

IIC Annual Report

Inter-American Investment Corporation

To fulfill its mission, the IIC makes direct loans and equity investments and grants lines of credit to local financial intermediaries. It particularly targets small and midsize companies that have difficulty obtaining financing from other sources on reasonable terms. The Corporation also provides fee-based advisory services that complement its core activities.

THE INTER-AMERICAN INVESTMENT CORPORATION (IIC) IS A MULTILATERAL organization. It began operations in 1989 to promote the economic development of its Latin American and Caribbean member countries by financing small and medium-size private enterprise.

To fulfill its mission, the IIC makes direct loans and equity investments and grants lines of credit to local financial intermediaries. It particularly targets small and midsize companies that have difficulty obtaining financing from other sources on reasonable terms.

In a sense, IIC finance is seed money. The Corporation serves as a catalyst for attracting other resources: additional financing, technology, and know-how. These resources are mobilized through cofinancing and syndication, supporting security underwritings, and identifying joint venture partners.

Lending and investing require evaluation of project soundness and probability of success. In this preliminary evaluation process, the IIC advises clients on project design and financial engineering and helps them to structure their financial plan.

As a natural outgrowth of its project financing, the IIC offers fee-based advisory services. These services include counseling private companies on financial engineering and corporate reorganizations and helping member governments to modernize their foreign investment policies and develop capital markets.

To obtain IIC financing, projects must offer profitable investment opportunities. They must also further economic development in some way: by creating jobs, broadening capital ownership, generating net foreign currency income, facilitating the transfer of resources and technology, utilizing local resources, promoting local savings, or promoting the economic integration of Latin America and the Caribbean. Any environmentally sensitive project must include specific preventive or restorative measures.

All the powers of the Corporation are vested in its Board of Governors. The IIC Board of Governors consists of a representative and an alternate from each member country. Voting power is proportional to each country's paid-in shares. The Board of Governors appoints a Board of Executive Directors to which significant authority and powers are delegated.

The Corporation is part of the Inter-American Development Bank Group. The IIC is legally autonomous, and its resources and management are separate from those of the Inter-American Development Bank.

Thirty-five countries are shareholders in the IIC: twenty-four Latin American and Caribbean countries (Argentina, Bahamas, Barbados, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Trinidad and Tobago, Uruguay, Venezuela); eight European countries (Austria, Denmark, France, Germany, Italy, the Netherlands, Spain, Switzerland); and Israel, Japan, and the United States.

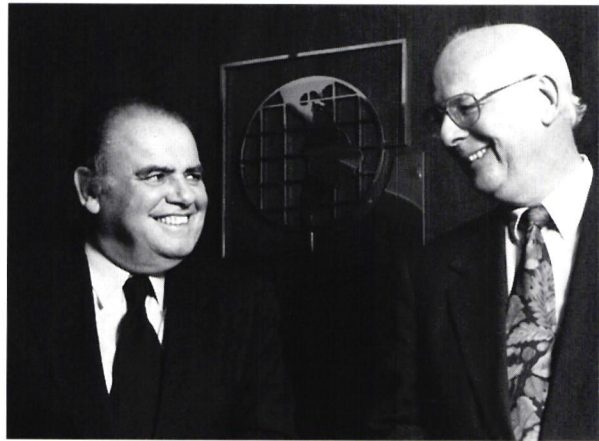
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LETTER OF TRANSMITTAL FROM THE CHAIRMAN OF THE BOARD OF EXECUTIVE DIRECTORS

February 5, 1998
Chairman
Board of Governors
Inter-American Investment Corporation
Washington, D.C.

Mr. Chairman:



From left to right: Enrique V. Iglesias, Chairman of the Board of Executive Directors of the IIC, and John C. Rahming, General Manager, *ad interim*, of the IIC.

Pursuant to Article IV, Section 9(a) of the Agreement Establishing the Inter-American Investment Corporation, I transmit to you the 1997 Annual Report of the Corporation and the audited financial statements, including the balance sheet, a statement of income and retained earnings, and a statement of cash flows for the year ended December 31, 1997.

The Corporation has successfully completed the third and final year of the 1995-1997 action plan drawn up under the guidance of the Board of Directors and approved by the Governors.

I am particularly pleased to note the synergism created within the IDB Group among those units charged with strengthening the region's private sector. These units have drawn on each other's specific expertise to further the specific developmental mandates of each, while helping the IDB Group as a whole to fulfill its broader economic and social goals for Latin America and the Caribbean.

The Inter-American Investment Corporation's Board of Directors, Management, and staff are to be commended for making the Corporation an increasingly valuable member of the IDB Group.

Yours sincerely,

A handwritten signature in dark ink, appearing to read 'E. Iglesias', written over a horizontal line.

Enrique V. Iglesias
Chairman
Board of Executive Directors
Inter-American Investment Corporation

THE YEAR IN REVIEW

THE CORPORATION

In March 1995 the Inter-American Investment Corporation's member countries gave the institution clear instructions for the three-year period then beginning. At its Annual Meeting held in Jerusalem, the Board of Governors approved the *Action Plan for the Inter-American Investment Corporation during the 1995–1997 Period and for the Mobilization of Additional Financial Resources*. The plan called for the Corporation to leverage and improve the return on its limited resources while continuing to comply with its developmental mandate.

The action plan called for the Corporation to seek an adequate balance between its own profitability and the developmental impact of its operations. It also urged the Corporation to make more equity investments. Lending operations in A and B countries were to target companies with solid prospects for cofinancing. In C and D countries, the preferred borrowers were to be small and medium-size companies with no alternative sources of long-term funding. The Corporation was also asked to step up cofinancing activities to achieve a greater multiplier effect; provide more advisory services, both to private sector equity funds and to other IDB Group members; increase its physical presence in its target region; and work more closely with the different arms of the IDB Group that provide support for the private sector. The plan also called for the Corporation to seek new member countries from among IDB member countries and to submit to the Board of Governors no later than January 1998 a proposal for a general increase in resources.

These goals have guided the IIC's operations during the past three years. I am happy to report that the Corporation has ful-

filled all of them. It has reported a profit in all three years. Equity investments accounted for 45 percent of total operations over the three-year period covered by the plan. IIC participation in developmental investment funds, which provide excellent leverage for the limited resources that the Corporation can use for equity investing, has increased from seven funds at the end of 1994 to twenty-three at the end of 1997. Eighty-five million dollars of IIC resources has gone to investment funds that have a total capitalization of \$1.2 billion—a 14:1 leverage ratio. A and B country lending amounted to \$159 million, while C and D country lending totaled \$41 million. Cofinancing commitments increased sevenfold, from a total of \$55 million during 1989–1994 to \$409 million by the end of 1997. During the action plan period, the IIC obtained commitments from twenty-eight banks to provide \$280 million. It participated in an advisory capacity in thirty-one MIF projects and three IDB Private Sector Department projects. IIC officers sit on the IDB Loan Committee for Private Sector Projects, and IIC coordinators are members of the IDB Credit Review Group.

Also in compliance with the action plan, the Corporation established a field presence in Uruguay in 1996 to take charge of supervising most of the IIC's portfolio in Argentina, Bolivia, Brazil, Chile, Paraguay, and Uruguay. In early 1997 the Corporation transferred a member of its staff to Colombia to supervise and identify projects in Colombia, Ecuador, Peru, and Venezuela. These two regional presences, together with the one established in Costa Rica in 1992, have already paid off in more cost-effective monitoring of the Corporation's loan and equity portfolio and are allowing

the IIC to forge closer links with the region.

The Corporation also met the Governors' request to seek new member countries and initiate the process for requesting a general increase in resources. Denmark formally joined the IIC in a July 1997 signing ceremony held in Washington. Discussions are under way with six other IDB member countries that have shown an interest in becoming members of the IIC. In the third quarter of 1997, the Corporation's management submitted to the Governors the initial documents calling for an increase in the institution's available resources. Discussion has begun on the need for an increase in resources and will continue into 1998.

FISCAL 1997

In 1997 the IIC's Board of Directors approved twenty-five projects in eleven countries totaling \$150 million. Forty percent of the funds approved were for equity investments and 60 percent for loans. Seven of the equity investments went to developmentally oriented country or regional investment funds, providing a 14:1 leverage of the IIC's equity investments for the year. Four of the loans were cofinanced; these operations used \$33 million of the Corporation's own resources to mobilize a total of \$25 million in funding from banks and other third parties.

IIC income from all sources in 1997 amounted to \$33.6 million. Total expenses, including \$13.7 million in provisions, were \$31.4 million, producing a net profit of \$2.1 million. Income from lending operations totaled \$20.1 million (\$19 million from interest and \$1.1 million from fees). Capital gains and dividend income from the equity investment portfolio amounted to \$4.9 million. Administrative expenses for the year were \$12.1 million.

