total Financing (H = E + F + G)	42.9	93.1	152.0	505.2	654.4	698.5	636.8	595.2
	As percentages of the total private sector financing							
Productive chains	...	27.7	56.9	49.6	38.4	33.1	36.1	35.8
Fixed asset financing	...	18.2	7.7	0.8	0.7	3.8
Micro-businesses	...	1.6	2.4	2.2	2.8	3.0	5.3	3.3
Traditional programs	86.2	42.5	13.8	6.3	4.9	5.3	9.9	11.6
Second Tier Credit	86.2	90.0	80.8	59.0	46.9	45.2	51.2	50.7
First Tier Credit	6.2	2.0	0.5	1.4	0.6	1.0	1.9	3.6
Total Direct Private Sector Credit	92.3	92.0	81.3	60.4	47.4	46.2	53.1	54.3
Guarantees and induced credit	7.7	8.0	18.7	39.6	52.6	53.8	46.9	45.7
Total Private Sector Financing	100	100	100	100	100	100	100	100
Private/Total Financing (E/H), %	45.4	53.8	92.3	99.9	99.9	100	99.3	99.4

Note: ... denotes not available

Source: Authors' own elaboration based on data from NAFINSA's annual reports 2000-2015 <http://www.nafin.com/portalfnf/content/sobre-nafinsa/otra>

2.7 NAFINSA MAIN AREAS OF ECONOMIC ACTIVITY

- NAFINSA's total portfolio of direct and induced credit grew rapidly in 2010-15 (40% in real terms). Allocation of direct credit increased by 70%, and guarantees by 50%, while the factoring program of production chains fell 40%.
- "Cadenas Productivas", a flagship initiative of NAFINSA, lost relative weight in recent years. Its decline in the portfolio is related to exit from it of many, so called first order companies (FOC) of the private sector, marked by high levels of operation that shifted to similar schemes from the commercial banks.
- Their exit was partially offset by an increased outlay of funds to suppliers of SOEs and entities in the Federal Procurement Program. By 2015, around 40% of the funds operated by the program "Productive Chains" operated through this window.

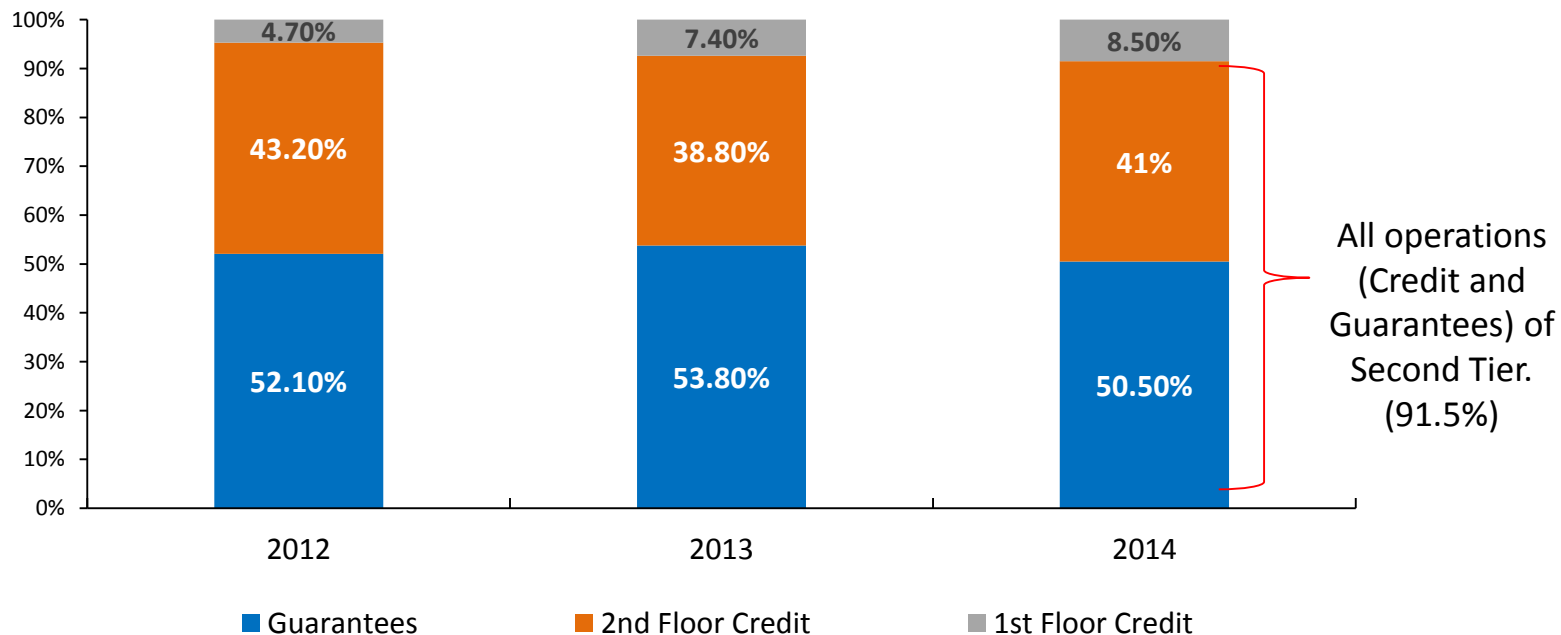
2.8 NAFINSA: PROGRAMS AND EXTERNAL FUNDING

