Mexico´s modernization of development banks: NAFINSA´s lights and shadows

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A LONG TRADITION OF DEVELOPMENT BANKS IN MEXICO

Seven major development banks were created in Mexico in 1933-63:

Development Banks

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. It performs the functions of "Financiera Rural", the development bank for the agricultural sector which in 2002 replaced the "Banco Nacional de Crédito Rural", that in turn englobed the three institutions that preceded it until 1965: "Banco Nacional de Crédito Ejidal"; "Banco Nacional Agropecuario" and "Banco Nacional de Crédito Agrícola". Of these institutions, the oldest one dates from 1926.

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

WITH AN AMBITIOUS VISION

- Development banks in Mexico traditionally focused on two general goals:
  - Strengthen the domestic financial market and promote financial inclusion
  - Stimulate the structural transformation of the economy
- The original mission of NAFINSA, from 1940 until the mid-1980s involved building up the stock market, promoting financial inclusion, provide financial support at favorable conditions for capital formation in key industries and infrastructure. It worked mainly with SOEs and the Federal Government, and also acted as financial agents of the federal government;
- However the Oil Bust in 1981 soon changed everything in development policy in Mexico, and in DBs per forza

BUT NEOLIBERALISM BROUGHT A MODERN WAVE: DBs vs market failure and pro-capital sustainability

The Old Model:

- Development Banks are an instrument to **promote capital accumulation in strategic productive sectors,** and deepen financial markets, all with a view to promote structural change.

- They were a policy tool within a State-led **developmental strategy** to industrialize as key for sustained and robust economic growth.

The New Model:

- Development Banks must play a **subordinate role** in regardd to commercial banks.
- They should act as 2nd tier banks, **complement of commercial banks; and intervene only** to **correct for market failures** that could not be solved otherwise.
- **A key policy change was to set capital preservation as top priority. DBs should be self sustainable, and not put any pressure on fiscal resources.**
- Organic law of DBs were changed to reflect the new mission, vision and instruments.

FOR NAFINSA THIS MODERNIZATION WAS DEFINED BY ONE OF ITS EX-CEOS (A.GURRIA) IN DETAIL:

	Old hat	¨Modern¨ view post 1989-92
Perspective and criteria	Industrialization, market creation. S&E development	Services, commerce, industry; open markets, unprotected
Priorities	State policy identified key industries, infrastructure and regions	Preserve capital, do not pressure fiscal performance. Financial inclusión.
Tools	Preferred loans/credit, direct intervention in capital formation	Financial instruments to help Commercial Banks lend to SMEs
Target population	Mega-projects and large firms, mainly public ones	Mainly SMEs & some new technologies. Private firms
Marketing	Supply –actually development policy-oriented	Demand driven, investment projects
Fund allocation	Direct - first tier	Indirect/ second tier
Relative competitiveness	Subsidies on interest rates, Access and amounts	Products, advisory service, ease of Access
Resources	Private saving/Federal fund	Private and external/foreign

THE NEOLIBERAL SHIFT WAS SOON FELT IN NAFINSA

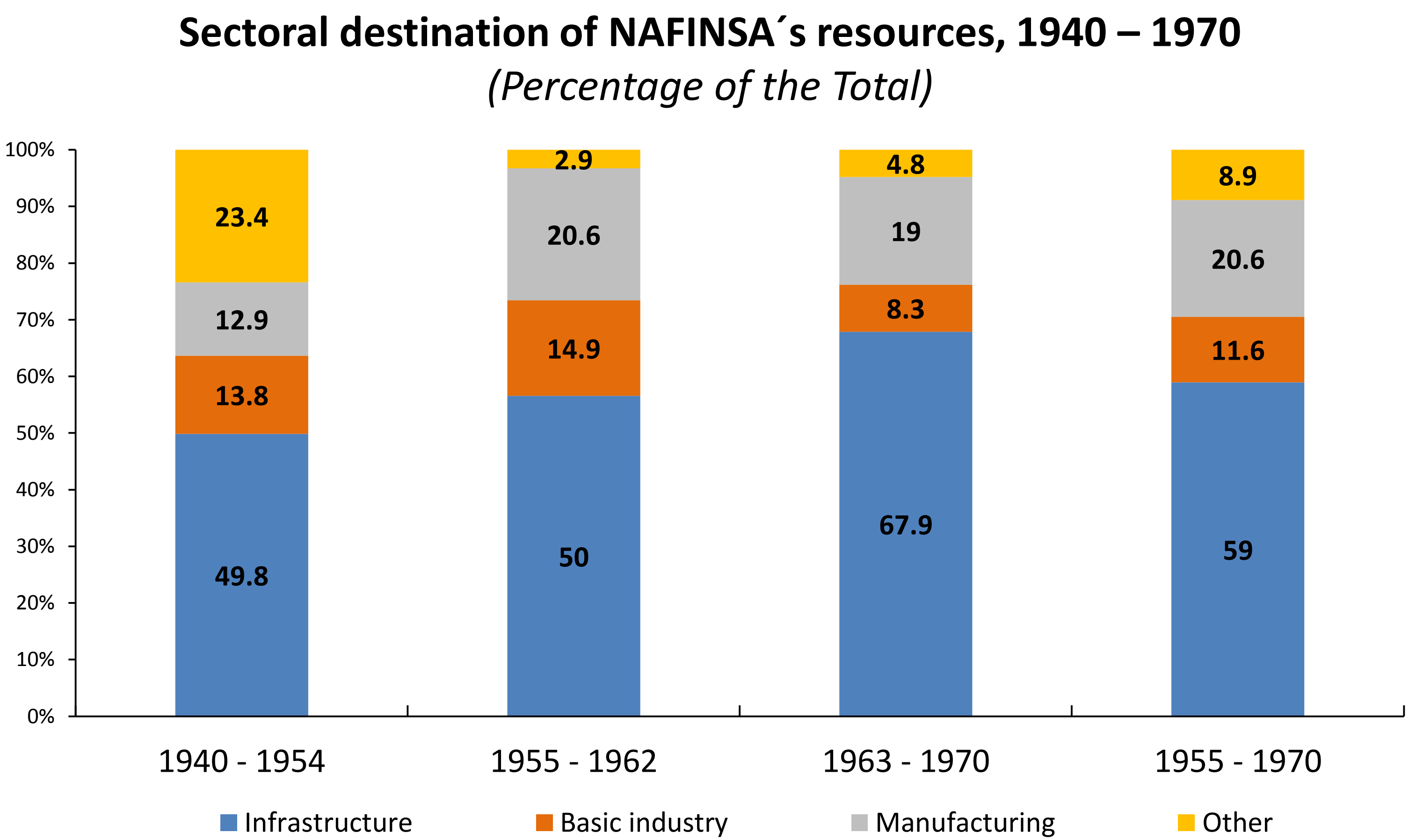
- In **1940-47** the most important public works projects of NAFINSA were irrigation, roads and bridges, dams etc. In **1948-54** investment in electricity and transport were predominant. In **1970-82**, NAFINSA undertook numerous industrial projects, and was in charge of several large companies.

- With the **Debt Crisis of 1982**, NAFINSA´s mission changed radically: it sold or divested its industrial forms, and ceased its key role as promoter of industrialization. The trust funds it had, devoted to such objective, were dwarfed, merged or eliminated. The New Organic Law limited its activities and stated that it could participate directly in investment projects only as minority partner (up to 15%) and form less than 3 years.

- **In 1989-92, its** mandate was radically changed to first of all, preserve its capital and its sustainability, and then to promote financial inclusion, acting as 2nd tier bank, to focus on MSMEs, and was subjected to multiple regulatory and supervision constraints, most important t was set to comply with each and every rule as the commercial banks, later even ordered to comply with Basle III standards.

FOR A START, NAFINSA´S "DNA" THAT WAS INFRASTRUCTURE AND MANUFACTURING

The funds of NAFINSA were directed mainly to **infrastructure, and manufacturing.**



Source: *Nafinsa (1978*); 2016

SHIFTED TO COMMERCE AND SERVICES

From the 1990s, in the context of its new mandate, NAFINSA gave greater **emphasis to indirectly fund SMEs in commerce and service sectors, and not only in industry as before**. Its aims was to give financial services to sectors that previously had no access to the formal banking system

Mexico. Credit and beneficiaries by economic sector

1989 - 1994, percentages of total funds and numbers of agents

Sector	1989	1990	1991	1992	1993	1994
Industrial credit	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
Industrial beneficiaries	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: NAFINSA, 1995.

2. NAFINSA today: Objectives and scope of action

MEXICO´s RECENT FINANCIAL REFORM (2014)

- Main justification: financial intermediation is extremely low in Mexico international comparions put it in a lamentable place; even more regarding finance for private comercial-business purposes. Finance should be a handmaiden of economic growth

- Purpose: 1) increase competition in the banking sector; 2) promote much more credit through development banks; 3) boost credit through private financial (B and Non B) institutions; 4) maintain a sound and prudent financial system; and 5) make more effective financial institutional regulation.