Multilateral Investment Fund

The Multilateral Investment Fund (MIF) was established in 1992 to promote the economic and social viability of market

economies in Latin America and the Caribbean. The MIF is administered by the IDB. In 1997 the Corporation carried out eleven advisory assignments for the MIF.

AIG-GE Capital Corporation Latin America Infrastructure Fund

The IIC provided advisory services to the Emerging Markets Partnership for eleven projects in the power, telecom, and transportation sectors. The partnership set up a one-billion-dollar fund to invest in infrastructure projects in Latin America.



From left to right: Moeen A. Qureshi, EMP Chairman, and John C. Rahming, General Manager, *ad interim*, of the IIC.

Other Developments

- The Executive Directors of the Corporation approved the use of the leverage increase previously agreed to by its member countries. In October, the Inter-American Development Bank approved a \$300 million loan to the IIC that will be used to respond to the credit needs of small and medium-size businesses in the region.
- The IIC compiled *SMEStat*, a database on small and medium-size enterprises in Latin America and the Caribbean. The database contains country-by-country figures on SME employment, manufacturing output, and export growth rates.
- The Brazilian business magazine *Exame* named Fábrica de Papel Santa Therezinha S.A. (SANTHER) Brazil's best paper and cellulose manufacturer for 1997 based on its 1996 performance. SANTHER ranked at or near the top of its sector in such areas as profitability, growth, and sales per employee. The IIC approved an \$8 million loan to SANTHER in 1993.

THE REGION

The economic landscape of Latin America and the Caribbean is changing. The region-wide average rate of inflation has plummeted from 1,500 percent in 1990 to less than 10 percent in 1997. Average GDP growth was a solid 5.2 percent in 1997.

This turnaround is due to steadfast efforts on the part of the region's governments to impose fiscal discipline; improve resource management; implement tax reforms; sell off state-owned enterprises or assets that would be more productive in private hands; and ease controls, subsidies, and licensing requirements. Prices and interest rates have been deregulated, trade barriers have been lowered, and exchange rates have been stabilized. Export performance has improved. Growth in the agribusiness sector is picking up, and industrial production is recovering after the downturn of the eighties. The mining sector is thriving, while transportation and communications infrastructure has improved and the restructured financial services sector supports faster economic growth. With continued economic growth, capital flows are expected to increase.

One result of the overall economic improvement of the region has been a surge in savings, investment, and production. Private investment as a percentage of GDP has increased significantly, displacing public sector investment. Private investment opportunities abound in such sectors as food and beverage production, mining, infrastructure, banking, telecommunications, and energy—all areas that are essential building blocks for sustainable growth and improved standards of living.

Another result has been greater economic stability in the face of crises in other parts of the world. The world's economies are so intertwined that problems in one region are obviously cause for concern elsewhere. But the improved economic fundamentals of Latin America and the Caribbean have made the region better



Denmark became the thirty-fifth member country of the Inter-American Investment Corporation at a July 1997 signing ceremony held at the Inter-American Development Bank headquarters in Washington, D.C. The document was signed by IDB President and Chairman of the Board of the IIC Enrique V. Iglesias (center) and Minister Sven Boje Madsen, Denmark's Chargé d'Affaires in the United States (left). IIC General Manager *ad interim* John C. Rahming (right) was also present at the ceremony.

Denmark, which is a leading donor country in terms of percentage of gross domestic product earmarked for development assistance, is the Corporation's first new member country since the Agreement Establishing the Inter-American Investment Corporation was signed in 1986.

prepared to weather the ripple effects of problems such as the stock market turmoil that some countries experienced in late 1997.

However, to achieve sustained investment and growth as well as help protect the region from spillover economic instability, the private investment climate must be improved even further. More capital resources are needed, and private investment in infrastructure projects must supplement public sector investment. Particular attention must be paid to the funding needs of the region's small and medium-size enterprises. Despite current economic improvement, these enterprises still run into difficulties in obtaining financing—particularly equity financing.

Uneven Progress

Notwithstanding the large flows of international capital currently finding their way to Latin America, there are financing requirements that are going unmet. The economic adjustment process has generated an enormous demand for financing, and the uneven distribution of that financing might hamper development in some countries and sectors. Only a few Latin American and Caribbean countries have managed to tap international financial markets. For small and medium-scale enterprises, private financing will, in all likelihood, be limited to short-term trade finance loans, even in the more stable countries. Financial resources for Latin American and Caribbean countries from such traditional external sources as multilateral institutions, institutional investors, and direct foreign investment will fall short of the region's requirements because of increased competition for these funds from other emerging markets. With few significant exceptions, the countries of the region lack solid capital markets capable of meeting the demand for resources.

Despite the burgeoning flow of direct and institutional investment, private equity participation in the long-term financing of small and medium-size companies is still at low levels. To realize their full potential, such enterprises increasingly require equity capital, loans on reasonable terms, and assistance in developing efficient production, marketing, and financial strategies. If the renewed surge in growth is to be sustainable, the region needs private investment that is willing to commit for the long term. The IIC will continue to help provide and catalyze those investment flows while shaping their developmental impact.

LOOKING AHEAD

The Inter-American Investment Corporation faces quite a challenge as it enters its ninth full year of operations. It must adapt to meet the changing needs and realities of its target market, both to take advantage of


the surge in investment opportunities and to help ensure that the region's economic turnaround is sustainable and equitable. It must also carefully husband its limited financial resources in view of the prolonged lag between approval of any general increase in resources and actual payment.

Adapting means reviewing loan pricing policies and product mix in response to rapidly changing market conditions. Ensuring sustainable and equitable economic growth means seeking maximum developmental impact, guarding against the speculative nature of investing in emerging markets, and finding ways to channel funds to countries and sectors that are not benefiting from the economic upturn. And husbanding the Corporation's limited financial resources means seeking the greatest possible multiplier effect by stepping up cofinancing operations. It will also mean making fewer equity investments because the resources that the Corporation can use to make them are limited and can only be replenished by reflows from the sale of maturing investments until a capital increase is approved and paid in.

Over the coming years, the IIC's management will work closely with the Board of Directors and the Board of Governors to set a course for the Corporation aimed at achieving all of these goals.



John C. Rahming
IIC General Manager, *ad interim*



Developmental
Investment
Activities

DEVELOPMENTAL INVESTMENT ACTIVITIES

THE IIC'S DEVELOPMENTAL FINANCING PROGRAM TARGETS SMALL AND MEDIUM-size private companies in Latin America and the Caribbean that have limited access to sources of equity capital or commercial credit.

IIC loans are denominated in United States dollars. Loan amounts may be up to 33 percent of the cost of a new project or up to 50 percent of the cost of an expansion project. Loan repayment periods generally range from five to eight years (with a maximum of twelve years) including an appropriate grace period. The loans, which are priced in keeping with international market conditions, are variable in rate, based on LIBOR. In certain cases, the IIC may provide convertible, subordinated, or participated loans.

The IIC also makes equity investments of up to 33 percent of the investee company's capital. At the end of the investment period, the IIC sells its shareholding. Possible exit mechanisms include sale on the local stock market, private placement with interested third parties, and sale to the project sponsors under a prenegotiated put option agreement.

Sixteen of the operations described below include loans totaling \$90 million; eleven include equity investments totaling \$59 million. The year's four cofinanced loans will mobilize an additional \$51 million in funding, and the seven investment funds in which the IIC acquired an equity participation will further leverage the resources available for the region's small and medium-size companies. The total cost of the projects that will directly or indirectly receive funding as a result of the operations approved by the IIC in 1997 is \$975 million.

Committed Portfolio, Cumulative as of 12/31/97

Millions of US\$



Regional

THE RECENT MACROECONOMIC PERFORMANCE OF LATIN AMERICA IS SPURRING economic growth and lowering inflation. Government reforms are opening the door to increased savings and insurance sales to the region's growing population. And as per capita income increases, so does the demand for insurance products—among other reasons, as a way to channel savings. There is also a spillover effect in which increased financial resources devoted to insurance protection are channeled to the region's capital markets. The insurance business is starting to consolidate, and small and medium-size insurance companies will have to develop new products to carve market niches and be able to compete with larger, stronger companies. Supporting the development of the insurance industry in Latin America and the Caribbean will thus increase the savings available to the economies of the region while contributing to the strengthening and deepening of the financial markets.