- It has several programs aimed at microcredit: Entrepreneurs; Financing Program, Supporting women microentrepreneurs, the Comprehensive Modernization Microenterprise, and the Business Adheridos (aimed at supporting the formalization of businesses). None of these programs channeled large amounts but are hoped to shed light on future actions.
- NAFINSA has also been a key financial agent in securing funds from the external capital markets. A few years ago it floated a Green Bond signaling its return to the world capital markets for the first time in 18 years

2.9 THE FOCUS OF NAFINSA'S PORTFOLIO

Virtually its entire portfolio is based on its Credit and Guarantees programs, with operations aimed at giving “second-tier” support through commercial financial institutions. Today less than 9% of its funds to the private sector go as first-tier operations.

Transactions in the loan portfolio and guarantees NAFIN, 2012-2014
(Percentage of Total)

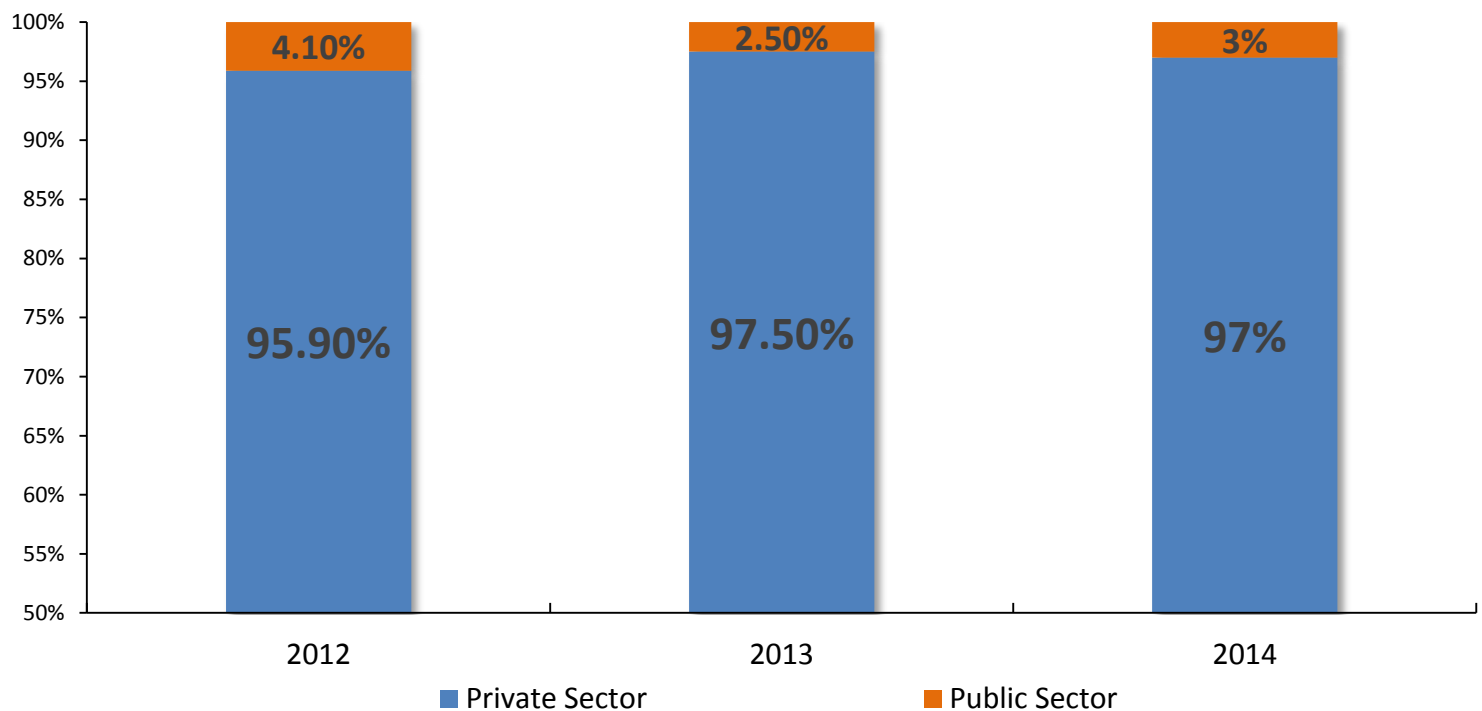


Source: Nafinsa Annual Inform 2014; 2016