- A key concern is that the reform should help to consolidate the macroeconomic stability of the country; while at the same time remove credit insufficiencies and rationing role as binding constraints on Mexico´s economic growth.

THE FINANCIAL REFORM OF 2014 AND NAFINSA

Main changes:

- **Need for new Mandate: The old mandate was missligned with the objective of promoting credit given that its key function was to preserve and maintain the value of the capital. Thus credit stalled and was misdirected. The new mandate changes this, stresses that NAFIN should** aim to boost financial inclusion and funding to productive actvities aimed at boosting productivity and economic development, considering capital sustainability. It is now not the top priority.
- **Greater Flexibility:** Gives more options to operate by giving more autonomy to the Director, reducing redundant supervisory instances. Allowing acquisition of securities of other credit institutions, or as colateral, as well as lending to maintain the operation of a production plant, over and above the previous limits as % of capital or in years of intervention. Eliminates constraints/consultations on hiring of services and imprving human capital.

POST REFORM NAFINSA HAS -OR KEEPS- A PREDOMINANT ROLE AMONG DEVELOPMENT BANKS IN MEXICO

- **NAFINSA has the widest mandate of all development banks in Mexico.**

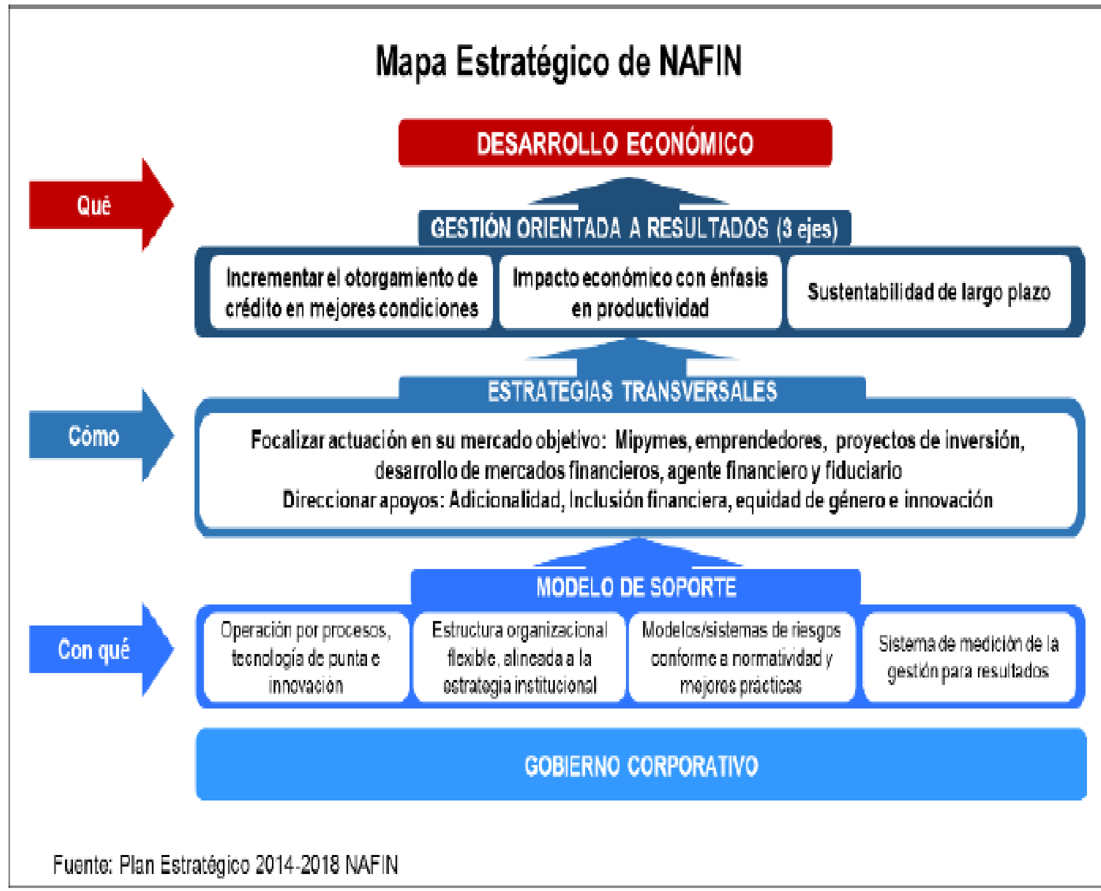
Main Objectives of the Development Banks in Mexico

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 based on the Organic Law of each institution*;* 2016

ITS LEGAL FRAMEWORK IS GROUNDED IN THE CONSTITUTION, PLANNING LAWS AND ORGANIC LAW

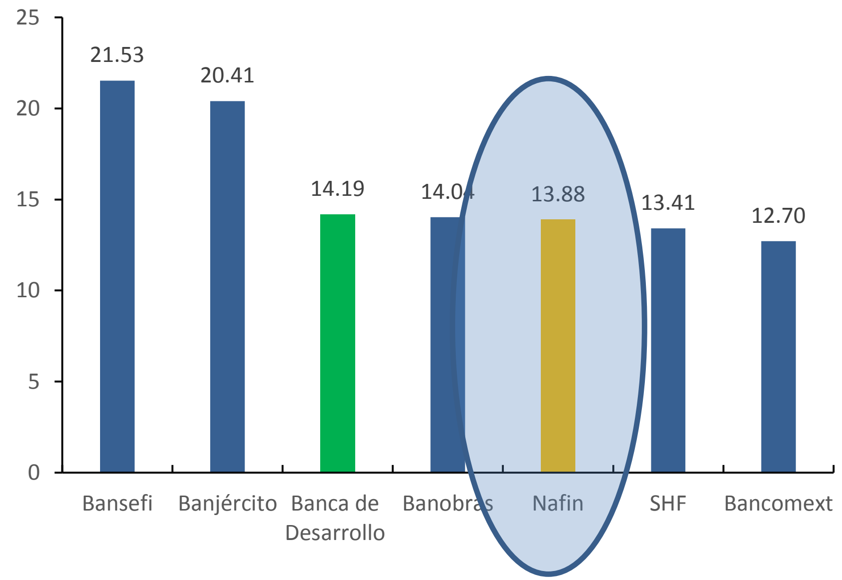
And its operational strategy is now NOT determined only by capital solvency



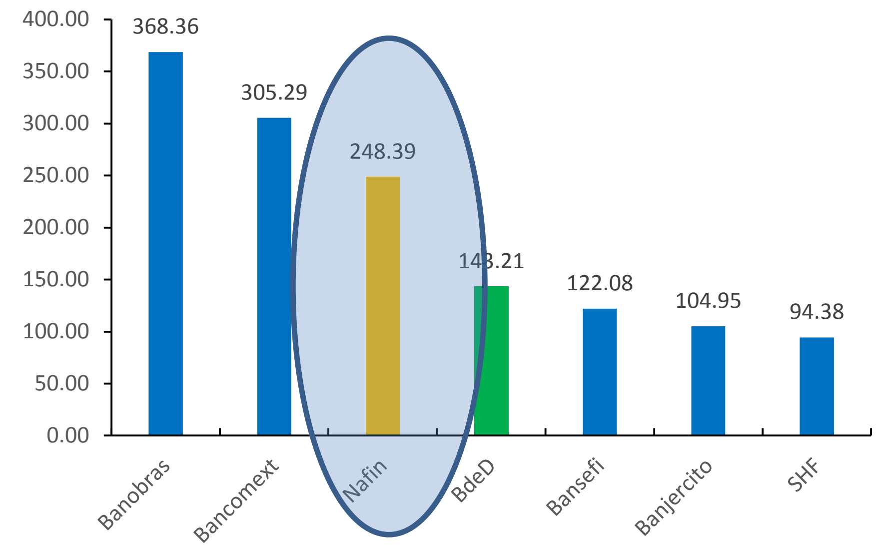
Concern of inclusion SMEs is still conspicuous. And a laudable, but fuzzy, goal is introduce: “boost NAFIN´s economic impact with emphasis on productivity” How?