ELDON PANAMERICAN FUND, L.P. is a regional fund with a target capitalization of \$100 million that will invest in private insurance and insurance services companies throughout Latin America and the Caribbean. The fund is sponsored by Eldon Capital Incorporated. As a limited partner, the IIC will make an equity investment of up to \$8 million in the Eldon fund. The Corporation will thus help to strengthen and modernize small and medium-size insurance companies, attract other institutional investors, and facilitate the flow of fresh capital to the region.

The IIC will make a \$5 million equity investment in an eight-year, \$100 million fund sponsored by the FondElec Group that will invest in power, gas, water, wireless communications, and other projects in emerging markets. At least 75 percent of FONDELEC ESSENTIAL SERVICES GROWTH FUND, L.P.'s investments will be in Latin America, where it will seek medium-scale infrastructure projects aimed at improving the range and quality of services that the consumers receive. FondElec will also help its portfolio companies to go public on the local and international stock markets. All of the projects that FondElec finances will have a local partner and will be required to meet the IIC's environmental protection standards. The IIC will not participate in FondElec projects outside Latin America.

The IIC's investment in the fund will constitute a vote of confidence in the region's growth prospects and in the ability of the infrastructure sector to attract private capital. The resources provided by other contributors will enable the IIC to leverage its own investment by as much as 20:1.

Private sector participation in the healthcare industry will increase in Latin America and the Caribbean as governments transfer certain services to private healthcare providers. Factors that will contribute to this trend are the rising GDP per capita and the aging of the populace.

THE LATIN HEALTHCARE FUND, L.P. is an equity fund sponsored by Ascendant Healthcare International and the Global Environment Fund with a target capitalization of \$50 million. It will invest in small and medium-size private companies that develop, own, or operate healthcare service companies in Latin America or the Caribbean. The IIC will invest \$5 million or up to 20 percent of the fund's total capitalization. The fund will provide its investee companies with long-term capital for modernizing, expanding capacity, and delivering better quality services efficiently and profitably. The fund's preferred divestment vehicle will be initial public offerings on the local stock exchanges, thus contributing to the IIC's goal of developing and expanding the local capital markets.

NEWBRIDGE ANDEAN PARTNERS, L.P. is a \$60 million regional fund established by ACON Advisors and NLA NAP Acquisition, L.P. to invest in equity and quasi-equity securities in companies and projects located primarily in the Andean nations of Bolivia, Colombia, Ecuador, Peru, and Venezuela. There are no other funds dedicated specifically to the Andean region. The IIC's \$5 million investment in the Newbridge fund could serve as a catalyst to bring much-needed capital to these countries. In addition, the Overseas Private Investment Corporation has provided a \$100 million loan guarantee to the fund that will increase the fund's leverage capacity and, thus, the multiplier effect sought by the IIC in this type of operation.

The fund will reach some twenty final beneficiaries over its expected life, creating about six hundred jobs, an estimated \$200 million in annual export earnings, and contributing some \$600 million annually to the region's GDP. By participating in the fund, the IIC will also help to provide medium-size companies in the region with the improved management techniques and modern technologies that they need to become more efficient and gain better access to long-term debt financing.

The IIC will contribute up to \$10 million to the formation of an equity fund with a capitalization of \$38 million. **SOUTH AMERICA PRIVATE EQUITY GROWTH FUND COINVESTORS, L.P.** will coinvest in middle-market South American companies with South America Private Equity Fund, L.P., an existing \$180 million fund sponsored by the Overseas Private Investment Corporation. Both funds will be managed by WestSphere Equity Investors, L.P., a partnership formed by a group of investment professionals headquartered in New York. The group, WestSphere Capital Associates, L.P., has offices in Argentina, Chile, Colombia, and Venezuela.

The investment is in line with the IIC's goal of supporting medium-scale enterprises with strong growth potential that need long-term capital for capacity expansion. In addition, the preferred divestment vehicle will be initial public offerings on the region's stock exchanges, thus furthering the IIC's objective of democratizing capital. The fund will reach approximately twenty end beneficiaries over its expected life, creating about 600 jobs and an estimated \$200 million in annual export earnings. It will also contribute about \$600 million annually to the region's GDP.



Argentina

The IIC approved a \$10 million loan to an Argentine company that manufactures non-woven fabric for hygiene products. Up to \$5 million of the loan may be cofinanced by an international commercial bank. DOMINION NONWOVENS SUDAMERICANA S.A. will use the funds to equip a state-of-the-art facility—the first of its kind in South America—that will make spunbond fabric for disposable baby diapers. The new plant's production will substitute the imports that currently account for 15 percent of Argentina's nonwoven fabric consumption. The plant will also export to Brazil.

The \$44.7 million Dominion Nonwovens project will create fifty permanent jobs and one hundred temporary jobs during construction. In addition to providing foreign exchange savings by substituting imports, the project will generate sufficient foreign exchange earnings to pay for the imported equipment and the raw materials that will be sourced internationally during start-up, and to pay off Dominion Nonwovens' foreign-exchange debt.

A \$10 million A loan from the IIC and a \$10 million B loan from international commercial banks mobilized through the IIC's cofinancing program will enable HIDRONIHUIL S.A. to design, build, and operate a 30-megawatt hydroelectric power plant in Argentina's Mendoza Province. The plant will sell power to the local utility company, thus helping to reduce the province's energy gap.

The \$32 million Hidronihuil project is in line with the IDB Group's policies that seek to increase the participation of the pri-

vate sector in the provision of basic services and, in the particular case of utilities, to increase competition. In addition to creating ten direct jobs, the project will benefit local economic agents by generating \$105 million in value-added during the first fourteen years of operations. Furthermore, savings in natural gas consumption should lead to increased exports to neighboring countries amounting to approximately \$43 million. Thus, the IIC will be assisting a sector that is key to Argentina's development and economic growth.



Brazil

One of the IIC's developmental goals involves seeking new ways to provide capital-starved companies in its target region with funding that is otherwise unavailable to them on reasonable terms. A \$10 million bond subscription facility for BANCO CREDIBANCO S.A. will assist small and medium-size Brazilian companies that want to raise funding by issuing dollar-denominated bonds. Such companies would otherwise be unable to issue and place this kind of long-term capital market instrument. The proceeds from the secured bond issues will help the participating companies modernize their businesses and become more competitive internationally.

Alternatively, the \$10 million facility can be used to finance smaller infrastructure projects in public service concessions, including sewage treatment, trash collection, and vehicle inspection. Projects in these areas are in need of financing and can make a marked contribution to preserving and improving the environment.

The IIC approved an investment of up to \$4 million in MG FUNDO MÚTUO DE INVESTIMENTO EM EMPRESAS EMERGENTES, a closed-end private equity investment fund to be established in Minas Gerais. The fund is sponsored by Banco Fator, together with the Federation of Industries of the State of Minas Gerais and Banco BMG. With a target capitalization of 40 million reais (\$37.7 million), the fund will invest in small and medium-size companies in Minas Gerais. By investing in the fund, the IIC will further its own goal of democratizing capital in the region. Not only will the fund's preferred exit mechanism be the local stock markets, but MG-FIEE itself will be among the first emerging company investment funds to be listed on the stock market.

MG Fundo Mútuo de Investimento em Empresas Emergentes is expected to reach some fifteen end beneficiaries over its ten-year life. It will thus create about three hundred jobs, generate \$250 million in export revenue, and contribute about \$250 million to Brazil's GDP.

S.B.G. PARTICIPAÇÕES E EMPREENDIMENTOS S.A., INJEPET EMBALAGENS DA AMAZÔNIA S.A. and INJEPET EMBALAGENS LTDA. will use an \$8 million loan from the IIC to finance a \$26 million plant construction and modernization project. After project completion, Injepet's facilities in São Paulo and Manaus will turn out an additional 135 million preforms and 226 million polyethylene terephthalate (PET) bottles per year for the growing Brazilian carbonated soft drink market.

In addition to generating \$212 million in foreign exchange savings for Brazil, the Injepet project will foster the production and use of PET, which is 100 percent recyclable. And modernizing the Manaus plant, which is located in one of the country's least developed regions, will help stimulate the local economy.



Colombia

Approximately twenty small and medium-size Colombian companies will receive subloans of up to \$750,000 from the proceeds of a \$10 million loan from the IIC to CORPORACIÓN FINANCIERA SANTANDER S.A., a medium-size Colombian financial institution.

Corfisantander, with a diversified ownership of more than three hundred shareholders, will make medium and long-term subloans to companies that need the funds to finance investments in fixed assets and permanent working capital. The beneficiary companies will thus be able to compete more effectively with large local groups or foreign companies that have ready access to similar types of financing. The beneficiaries are expected to create about six hundred jobs in the process, as well as generating more than \$40 million in annual export earnings and contributing more than \$320 million to Colombia's GDP over the eight-year term of the credit facility.