2.10 THE MISSION: TO FINANCE THE PRIVATE SECTOR

Vast majority of NAFINSA resources finance the private sector

Total Balance Portfolio Credit and Guarantees of NAFINSA

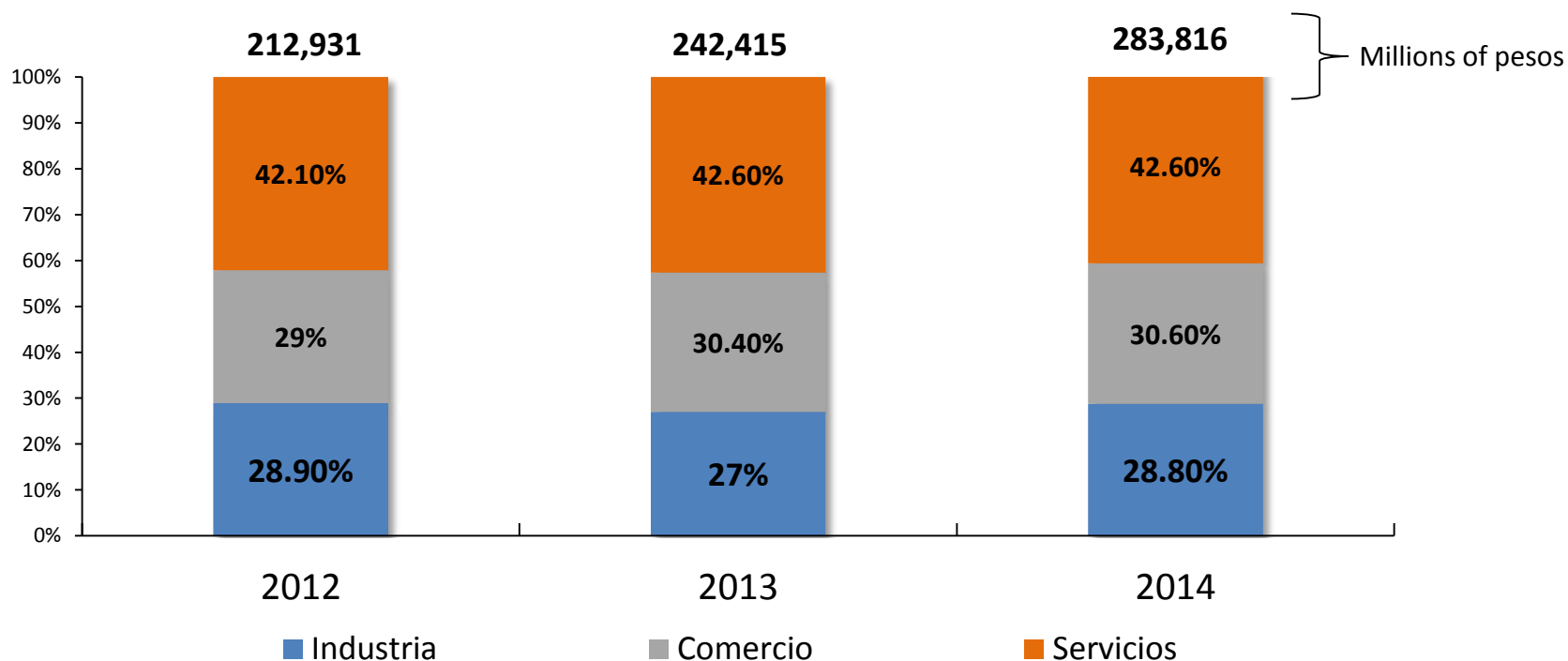


Source: Nafinsa Annual Inform 2014; 2016

2.11 SECTORAL COMPOSITION OF THE PORTFOLIO

NAFINSA's resources are distributed almost evenly between commerce and industry, with relatively more to other services

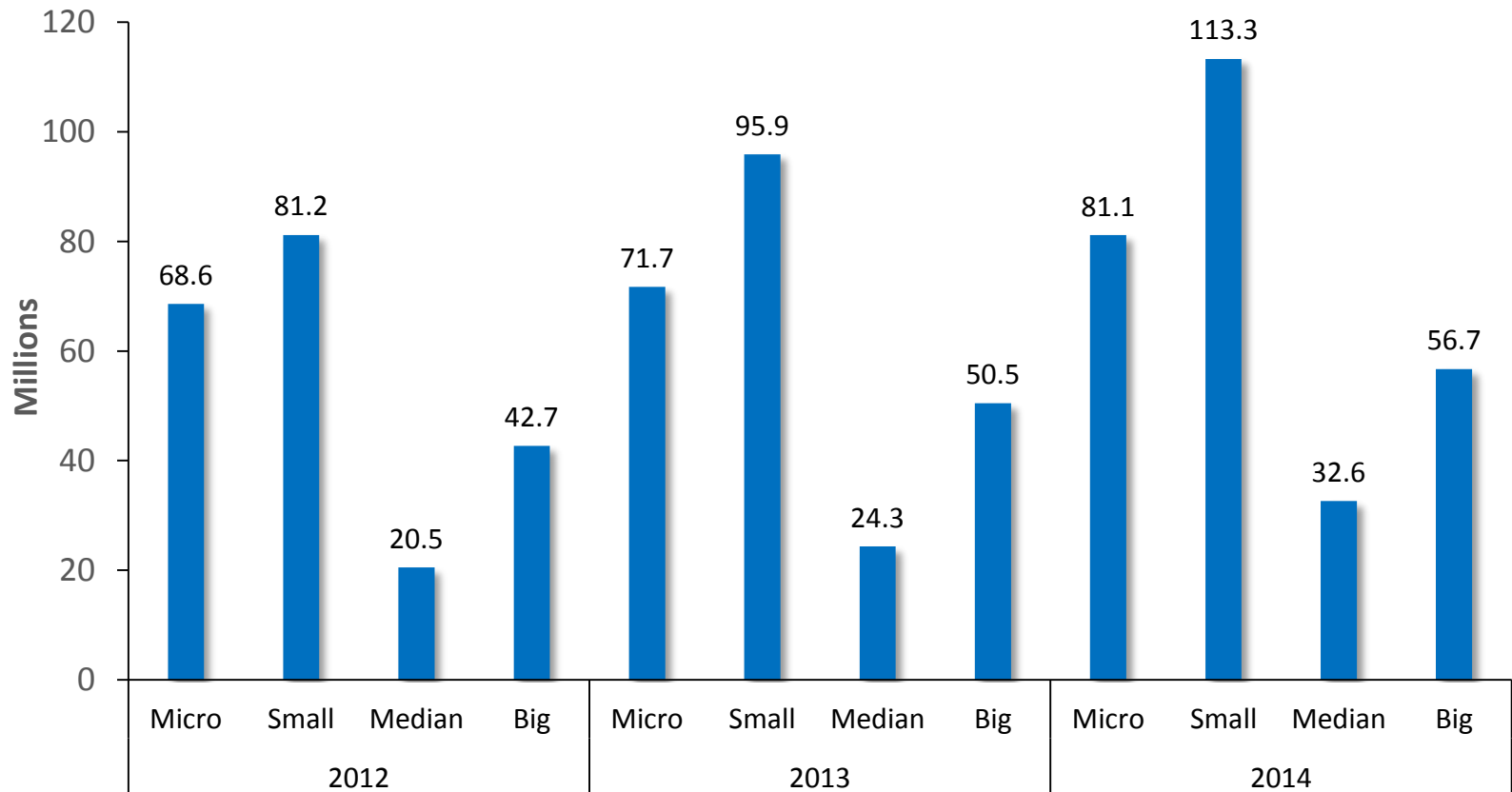
Loan portfolio and guarantees to the private sector by economic sector, 2012-14