NAFINSA´s FINANCIAL PERFORMANCE IS GOOD

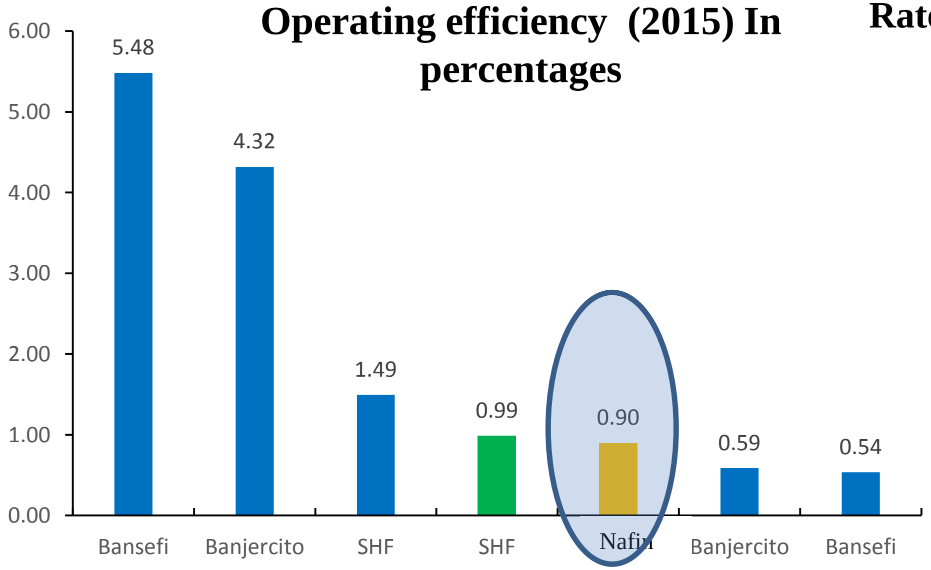
Capitalization Index (2013)



Coverage Index (2013)



Operating efficiency (2015) In percentages



Rate of return over assets (ROA) and Rate of return over equi (ROE) (2016)

Development banks	ROE	ROA
Average	**3.83**	**0.37**
Bancomext	4.26	0.29
Banobras	6.19	0.39
Nafin	4.95	0.33
SHF	-10.25	-1.49
Banjercito	13.23	2.51
Bansefi	4.57	0.19

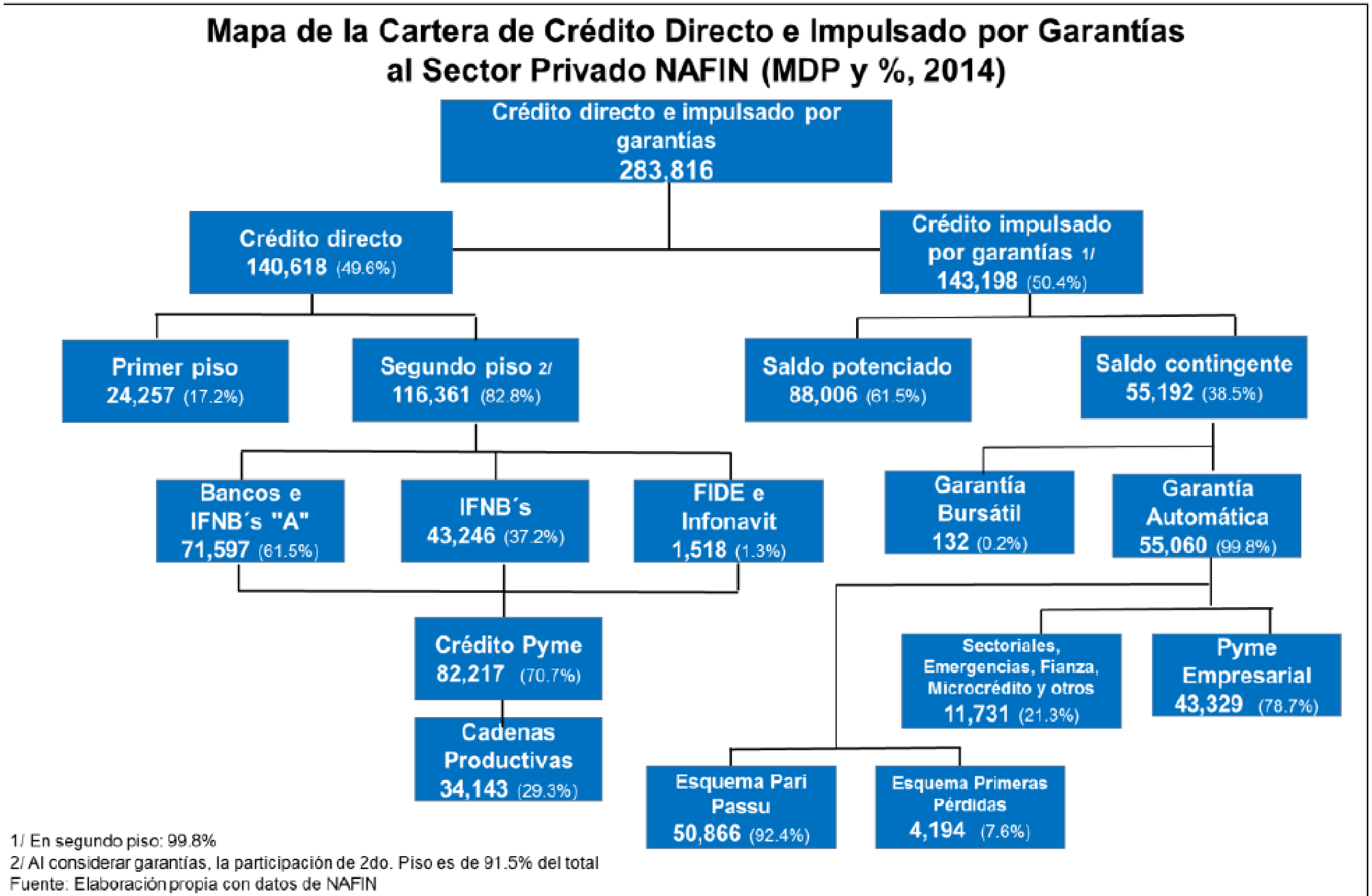
A FREQUENT CLASSIFICATION OF NAFIN´S FINANCIAL SUPPORT IS BY: GUARANTEES, PRODUCTIVE CHAINS AND (OTHER) CREDIT T

Portfolio Balances of Direct and Induced Credit to the Private Sector: NAFINSA 2011-2014

	2011	2012	2013	2014
Total Portfolio (Thousands Million Pesos)	191.7	212.9	242.4	283.8
Guarantees	89.8	111.0	130.4	143.2
Credit	57.6	63.3	80.4	106.5
Productive Chains	44.4	38.7	31.6	34.1
Total Portfolio %	100.0	100.0	100.0	100.0
Guarantees	46.8	52.1	53.8	50.5
Credit	30.0	29.7	33.2	37.5
Productive Chains	23.2	18.2	13.0	12.0

Source: INFORMES ANUALES, NAFINSA; 2016

NAFIN 2014 REPORT SEES IT AS : DIRECT CREDIT (1ST & 2ND TIER FACTORING) & INDIRECT (GUARANTEES OF VARIOUS TYPES)



Source ITESM, (2015)

AND IDENTIFIES OTHER SMALL PRODUCTS: VENTURE CAPITAL, FINANCIAL AGENT OF THE GOV./TRUST FUNDS, ETC

	Productos y Servicios	Visión de Política Pública	Coordinación Clave
Financiamiento	Garantías	Inclusión Financiera, Mejora en condiciones de acceso al crédito, Desarrollo Sectorial, Masividad, Innovación, Formalidad y Viabilidad Empresarial, Sustentabilidad	INADEM (SE), SHCP, Intermediarios Financieros, SFP, Bancomext, SEDESOL, BANSEFI, SHF, Gobiernos Estatales, SENER, CFE. FIDE, BANOBRAS.
	Cadenas Productivas		
	Financiamiento Contratos GF		
	Eco-Crédito Empresarial		
	Emergencias		
	Crezcamos Juntos (RIF)		
Banca	Capital Emprendedor	Desarrollo de sectores prioritarios, Infraestructura para el desarrollo, Sustentabilidad	SHCP, BANOBRAS, PEMEX, CFE, SENER, Intermediarios Financieros, Conacyt, SEMARNAT
	Proyectos Sustentables		
Mandatos	Agente Financiero	Desarrollo de sectores prioritarios, Infraestructura para el desarrollo	SHCP, BID, BM, Dependencias y Entidades, Gobiernos Estatales
	Fiduciario		
Otros Pord y Servicios	CETES Directo	Inclusión financiera, Cultura empresarial	SHCP, BANSEFI, Fondo México Emprende, SENER, CFE, Universidades, INADEM, FIDEAPO
	ENERFIN		
	Capacitación y Asistencia Técnica		