The Corporation approved a \$6 million preferred equity investment in LEASING BOLÍVAR S.A. Leasing Bolívar will use the funds to provide small and medium-size Colombian companies with medium and long-term lease financing. Leasing operations benefit such companies because the security arrangements are simpler and the transaction costs are lower than with conventional bank loans. Leases also make it possible to finance a higher percentage of the capital cost of equipment.

Lending to financial institutions like Leasing Bolívar that provide financing to small and medium-size companies is a cost-

effective way for the IIC to use its resources. Through a single operation the IIC reaches a larger number of end beneficiaries while ensuring that the funds will be channeled according to the Corporation's environmental protection and other guidelines. The purchase of preferred shares in Leasing Bolívar will enable the Corporation to provide medium and long-term funding to more than one hundred small and medium-size companies.

In 1993 the Colombian government awarded **SOCIEDAD PORTUARIA REGIONAL DE CARTAGENA S.A.** a twenty-year concession to manage, operate, and upgrade the port facility in Cartagena. The \$54 million master plan for the facility calls for transforming it from a general cargo port into a container terminal with facilities to handle general cargo as well. The upgraded facility will be able to handle 200,000 containers per year and will have docking for second and third generation vessels with capacities ranging from 1,500 to 3,000 containers per vessel. Upgrading the facility will shorten delivery times, lower freight costs, and make the port more competitive as a Caribbean transshipment center. The upgraded facility will also provide thirty-five additional direct jobs and generate foreign exchange earnings of approximately \$98 million during the first eight years of operations. Local staff will be trained to use state-of-the-art equipment and procedures for handling containers.

The IIC has approved a loan of up to \$8 million for Puerto de Cartagena, which had been unable to obtain reasonable long-term funding for dredging and construction work. The Corporation will thus help the Cartagena facility to continue to be the leader among the four Colombian ports privatized in 1993, thereby contributing to the consolidation of the privatization process.



El Salvador

The IIC will purchase \$2.5 million worth of shares in **BANCO HIPOTECARIO DE EL SALVADOR, S.A.** as part of the latter's privatization process. The sale of the government's 95 percent share of Banco Hipotecario will complete the privatization of state-owned Salvadoran banks that began in 1991. Banco Hipotecario's other shareholders are local cattle-farming and agricultural associations.

The involvement of the IIC as a multi-lateral institution willing to acquire a holding in Banco Hipotecario will have a catalytic effect that will attract other institutional investors and facilitate the flow of direct foreign investment. It will also help to channel funds to agriculture, cattle-farming, and other sectors that lack sufficient financing. Supporting the development of these sectors will have a multiplier effect that will create jobs, increase per capita GDP, and spur import substitution.



Guatemala and Nicaragua

POLYPRODUCTOS DE GUATEMALA, S.A.; RAFLAS Y EMPAQUES DEL ISTMO, S.A.; and MANUFACTURERA CENTROAMERICANA, S.A. are three small companies in two of the IIC's smaller member countries. With a \$3.5 million loan from the IIC these companies will upgrade their equipment, increase production, and enhance their warehousing and exporting capabilities. Once the \$7.12 million project is completed, the companies will export a newly-diversified line of products—jumbo sacks, laminated and valvate sacks, jumbo liners, and shade fabric—to the United States and Canada. The project will generate approximately 190 jobs, split evenly between Guatemala and Nicaragua. Most of them will be skilled jobs requiring the extensive technical training of local workers. The project is also expected to generate a total of \$13 million in foreign exchange for the two countries.



Haiti

A senior loan from the IIC for the lesser of \$1 million or 50 percent of the new loans granted to A&M INDUSTRIES S.A. will support the backward integration of this assembly operation, transforming it into a manufacturing company. A&M's integrated manufacturing operation will include metal stamping, plastic injection, and compression molding, a fully operational tool and die

shop, and the preexisting assembly business. The company will produce residential and commercial wiring devices for export to U.S. electrical manufacturers. Production will also be sold in the Dominican Republic, Jamaica, Puerto Rico, and Haiti as well as Central and South America. The total cost of the project is estimated at \$4.77 million.

The economic impact in terms of job generation is an important aspect of this project, the Corporation's first in Haiti. Unemployment is a serious problem in Haiti, where A&M expects to create about 388 jobs in its first year of operations. The workers will receive training from technical experts, who will also bring their know-how to the project. And A&M will generate foreign exchange earnings for Haiti on the order of \$10 million during the first five years of operations.



Honduras

The IIC will provide a credit facility of up to \$1.5 million to ZIP CHOLOMA, an industrial park that has become the flagship of the maquila industry in Honduras. Choloma offers a complete package of high-quality services to its clients, complies with high environmental standards, and provides a safe working environment. The credit facility will enable Choloma to expand the industrial space that it built with a 1990 loan from the IIC by adding two industrial shells and building a parking lot for containers. The \$2.65 million project also entails the implementation of various measures that will improve the already careful and diligent management ZIP Choloma applies regarding the environmental aspects of the operation.

The sewage water treatment plant will be expanded and a solid waste incinerator installed.

A total of 10,685 people work at ZIP Choloma, and the expansion will add approximately 1,400 more jobs. The project will generate approximately \$2.8 million in annual hard currency earnings for Honduras. In addition, the companies installed in the new industrial shells will generate \$4.2 million per year because their production will be completely export-oriented.



Mexico

The IIC will become a limited partner of THE BARING MEXICO PRIVATE EQUITY FUND, L.P. by means of a \$5 million subscription in the \$60 million second closing of the fund. The main promoter of the fund is the Baring Private Equity Partners Group, headquartered in London. In addition to the IIC's investment, equity contributions from the fund's other shareholders and international institutional investors will help the fund reach the target set for its second closing. The first closing, at \$20.6 million, took place on May 20, 1996.

The Baring Mexico Private Equity Fund will make investments ranging from \$1 million to \$5 million in small and medium-size Mexican companies. Such companies have few other options for financing operating needs, maintenance, and growth because traditional bank funding has been limited to large, well-capitalized firms in the wake of the country's banking crisis. The fund will invest in ten to fifteen companies throughout Mexico over its ten-year life, creating some 450 jobs, boosting export earnings by \$150 million a year, and

contributing about \$300 million annually to Mexico's GDP.

This project will further the Corporation's goal of democratizing capital because the preferred divestment vehicle will be initial public offerings on the Mexican stock exchange. Moreover, the fund will serve as a pilot program to be replicated in other Latin American countries.



Nicaragua

The IIC will support an innovative financial arrangement for Nicaragua with a \$3.3 million bond purchase facility for BANCO DE CRÉDITO CENTROAMERICANO, S.A. (BANCENTRO). BANCENTRO will issue up to \$10 million in 370-day notes, the proceeds of which will be used to finance loans to growers and processors of agricultural products for domestic consumption and for export. It is expected that most of the bonds will be purchased by private investors from Central America and that the IIC's involvement will attract other banks and foreign investors.

The IIC facility will raise funding for Nicaragua's agriculture sector, which accounts for at least 30 percent of the country's gross domestic product and provides employment for more than one-third of the labor force. It is expected that IIC's bond facility will also lead to \$3 million in annual

export revenues and about \$6 million in yearly contributions to Nicaragua's GDP.

The IIC agreement with BANCENTRO is in line with the IDB Group's goal of promoting innovation in Nicaragua's banking sector, encouraging private savings through commercial banks and capital markets, and developing financing mechanisms for the agricultural sector.

In 1972 an earthquake destroyed 62 percent of the leading-class hotel rooms available in Managua, leaving the city with an inordinately short supply of hotel accommodations in comparison with the rest of Central America. A loan of \$5.1 million to CORPORACIÓN DE INVERSIONES TURÍSTICAS, S.A. from the IIC will help a group of Nicaraguan nationals to build a \$15.5 million, 159-room hotel under the name of Holiday Inn. The hotel will have conference rooms and other facilities designed to attract business travelers and tourists alike. The hotel will be operated as a Holiday Inn franchise under an agreement with Bass International Holdings, NV.

In addition to providing long-term financing that is difficult to obtain in Nicaragua, the Holiday Inn project will make the latest hotel management and operating skills available to Nicaraguan nationals. It will create more than 180 direct jobs and approximately 540 indirect jobs elsewhere in the tourism industry, which is Nicaragua's fourth largest earner of foreign exchange. The project itself is expected to generate \$50.2 million in foreign exchange for the country during the first ten years of operations.