2.12 NAFINSA'S FUNDS AND BUSINESS SIZE

Support for MSMEs is carried out mainly through bank or other specialized commercial intermediaries

Nafinsa Loans and Guarantees by company Size



2.13 FINANCIAL INCLUSION.

Financial inclusion is supported both by direct credit and guarantees for products such as microcredits. NAFINSA (with the Ministry of Economy) has created different funds with the purpose to invest in projects of Mexican entrepreneurs.

Financing of SMEs in the capital market in Mexico, 2004-13

Year	SME fund size	Number of projects or funds	Average capital investment
2004-10	230	43	USD 5 500 000
2006*	2,500	nd	nd
2011	1,170	15	USD 50 000 000
2012	300	1	20 000 000 pesos
2013	740	15**	50 000 000 pesos

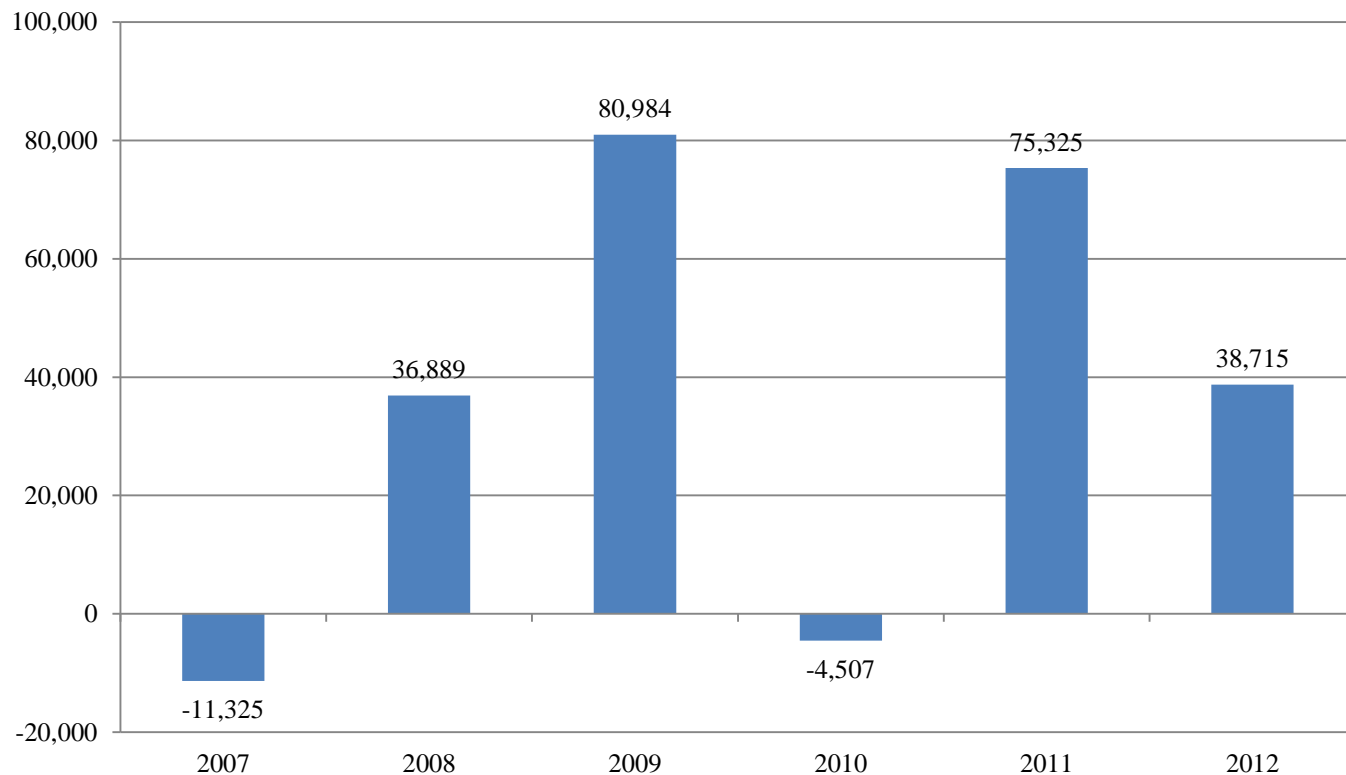
Notes: * Unvalidated Information; ** Forecast 2013; nd: not available; **Source:** OCDE (2015); 2016