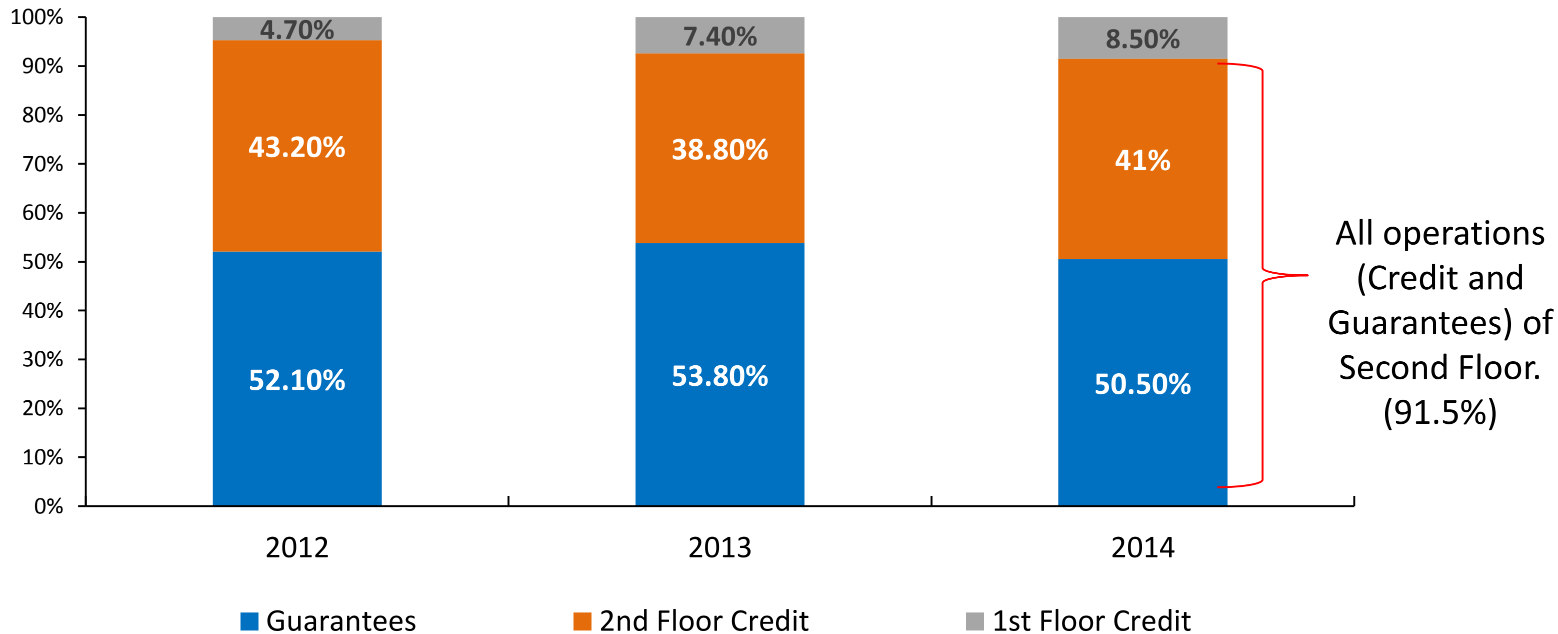
Source ITESM, (2015)

IN ANY CASE NAFINSA IS CLEARLY A 2nd TIER BANK

NAFINSA´s provides credits and guarantees, -to promote financial inclusion of MSMEs- acting as 2nd tier bank with commercial banks and, to a lower extent, with non-bank financial intermediaries. Currently, only 8.5% of its support is done in first-tier operations; mainly on large scale public work projects with the government.

Transactions in the loan portfolio and guarantees NAFIN, 2012-2014

(Percentage of Total)

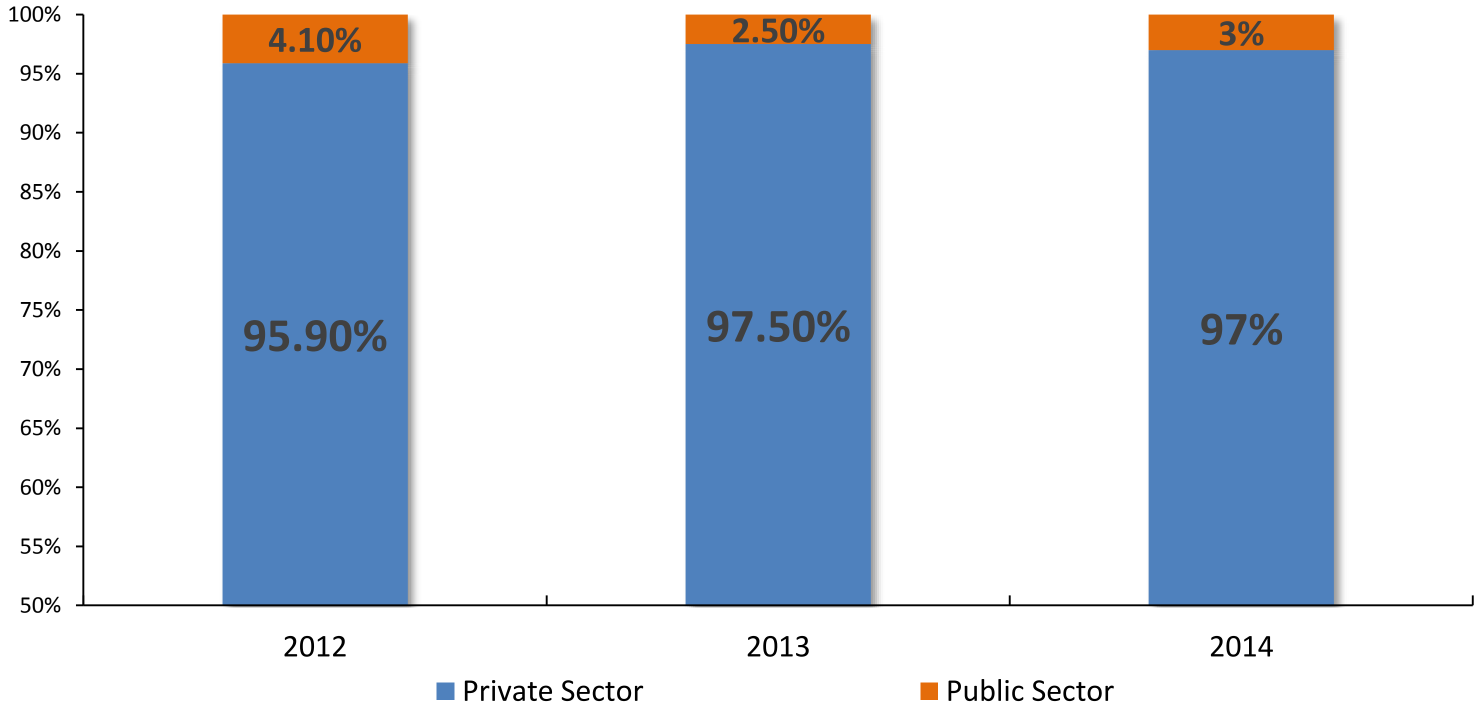


Source: Nafinsa *Annual Report 2014*; 2016

COMMITED TO FINANCING THE PRIVATE SECTOR

In stark contrast to the its historic path, the vast majority of NAFINSA financial support is targeted to **the private sector**