POLYPRODUCTOS DE GUATEMALA, S.A.;
RAFIAS Y EMPAQUES DEL ISTMO, S.A.;
and MANUFACTURERA CENTRO-
AMERICANA, S.A. (See section on
Guatemala above.)



Peru

The IIC will lend \$3 million to and make a \$3 million equity investment in BANCO BANEX. This multiservice bank will use the loan to provide lease financing to small and medium-size Peruvian companies for the purchase of fixed assets and equipment. And the equity investment will enable BANEX to leverage an additional \$30 million or more.

Supporting BANEX will enable the IIC to reach a larger number of private Peruvian companies (approximately twenty) than it could reach directly. In addition, it will help to finance more than one hundred small and medium-size companies through the multiplier effect of its equity investment in BANEX. It is expected that about three hundred jobs will be created as a result of the loan, and many more through the equity component. Through BANEX, the IIC will also be encouraging investment, broadening competition in financial services, and introducing Peruvian businesses and financiers to innovations such as cash-flow-based credit analysis.

After decades of being a leading world producer of sugar, Peru became a net importer in 1981. In 1996, Peru imported 33 percent of the sugar it consumed, despite having enough plant capacity to be self-sufficient.

With a \$4 million loan to and a \$1 million equity investment in **AGROINDUSTRIAS SAN JACINTO S.A.** the IIC will help support the Peruvian government's program for the recovery of the country's sugar industry through private sector investment.

San Jacinto will use the proceeds to finance a \$15.2 million modernization project that will double its plantation acreage and triple its sugar production, thus reducing Peru's dependence on imported sugar. San Jacinto will be only the second of Peru's sugar companies to modernize under the government program, thereby having a significant demonstration effect. Moreover, carrying out the project will help to secure 1,000 jobs at San Jacinto, which would have faced an uncertain future without the capital and long-term financing provided or mobilized by the IIC. The project is also expected to generate a total of \$177 million in foreign exchange.

The \$17.2 million Miraflores Park Plaza Hotel in Lima is a successful eighty-one-room hotel built by **INVERSIONES MALECÓN DE LA RESERVA S.A.** with burdensome financing that would cost close to \$2 million in interest and principal in 1998 alone. The IIC will help to restructure the hotel financially with a \$6.5 million ten-year loan. In so doing, the IIC will support the Peruvian hotel industry as it recovers from years of lack of investment. Lima's existing hotel infrastructure cannot meet the surging demand on the part of business travelers and tourists who enter Peru through its capital city.

The Miraflores Park Plaza is fully owned and operated by Peruvian businesspeople. The IIC loan will thus help a well-run domestic hotel compete with large international chains. The Miraflores employs 140 people and is projected to generate close to \$6 million in foreign exchange revenues annually. Most of its supplies are purchased locally.

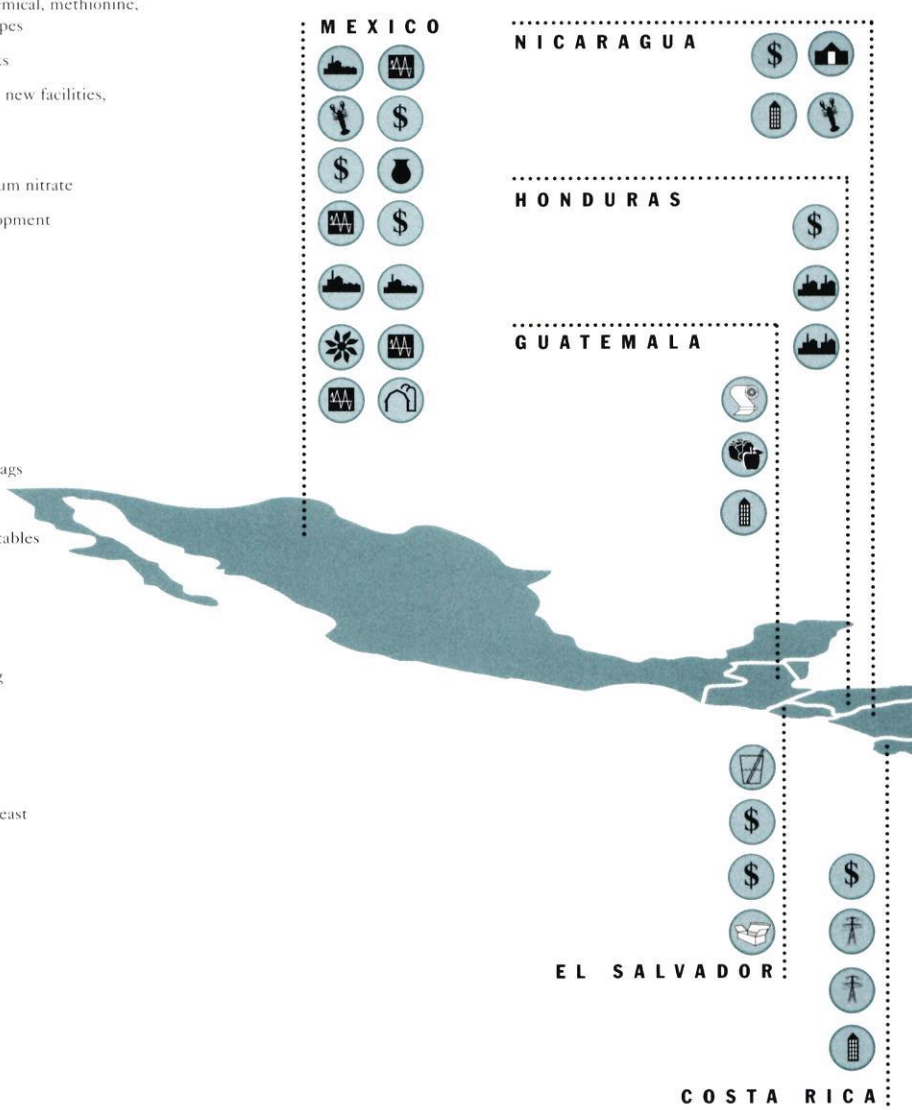


Venezuela

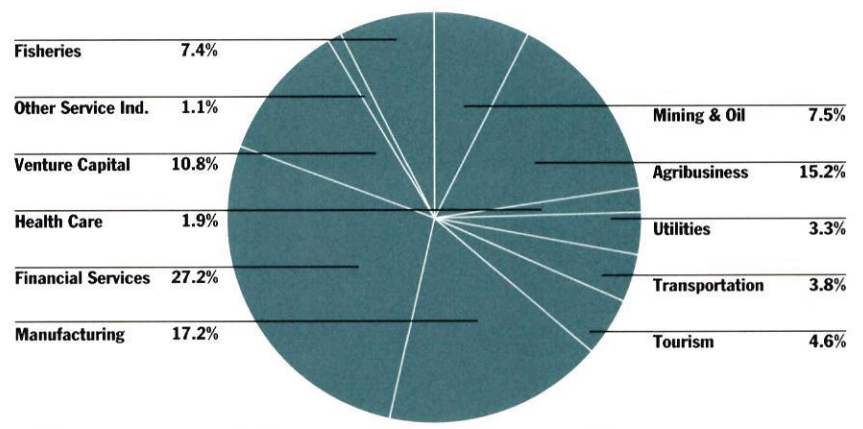
Many Venezuelan companies that had to forgo investments during the country's recent economic crisis have resumed their plans for growth. **INVERSIONES SELVA, C.A.**, a leading manufacturer of disposable plastic products, will use an \$8 million loan from the IIC to increase its production capacity and efficiency. The total cost of the project is \$16.3 million.

The IIC loan will provide a major employer in a small industrial city with long-term U.S.-dollar financing that is extremely difficult to obtain from other sources in Venezuela. The project will provide employment for an additional 200 workers who will be trained by the Swiss, German, U.S., and Italian manufacturers of the equipment that Selva plans to purchase. The company's goal is for exports to account for up to 50 percent of its total sales by 2006, thereby generating \$26.8 million in foreign exchange earnings for Venezuela.