2.14 FINANCIAL INCLUSION: NEW EFFORTS

- In addition, Nafinsa has created the “Programa Nacional de Franquicias” that allows larger SMEs to participate in a franchise with an interest-free loan through a financial institution that covers up to 50% of the costs to be reimbursed in 36 months. Between 2007 and 2011, the program supported 1,627 franchise outlets.
- The program of investment guarantee was created, which intended to boost investment in innovation-oriented SMEs or in high value added activities over a period of 3 to 5 years.
- Despite all these initiatives, funds for venture capital have not achieved a significant scale because the corporate culture, market competition and legal frameworks are not in an evolutionary stage that is sufficient to promote consistently development: a pending task that is only possible in the long term

2.15 NAFINSA'S RELATIVE COUNTERCYCLICAL ROLE

Difference between programmed and actual financial support provided by guarantees program for 2007-2012 (million pesos).



Source: Authors' own calculations on the basis of NAFINSA's annual reports 2007-2012

3. NAFINSA: strengths, weaknesses and future challenges



3.1 NAFINSA: STRENGTHS

This new role of development banks is very much in accordance with the shift brought about by the market reforms in Mexico in favor of open markets and of the retrenchment of the State in economic affairs.

NAFIN's experience shows that Development Banks can and should have important roles as an institutions committed to collaborate with the private commercial banking system in compensating market failures in financial intermediation and as a financial agents of the Federal Government .

3.2 NAFINSA: WEAKNESSES

Indeed, in the early 2000 the policy-induced weakening of NAFINSA's and its transformation as a second tier financial institutions soon translated into a credit crunch that severely affected SMEs and the overall level of economic activity, employment and poverty.

- Furthermore, as a renewed vision of the relevance of development banks gained momentum, NAFIN's activities resumed a strong pace and soon induced an improvement of financial inclusion by SMEs.

3.3 NAFINSA: FUTURE CHALLENGES

NAFINSA has been and continues to be a very successful story of a public sector financial intermediary that, has been able to radically transform itself and thus to meet its redefined goals in accordance to very different institutional priorities, regulatory contexts, and development agendas.

It is as an institution that -if given the resources and the regulatory elbow room- has the technical capacity to play an important role in development planning and financing at a sectoral cum regional level to bring about a structural change and modernization of the Mexican economy that inserts it in a long-term trajectory of so badly needed high and robust expansion.

3.3 NAFINSA: FUTURE CHALLENGES

The neoliberal market reforms forced a radical change in NAFINSA, modifying its objectives, instruments and channels of intermediation as well as its target population. From being Mexico's key policy bank it was downsized to become a 2nd-tier intermediary explicitly oriented to ease MSMEs' access to financial resources, essentially through innovative Factoring and Guarantees schemes.

Within the strict perspective defined by the priorities and objectives set decades ago by the market reforms and routinely ratified by subsequent governments, the challenges of NAFINSA boil down to having more capital, more leeway in selecting and expanding its body of human resources, and more possibilities to engage in first-tier, direct credit operations.

3.3 NAFINSA: FUTURE CHALLENGES

However, the conclusion is way different if we take into account the weak overall state of the Mexican economy. NAFINSA must be a relevant instrument in strengthening financial intermediation for capital formation with a developmentalist vision to promote a structural transformation of the Mexican economy, Thus it must recover the functions, prerogatives and responsibilities as a policy bank. But this implies that the government should adopting a new development agenda, with an active industrial policy and a boost of public investment; way different from the current one that sees stability as necessary and sufficient conditions for economic growth.

Will the Mexican government will do so, it is uncertain but the Trump effect seems to push it in that direction.

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Appendix: NAFINSA's Historical time line

April 19, 2017