Total Balance Portfolio Credit an Guarantees of Nafinsa

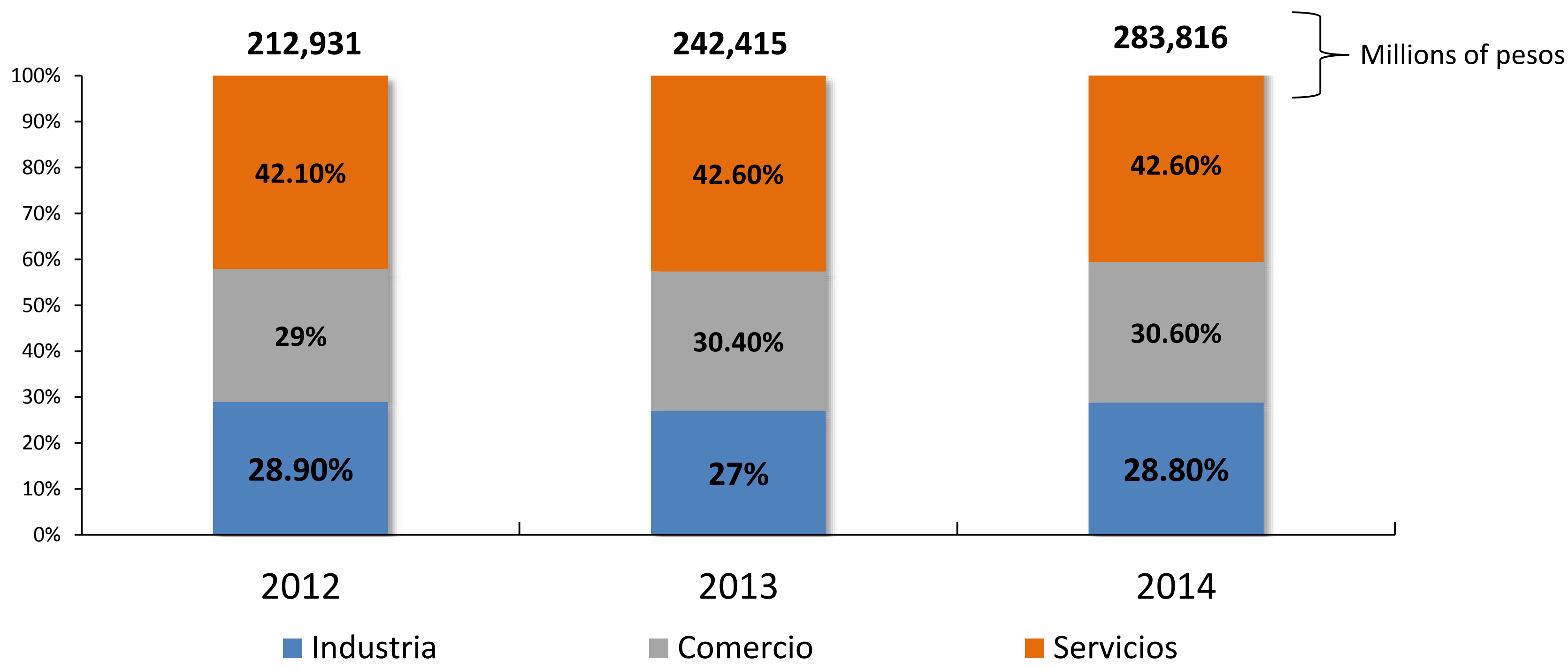


Source: Nafinsa *Annual Inform 2014*; 2016

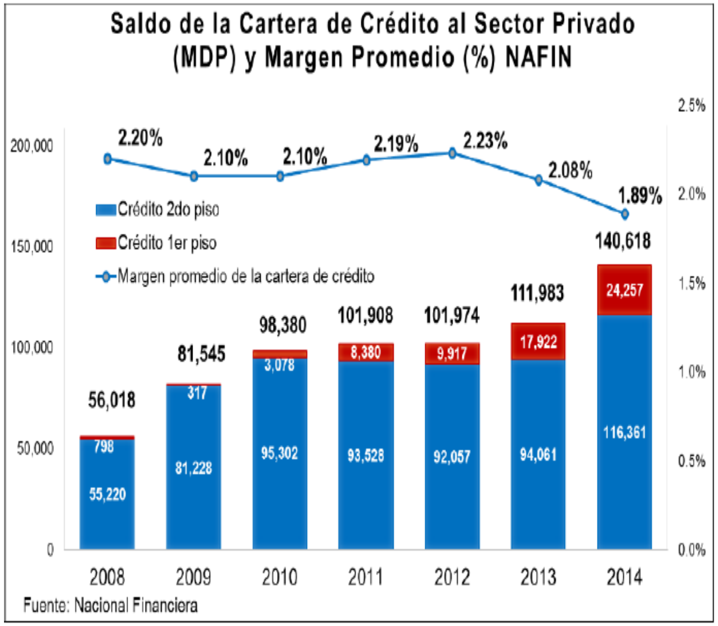
WITH SERVICES AND TRADE AS "PREFERRED" BENEFICIARIES (HIGHER PREVALENCE OF MSMEs)

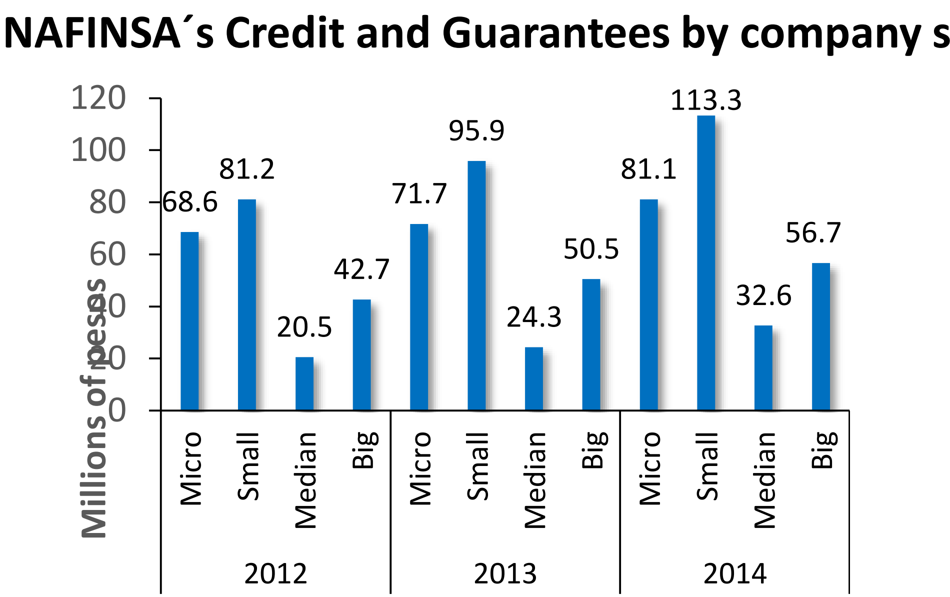
NAFINSA´s credits and guarantees are allocated more to services, then to commerce and, in a minor proportion to industry

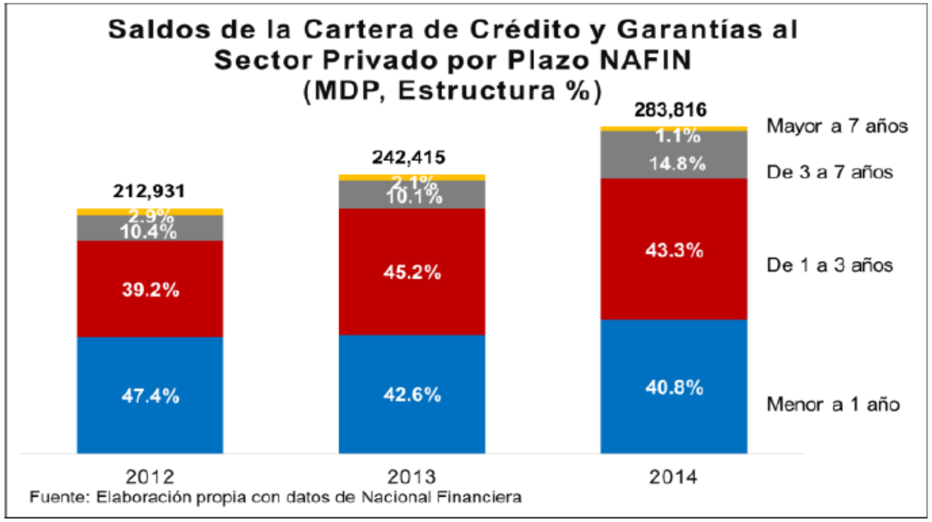
Composition of NAFINSA´s balance of credits and guarantees, 2012-2014