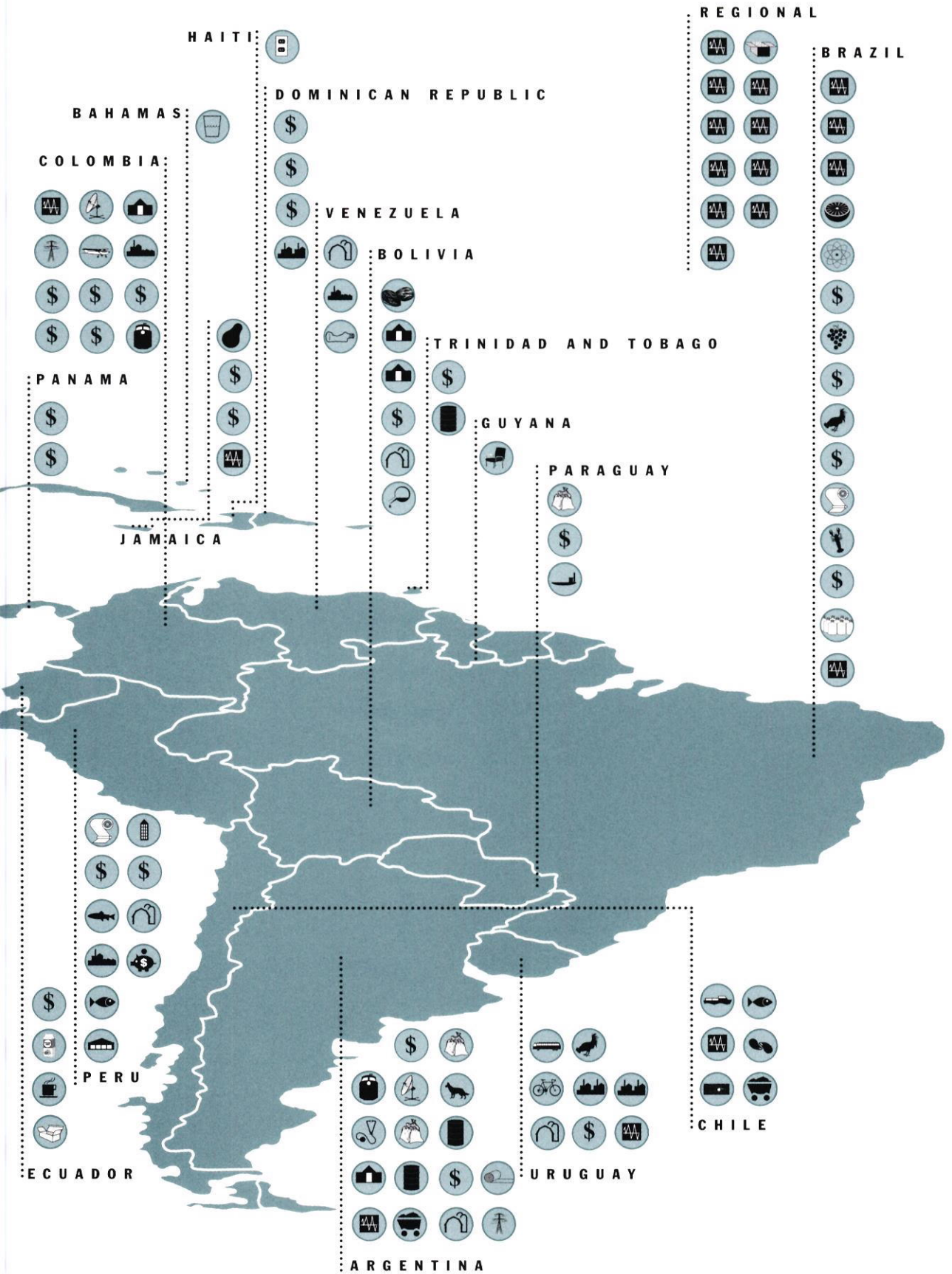
-  Financial services: credit lines to financial intermediaries, leasing companies, and investment banks
-  Venture & joint capital funds: local/regional
-  Industrial businesses: formica, chemical, methionine, zinc, quartz crystals, galvanized pipes
-  Free trade zones & industrial parks
-  Banking & underwriting facilities: new facilities, microenterprise bank
-  Shrimp/lobster farms & producers
-  Mining companies: potash & sodium nitrate
-  Agribusiness & agricultural development
-  Resort & hotel facilities
-  Power plants
-  Satellite communications
-  Cardboard/kraft manufacturing: flexible packaging & corrugated boxes
-  Poultry producers
-  Paper producers: tissue & paper bags
-  Fishmeal processor
-  Freezing facility for fruits & vegetables
-  Mango & papaya farm
-  Furniture factory
-  Bus terminal
-  Bicycle tire & tube manufacturing
-  Private clinic
-  Oil & gas production
-  Port & storage facility
-  Food processing: grains & flour, yeast
-  Biohydrolyzed pet food
-  Sawn & semifinished wood
-  Fishing fleet & fishmeal plant
-  Aquaculture
-  Brazil nuts
-  Boric acid
-  Grape juice
-  Electroerosion machines
-  Orange grower/processor
-  Warehouse service for air cargo
-  Shark fin & tuna products
-  Instant coffee
-  Fruit & juice processing
-  Light aircraft manufacturer
-  Ceramic/porcelain manufacturing
-  Pension fund
-  Flower farm
-  Potable water
-  Noncarbonated beverages
-  Barge transportation
-  Wiring devices
- Disposable plastic products
- Polypropylene packaging
- Bottle production
- Nonwoven textile plant



Approved Active Portfolio by Sector
As of 12/31/97



IIC PROJECT FINANCE ACTIVITIES 1989—1997





Small and
Medium-Size
Enterprises:
Key to
Sustainable
Development

SUSTAINABLE DEVELOPMENT IS THE design and implementation of innovative strategies that strengthen the economy at all levels while protecting the environment and improving the quality of life.

Small and medium-size enterprises (SMEs) can be one of the keys to sustainable development because, while local by

Most of the region's manufacturing enterprises employ fewer than fifty people. In Argentina, Peru, and Venezuela, more than three-fourths of manufacturing companies employ between ten and fifty workers. In Brazil over 70 percent of the enterprises employ between ten and forty-one people. In Colombia, Ecuador, El Salvador, and Panama, two-thirds of the establishments employ between ten and forty-one people.

nature, they are often the most direct link between people and national and global economic systems. SMEs provide a large part of the world's employment, goods and services, and entrepreneurial and investment opportunities. In the United States, for example, small businesses account for approximately 50 percent of private sector output and nearly 40 percent of the gross national product. In the countries of the European Union, SMEs are

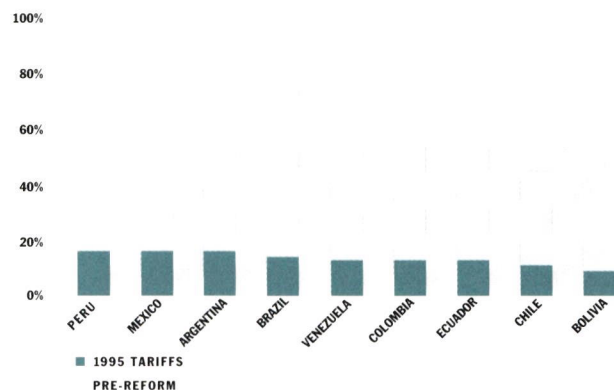
responsible for 66 percent of total employment and 65 percent of business turnover. And in Latin America and the Caribbean they account for more than 90 percent of

the manufacturing enterprises and employ more than one-half of the manufacturing workforce. Fifty-three percent of non-agricultural jobs in this region are created by small and medium enterprises. The region's six million small and medium-size companies account for one-half of its gross domestic product.

Worldwide economic trends are making small and medium-size enterprises an even more weighty factor in the economic equation. In the complex, market-based economic system that is emerging, large—even multinational—manufacturing companies in search of greater flexibility and lower overheads in the face of stiffening competition are purchasing more supplies and services from small, local, and specialized manufacturers. SME exports are increasing with the fall of the tariff barriers that kept them from competing outside their domestic markets. Tariff reductions have made imports accessible to update technology and make production more efficient. The global communications revolution is making it easier for small companies to market their exports throughout the world.

These and other economic, social, and technological changes are sweeping Latin America and the Caribbean as well. These changes represent both a risk and an opportunity for the region's small and medium-size enterprises, which are both vulnerable to change and, with appropriate support,

Latin America's Opening Markets



particularly suited to take advantage of change.

Appropriate support, however, has not always been readily available. Some of the development strategies followed by many Latin American and Caribbean countries during the 1950s and 1960s did not work in favor of SMEs. During those two decades, it was thought to be more important to accelerate industrialization based on large-scale production, capital intensity, import substitution, and modern technology. Larger enterprises that could benefit from economies of scale and higher efficiencies and productivity were promoted as the key to achieving faster economic growth. Small and medium-size firms were neglected as specific targets of government support. The shortcomings of this approach became evident in the 1970s, and support for SMEs reemerged as a way to fuel economic progress, particularly in light of rising unemployment levels and other problems caused by the changing macroeconomic picture.

The region's SMEs need funding and technical assistance to weather change, recover from past policy mistakes, and absorb some of the larger social and economic shocks. National governments and multilateral development institutions like the Inter-American Investment Corporation must support ongoing improvements to make local, market-based funding available to SMEs in Latin America and the Caribbean. And they must provide or mobilize targeted developmental financing in countries or sectors in which it is harder for SMEs to tap the financial markets.

GRASSROOTS ECONOMICS

SMALL AND MEDIUM-SCALE ENTERPRISES are labor-intensive and adaptable. Their overhead costs are usually lower than those of large companies because they have fewer layers of management. SMEs make advantageous use of local production factors, depend less on imports, and foster domestic entrepreneurship. It is now recognized that these characteristics make SMEs particularly important in developing economies as sources of job creation and growth.

By virtue of their numbers alone, small and medium-size companies are widely distributed geographically. The jobs that they create are, thus, local, and they help to counteract the domestic migration of labor to large cities. This helps to reduce the social costs of the overconcentration of labor in a small number of urban centers, the overloading of public services in the cities,

Latin American small and medium-size companies produce more than one-third of the region's manufacturing output and account for 30 percent of total investment in the manufacturing sector. Within the Latin American manufacturing sector, more than two-thirds of the small and medium-size companies turn out such key products as food, textiles, metal products, and chemicals.

Sector distribution of Latin American SMEs in the manufacturing sector

Food, Beverages, and Tobacco	23%
Textile, Apparel, and Leather	18%
Fabricated Metal Products	17%
Chemical Products	13%
Wood Products	8%
Paper Products	8%
Non-Metallic Mineral Products	6%
Basic Metal Industries	2%
Other Manufacturing	5%

SMEs employ nearly one-half of the region's manufacturing labor force, ranging from 67 percent in Panama and Uruguay to 19 percent in Chile. In the wood products industry, SMEs account for 100 percent of employment in El Salvador, Nicaragua, Panama, Paraguay, and Uruguay, and more than 75 percent in Argentina, Brazil, Colombia, Mexico, Peru, and Venezuela.

housing shortages, and the appearance of poverty belts, delinquency, and marginalization in metropolitan areas.

SMEs decentralize economic power, democratize the ownership of goods and the provision of services, and spur competition. Wider distribution of ownership, wealth, entrepreneurial risk, and decision-making makes for a more democratic social

system and lowers the risk of ups and downs in the economic cycle turning into full-blown crises.

PARTNERS IN OPENING MARKETS

Opening a market brings about greater specialization in the production processes and deepens the division of labor in modern economies. This means that large companies increasingly depend on the support of small and medium-size suppliers of parts

and components for the end product. The need for small-scale production, special buildings, and tailored services favors the development of smaller-scale companies.

Without numerous small and medium-size suppliers, large companies could not take advantage of the economies of scale afforded by the division of labor on, say, the assembly lines of durable (automobiles, home appliances) or capital (industrial or farm machinery) goods.

JOB CREATION AND MOBILITY

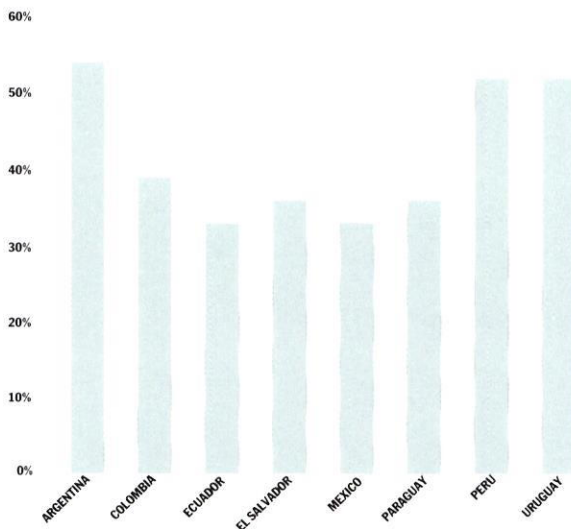
Small and medium-size companies have a lower capital-to-labor ratio: a given amount of capital invested generates more jobs. The higher job creation potential of SMEs is also related to a higher labor share of value added, thus having a positive effect on income distribution. The function of SMEs as job creators is not limited only to the provision of employment opportunities, but also involves creating an environment with greater flexibility for moving from one activity to another.

ENTREPRENEURSHIP AND INNOVATION

Although entrepreneurship is a quality that is not exclusive to small enterprises, such companies provide both a nursery and a

Manufacturing Production

(percentage share of SMEs)



proving ground for the development of new businesses. The successful launch of a small or medium-size company may spur the growth that leads to the establishment of a much larger operation. Even unsuccessful attempts at setting up small businesses can provide valuable training for entrepreneurs who can subsequently be successfully employed by larger companies.

These are some of the ways in which small and medium-size enterprises contribute to economic growth and help to stabilize developing economies. However, despite increasing recognition of their importance, Latin American and Caribbean SMEs do not have access to everything they need to make that contribution.

OBSTACLES IN THE ROAD

The overall economic situation in Latin America and the Caribbean has improved markedly over the past decade. Inflation has fallen from triple-digit rates to an average of less than 10 percent. Interest rates in most countries are falling. There has been a surge of foreign investment in the region.

However, the improvements are not distributed equally among countries, economic

sectors, or companies of varying size, and many obstacles remain.

Long-term debt financing can still be difficult for smaller companies to obtain, especially in the smaller economies and in the less-devel-

oped regions of larger economies. Factors such as perceived risk make most commercial banks reluctant to maintain high levels of long-term—or even medium-term—exposure to SMEs. One of the reasons for such reluctance is the lack of collateral; bank loans often must be secured for 100 percent to 400 percent of their value.

Another reason is the high operational cost of working with SMEs. Other impediments are inadequate financial management capabilities within the SMEs themselves and the lack of professionally audited financial statements.

Not having ready access to affordable financing or long-term capital forces SMEs to resort to expensive short-term debt. Burdensome debt financing limits the growth potential of these enterprises

and makes it difficult or impossible for them to adapt to the new global economy, exploit their competitive advantages, and successfully face increasing international competition in a freer trade environment.

Latin America and the Caribbean have also posted substantial gains in their efforts to build modern states and improve the legal framework governing private enterprise. But the headway made on these reform programs varies from one country to another. Small and medium-size companies in the region are thus still hindered by

- A complex legal, fiscal, and administrative environment that increases the cost of setting up or expanding a business.
- The lack of efficient capital markets acting as an interface between SMEs that need equity capital and investors willing to provide it. This inhibits the development of fast-growing companies engaged in high-technology activities and innovation that need regular injections of equity capital.
- Lack of access to global or regional market intelligence, while facing further barriers to internationalization due to limited capital, lack of specialized human resources, and difficulties in identifying partners.
- Difficulties in accessing research

Export Growth, 1990–1995

Brazil	12%
Chile	16%
Colombia	14%
Ecuador	16%
El Salvador	18%
Mexico	37%
Nicaragua	30%
Panama	24%
Peru	11%

Small and medium-size enterprises make up 90 percent of Bolivia's manufacturing sector. Seventy-five percent of these companies employ five to fourteen people.

programs and sharing and exploiting research results. In many cases, the business environment is not conducive to the devel-

In Argentina, SMEs dominate all manufacturing sectors, particularly wood and metal products, and account for two-thirds of manufacturing employment. SMEs contribute over half of Argentina's gross manufacturing output.

opment of new-technology-based firms due to the lack of sufficient risk capital, the existence of regulatory barriers, and a lower propensity to take risks.

■ Rigid labor legislation and high non-wage labor costs,

which can jeopardize the viability of SMEs and their capacity to effectively respond to changing market conditions, while also discouraging new employment.

OVERCOMING THE OBSTACLES

Some of the strategies that are helping individual SMEs to survive and prosper in the new economic environment include utilizing the comparative advantages of the specific country or enterprise; establishing strategic alliances with foreign companies as borders become less significant and foreign

competition increases; adapting foreign technologies and developing domestic technology; making export-oriented investments both in physical

The source for all data in this section on small and medium-size enterprise in the region is the SMEStat database compiled by the IIC.

infrastructure and in machinery; and improving labor relations.

THE BIGGER PICTURE

THE ROLE OF FINANCIAL INSTITUTIONS

The dissemination of new techniques for evaluating small projects and the specialization of financial institutions are essential if SME investment projects and international expansion plans are to be evaluated appropriately. The introduction of company credit rating systems and the specialization of companies in the evaluation of credit risk could lower financial institutions' portfolio provisioning requirements.