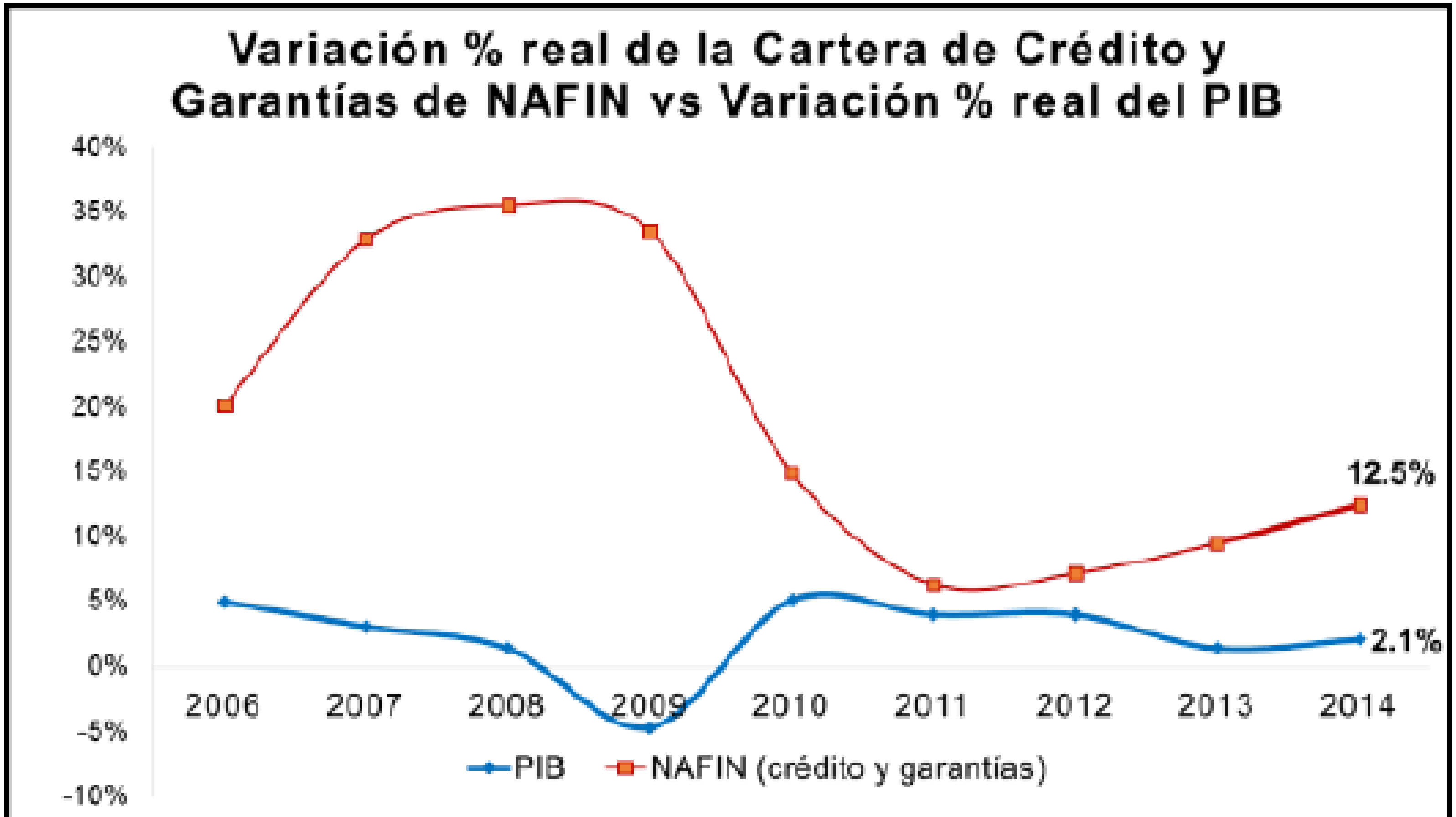
NAFINSA FOCUSES ON MSMES, SPEED UP IN 2014, LOWER MARGINS, AND SOMEWHAT MORE WITH A LONG TERM VIEW







AND IT ACTED, TO CERTAIN EXTENT, IN A COUNTERCYCLICAL WAY IN 2008-10



Source ITESM (2015)

NAFINSA: COMMENTS ON SOME PROGRAMS

- NAFINSA´s **total portfolio** of direct and induced credit grew very rapidly between 2011 and 2014 **(more than 35% in real term**s. **Its allocation of direct credit** increased **85% (nominal)**, and **guarantees by 60% (nominal), but t**he **factoring program of production chains fell 31% (nominal).**

- The "Cadenas Productivas¨(**supply chain)**, a flagship initiative of NAFINSA since 2001, declined in recent years as a number of the, so called, First Order Companies (Large private firms) –with typically very high levels of operations-left it. In part this was due to the surge of similar programs for Microfinance from commercial banks also based on electronic factoring.
- A few years ago, the authorities regulated that entities in the Federal Administration should pay their SMEs suppliers through NAFINA´s "Productive Chains" program. At the end of 2014, 40% of the Federal Procurement Program thus related payments operated through this window.

➢In terms of **microcredit** NAFINSA has several programs: **Entrepreneurs; Financing Program**, **Supporting women microentrepreneurs**, **Comprehensive Modernization Microenterprise**, and the **Business Adheridos** or inscribed to the **Fiscal Regime**. This last program aims at extending the formalization of SMEs. None of these programs involved large amounts of funding, and may serve nearly as pilot, case studies for future operations at a greater scale.

➢NAFINSA has also been a key financial agent in securing funds from international financial organizations and donors in the external capital markets. Recently it floated a Green Bond signaling its return to the world markets, for the first time in 18 years. The rates and contracting fees, however, have and may be subject to critical assessment.

FINANCIAL INCLUSION: NEW EFFORTS

- Nafinsa launched the **"Programa Nacional de Franquicias"** that allows 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 resulted in 1,**627 franchise outlets.**

- Also a program of **investment guarantees was created**, to boost investment in innovation-oriented SMEs or in high value added activities over a period of 3 to 5 years.

- However, despite these initiatives, funds for venture capital have **not reached a significant scale.** The corporate culture, market concentration, and legal framework are not yet sufficiently in tune with such efforts; a pending task for the long term

3. NAFINSA: strengths, weaknesses and future challenges

NAFINSA: STRENGTHS

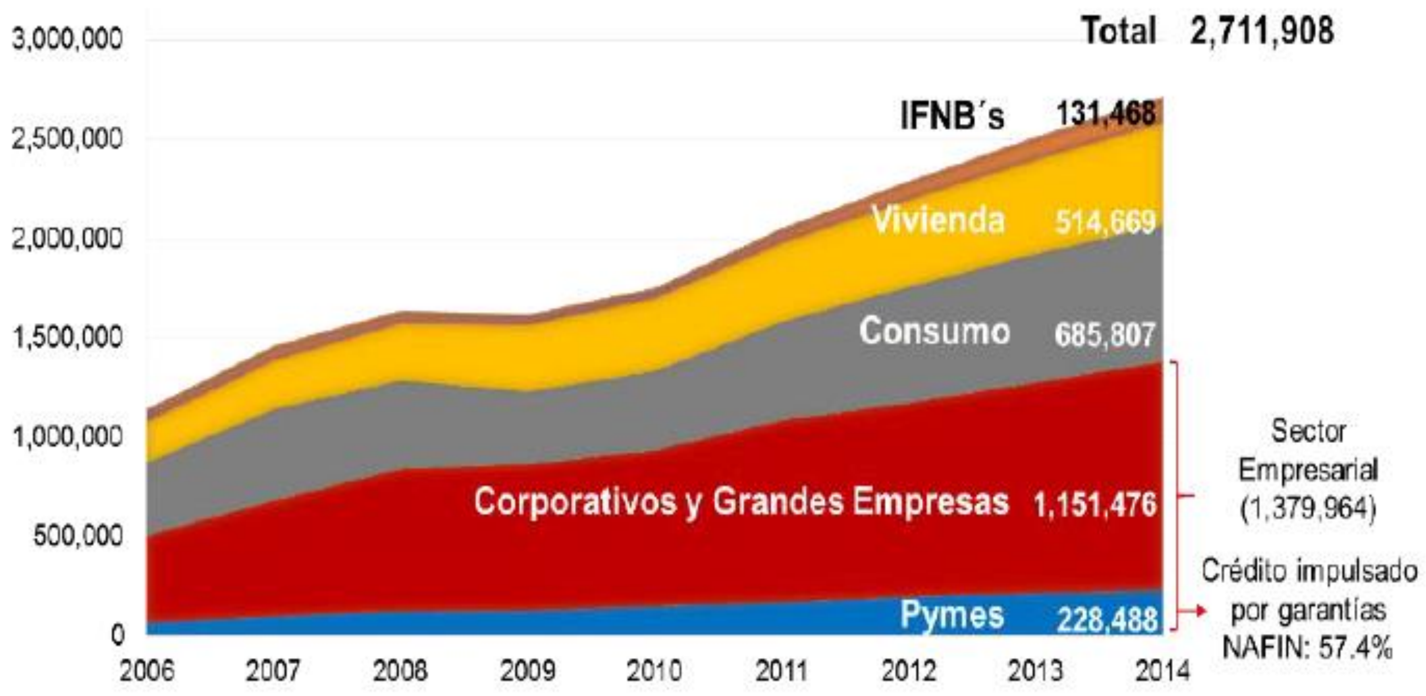
•In its new role, NAFIN has proven to be profitable, compliant with all indicators of sustainability even operating with the same regulations as commercial banks. It adjusted its practices to t**he shift brought about by the market reforms in Mexico** in favor of open markets and the retrenchment of the State in economic affairs.

•NAFIN´s such experience in boosting credit to MSMEs proves that as DB it can play an important (supportive cast)role -in **collaboration with the private commercial banking system- to promote development by compensating for market failures** in financial intermediation, not to mention as a financial agent of the Federal Government.

•But what is its impact on financial and much more on economic development?

BUT LOOK AT THE BIG PICTURE OF NAFINSA´S FINANCIAL SUPPORT TO MSMES. TOO LITTLE BUT INDISPENSABLE?

Credit by the commercial banking system to the private sector (millions of pesos)

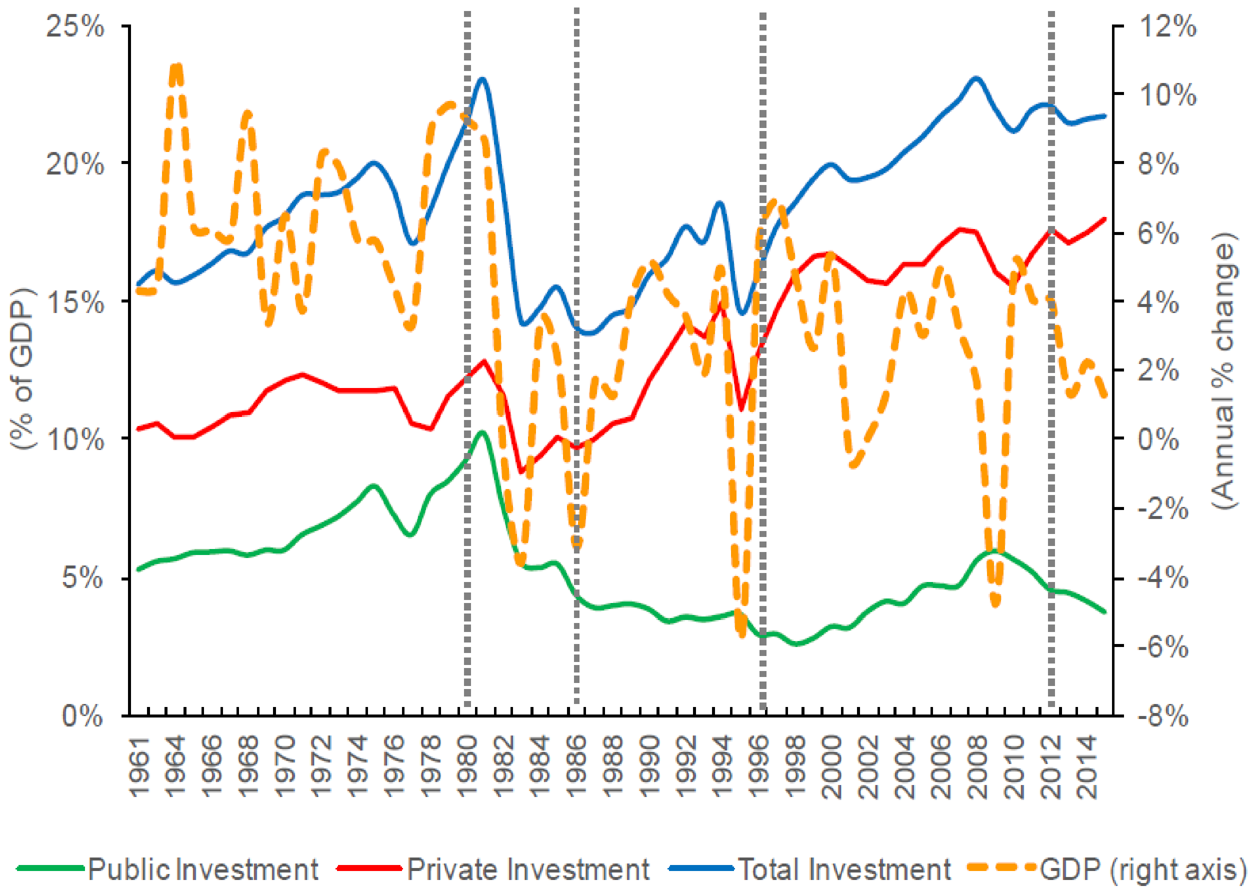


Fuente: BANXICO, Cartera Pymes CNBV

Source ITESM, (2015)

IN AN ECONOMY THAT IS STUCK IN A PATH OF LOW GROWTH AND DECLINING PUBLIC INVESTMENT (IN REAL TERMS)

Graph 1: Economic growth, private and public investment ratios, 1960-2015
(In percent of GDP and annual percent change)



Source Moreno Brid et al (2016)

NAFINSA´s CHALLENGES

•Mexico has a very **low ratio, as a proportion of GDP, of banking loans to private activities (19%).** Its domestic financial market is shallow, highly concentrated and characterized by the exclusion of manmicro, small and medium sized firms, informal, with low technology and few workers.

•More than 90% of firms have no access to loans from the commercial or DB sector. Lack of finance is identified by the business sector as a major obstacle on investment and growth.

•The task ahead of NAFINSA is to boost financial inclusion -not only in availability, cost and opportunity- but also with "better" sectoral orientation and longer term perspective to enhance impact on economic growth. Strengthening countercyclical capacity is a must.

NAFINSA´s -actually Mexico´s- CHALLENGES

•Can NAFINSA, even with the welcome changes introduced by the Financial Reform of 2014, become (again) a key policy instrument for Mexico´s structural transformation conducive to high and long term economic expansión?

•Yes, but not necessary or automatically!

•For this to happen is hard, and many things inside NAFINSA should change. But one key condition beyond NAFINSA´s sphere of action should occur: the Mexican government should consider adopting a new development agenda, different from the current one fully centered in keeping macroeconomic fundamentals (low p, G-T) and reducing/limiting the presence of the State in the economy as necessary and sufficient conditions for economic growth.

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

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Appendix: NAFINSA´s Historical time line

September 15-16, 2016

nacional financiera
Banca de Desarrollo

1934

Emergence of Nacional Financiera (July 2nd).

- Administrator and liquidator of property expropriated during the Revolution.
- Securities Market Development.

1937

Issue of the first financial securities.

1940

Redefined as Development Bank. (New Organic Law).

1941

Starts shareholding companies.

1941

First US Eximbank credit.

1945

Financial Agent of the Federal Government to negotiate foreign credits. (World Bank and Interamerican Development Bank).

1947

Office in Washington is opened.

Acts as Trustee of the Federal Government.

The publication "Mercado de Valores" is issued for the first time.

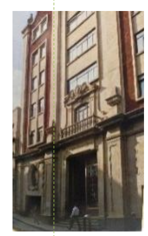
Flagship projects are backed

- Altos Hornos de México
- Fertilizantes de México
- Cementos Apasco
- Celanese Mexicana
- Refinería de Azcapotzalco
- Industria Eléctrica de México
- Cementos Portland
- Cobres de México

1952

Placing Industrial Development Bonds.

1953



1954

The Guarantee and Development Fund for Small and Medium Industry is created.

1956

Industrial certificates are issued.

- Financing large infrastructure projects.
- Main financial support of the public sector and large industry.

Flagship projects supported.

- Diésel Nacional.
- Constructora Nacional de Carros de Ferrocarril.

1961

1967

The National Fund for Studies and Projects (FONEP) is created.

1970

Build-up and mobilization of domestic savings
1934

Development of the Industrial Sector
1940 - 1952

Stabilizing Development
1953 - 1970

nacional financiera
Banca de Desarrollo

1971
National Fund for Industrial Equipment is created (FONEI).

1974
Association with the International Bank (New Organic Law).

1974
Authorized to operate as Commercial Bank, with 15 regional and one urban branches.

1976
Branch opening in Paseo de la Reforma and Representative Office in Tokyo.

1977
First issue of Petrobonos. Offices in New York and London are established. Integration of NAFINSA and International Financial Group.

1978
Integrated Support Program for Small and Medium Industry (PAI). Inauguration of the branch Lindavista.

1982

- Support through development funds.
- New network of regional branches.

Support for large SOE / External funding / Wide Regional Presence
1971 - 1982

1985
Nacional Financiera S.A. becomes Nacional Financiera, Sociedad Nacional de Crédito.

The institution loses 87% of its facilities due to earthquake.

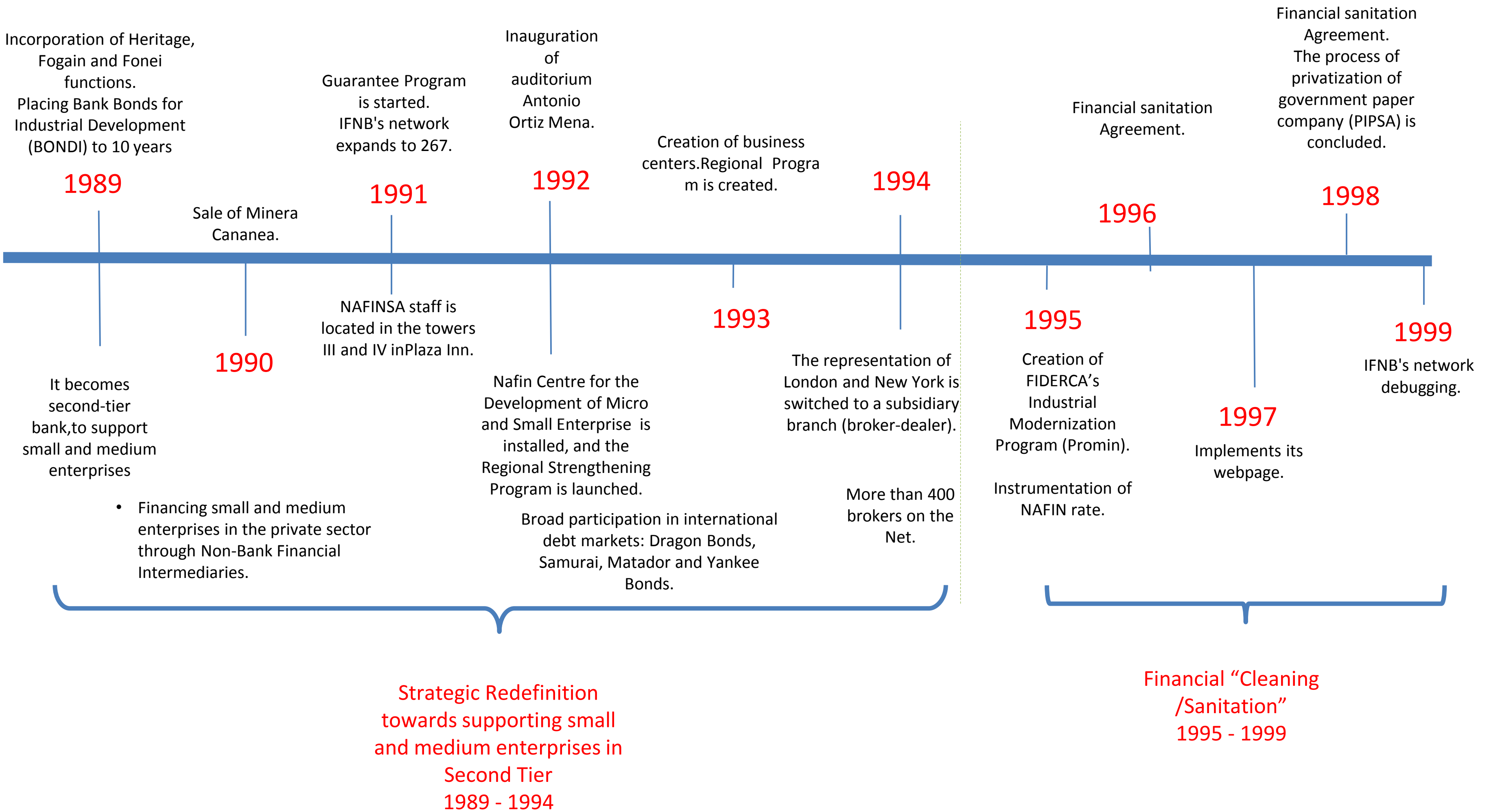
1986
Home Office is changed from Isabel La Católica to Plaza Inn in 1985 due to the earthquake.

1987
The workforce reaches the milestone of 3,678 people.

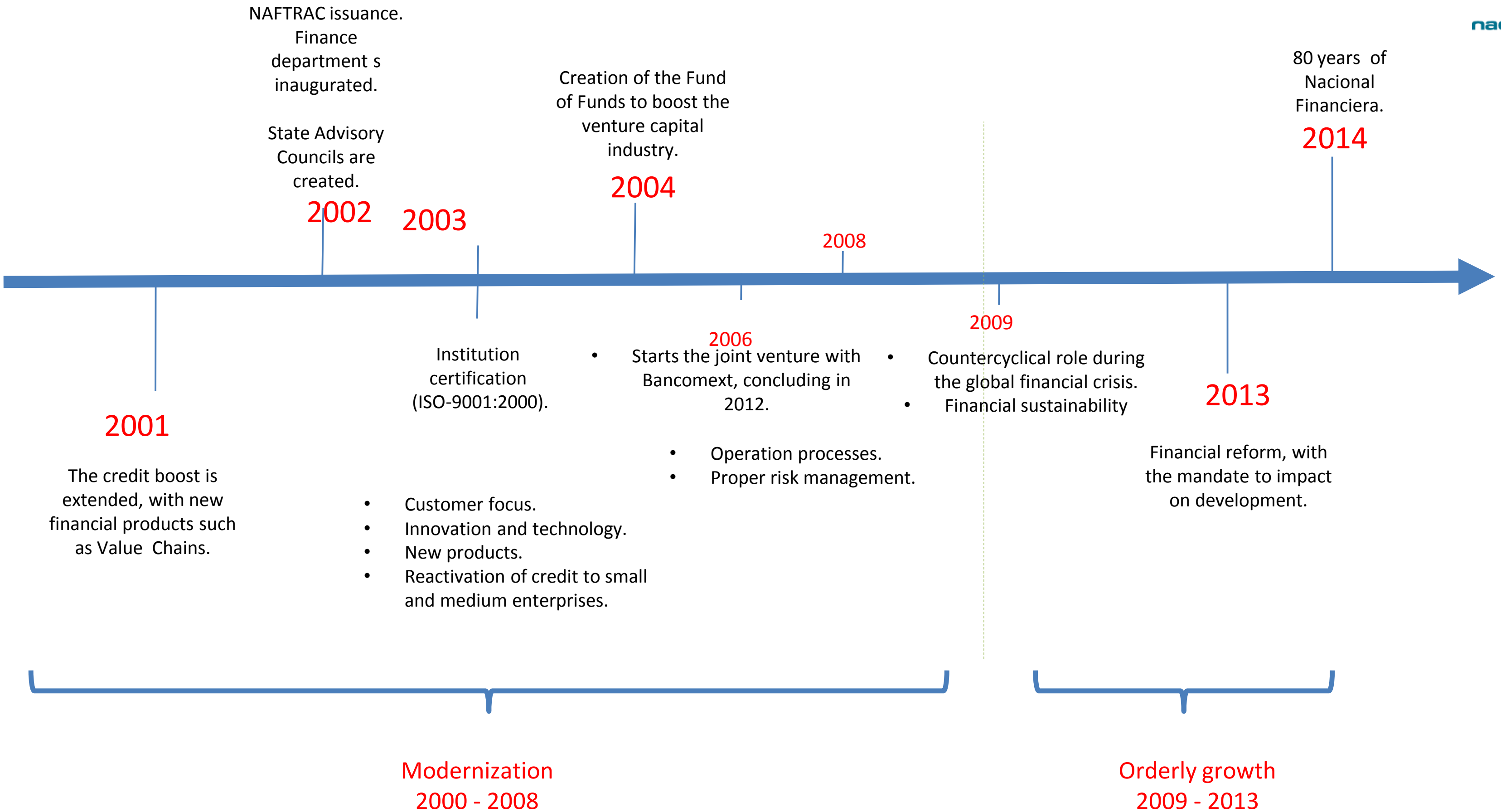
1988
Offices of the Information Center of Nacional Financiera in Plaza Inn are opened.

- Support for the renegotiation and restructuring of public and private external debt of institutions affected by the crisis.
- Stabilization of financial markets.

Economic stabilization / Transition to an open economy model
1983 - 1988


Incorporation of Heritage, Fogain and Fonei functions.
Placing Bank Bonds for Industrial Development (BONDI) to 10 years
1989
It becomes second-tier bank,to support small and medium enterprises
Sale of Minera Cananea.
1990
• Financing small and medium enterprises in the private sector through Non-Bank Financial Intermediaries.
Guarantee Program is started.
IFNB's network expands to 267.
1991
NAFINSA staff is located in the towers III and IV inPlaza Inn.
Inauguration of auditorium Antonio Ortiz Mena.
1992
Nafin Centre for the Development of Micro and Small Enterprise is installed, and the Regional Strengthening Program is launched.
Broad participation in international debt markets: Dragon Bonds, Samurai, Matador and Yankee Bonds.
Creation of business centers.Regional Progra m is created.
1993
1994
The representation of London and New York is switched to a subsidiary branch (broker-dealer).
More than 400 brokers on the Net.
1995
Creation of FIDERCA's Industrial Modernization Program (Promin).
Instrumentation of NAFIN rate.
Financial sanitation Agreement.
1996
1997
Implements its webpage.
Financial sanitation Agreement.
The process of privatization of government paper company (PIPSA) is concluded.
1998
1999
IFNB's network debugging.
Strategic Redefinition towards supporting small and medium enterprises in Second Tier
1989 - 1994
Financial "Cleaning /Sanitation"
1995 - 1999

nacional financiera
Banca de Desarrollo



- La existencia de un sistema financiero que funcione eficientemente es una condición necesaria para promover el desarrollo económico; sin embargo, existen fallas en los mercados financieros.
- Stiglitz identifica 7 fallas: 1) pocos esfuerzos por parte de los participantes en el mercado para monitorear a las instituciones financieras; 2) externalidades generadas por problemas de información asimétrica, como es el no poder diferenciar la calidad crediticia entre dos proyectos; 3) externalidades que se crean por la probabilidad de crisis de una institución; 4) mercados incompletos; 5) competencia imperfecta; 6) mercados competitivamente ineficientes porque su rentabilidad social difiere de la privada; y 7) inversionistas desinformados.