Diversifying financial instruments by developing nontraditional financial products such as leasing, factoring, new supplier financing formulas, risk capital, and cofinancing, would provide SMEs with more flexible access to funding. Special attention should be paid to the financing of investment via long-term loans or capital contributions, which are not generally available to SMEs. Such operations require greater specialization on the part of financial institutions. A particular goal should be to foster access to capital for creating new companies, undertaking expansion projects, or launching innovative ideas such as tapping domestic savings through domestic institutional investors and attracting foreign investors.

Institutions should seek new ways to secure loans to SMEs. There are different vehicles and models that have been used both in Latin America and elsewhere. Chief among these are collective security arrangements and private credit insurance, which should be explored in greater detail and adapted to the specific conditions in each country. Making financing more easily available to SMEs also requires helping them to ascertain their own financial needs and present them in the form of viable financial plans.

A strategic reorientation of developmental funding for SMEs requires taking a long-term view, reconsidering attitudes toward small enterprises, and developing comprehensive financing strategies. Technical consultancies—for example, production engineering and technology, quality control, cost accounting, management, and marketing—should be made available to the smaller enterprises that cannot usually afford them. Bank associations could contribute to this effort with financial and technical support.

THE ROLE OF MULTILATERAL DEVELOPMENT ORGANIZATIONS

Multilateral development organizations in general and the IDB Group in particular can further the region's progress by providing funding for and advice in

- Removing legal, economic, and bureaucratic obstacles that stand in the way of private investment or higher competitiveness or severely skew resource allocation.
- Strengthening public-sector institutions so they can more efficiently and effectively perform their regulatory and oversight functions in the private sector.
- Developing financial sectors that are responsive to the needs of a competitive private sector.
- Upgrading infrastructure and improving public services as a central component of efforts to help private enterprise compete and thereby prosper.
- Strengthening local capital markets and financial institutions to enable them to adapt more easily to demand from savers and investors, and to make them more accessible to small and middle-size companies.

The Inter-American Investment Corporation is uniquely positioned to contribute equity capital and lend to small and medium-size companies without requiring sovereign guarantees. It can thus help to ensure that resources are allocated effectively to small

and midsize businesses on terms that are competitive with alternate institutional financing avenues. The IIC will continue to provide funding, particularly through specialized financial intermediaries or venture capital funds, and in the form of direct support to businesses or projects that entail new products, new technologies, or new markets, and whose risk profile would likely close off other potential sources of capital. The IIC will also offer advisory services in project structuring and financial engineering, and provide investment banking services to mobilize other sources of funding.

Long-term (more than five years) funding for SMEs is still not readily available from local financial institutions or international commercial lenders, especially for greenfield or higher-risk projects. The IIC is therefore examining new financial instruments, such as guarantee mechanisms, revolving lines, and agency lines of credit, to help overcome the shortage of such funding that continues to hinder the development of small and medium-size enterprise in its target market.

Quantifying the SME funding shortfall is hindered by the dearth of comprehensive data on the region's private sector as a whole. According to conservative estimates, however, small and medium-size private industry in the region will need \$17 billion in long-term funding per year between 1997 and 2001. Financial markets in emerging economies are unable to meet such funding requirements. Development institutions like the IIC should therefore provide \$2.5 billion per year to help close the gap. To break the cycle of dependence on debt financing, one-third of this developmental funding—\$830 million per year—should be in the form of new equity. It should be pointed out that these projections are for the industrial sector alone and that the overall funding requirements for the region's small and medium-size companies are doubtless far greater.

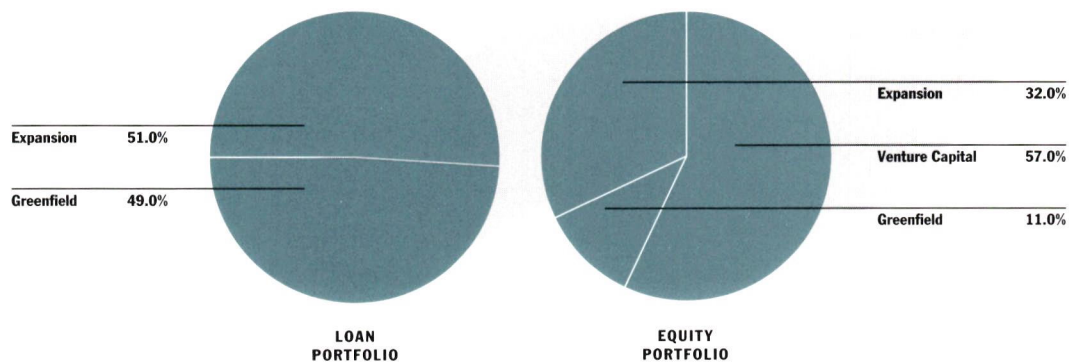
Approvals, Commitments, and Disbursements

(As of December 31, 1997—Millions of US\$)

Country	Number of projects	APPROVALS			COMMITMENTS			DISBURSEMENTS		
		Loan	Equity	Total	Loan	Equity	Total	Loan	Equity	Total
Argentina	22	102.6	10.97	113.6	63.6	8.8	72.4	62.4	8.8	71.2
Bahamas	2	6.0	0.0	6.0	1.0	0.0	1.0	1.0	0.0	1.0
Barbados	1	0.0	4.0	4.0	0.0	0.0	0.0	0.0	0.0	0.0
Bolivia	7	18.1	1.9	20.0	11.8	1.3	13.1	11.8	1.3	13.1
Brazil	16	74.8	18.5	93.3	47.9	16.9	64.8	47.9	12.9	60.9
Chile	9	27.3	15.3	42.7	21.3	9.1	30.5	19.1	9.1	28.2
Colombia	13	51.2	12.9	64.0	27.6	3.5	31.1	26.0	3.5	29.5
Costa Rica	6	27.5	1.5	29.0	20.0	0.5	20.5	20.0	0.5	20.5
Dominican Rep.	4	13.5	0.0	13.5	11.9	0.0	11.9	6.9	0.0	6.9
Ecuador	5	8.0	2.5	10.5	7.0	1.8	8.8	6.9	1.8	8.7
El Salvador	4	4.0	4.5	8.5	4.0	2.0	6.0	4.0	2.0	6.0
Guatemala	5	20.1	0.5	20.6	7.1	0.0	7.1	7.1	0.0	7.1
Guyana	2	3.3	0.0	3.3	0.8	0.0	0.8	0.8	0.0	0.8
Haiti	1	1.0	0.0	1.0	0.0	0.0	0.0	0.0	0.0	0.0
Honduras	5	12.4	1.0	13.4	6.0	0.0	6.0	5.0	0.0	5.0
Jamaica	6	19.3	1.5	20.8	5.6	0.0	5.6	5.6	0.0	5.6
Mexico	17	47.0	24.0	71.0	25.9	15.3	41.2	25.3	10.3	35.6
Nicaragua	5	11.4	1.4	12.8	4.0	0.9	4.9	4.0	0.9	4.9
Panama	2	6.5	0.0	6.5	6.5	0.0	6.5	6.5	0.0	6.5
Paraguay	3	9.5	0.0	9.5	6.7	0.0	6.7	6.7	0.0	6.7
Peru	13	45.5	10.8	56.3	20.9	4.5	25.4	17.9	1.5	19.4
Trinidad & Tobago	3	7.5	2.8	10.3	4.2	0.6	4.8	3.7	0.6	4.3
Uruguay	7	25.1	6.2	31.3	24.8	6.0	30.9	24.9	6.0	30.9
Venezuela	8	31.8	4.7	36.5	7.3	0.0	7.8	7.8	0.0	7.8
Regional	14	3.5	62.0	65.0	3.5	38.0	41.5	0.0	19.1	19.1
TOTAL	180	576.7	187.1	763.8	339.9	109.3	449.2	321.1	78.4	399.5

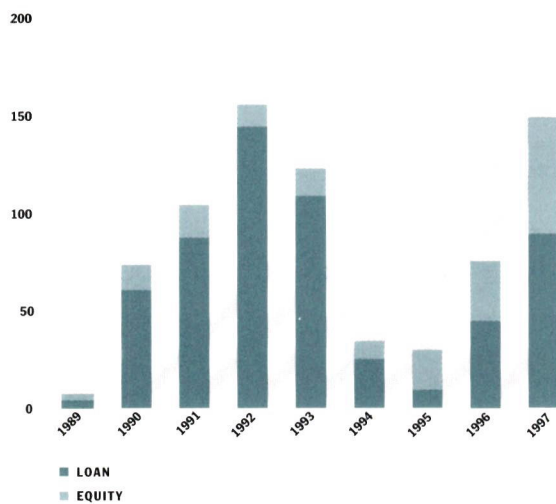
Approved Portfolio

As of December 31, 1997



Loan and Equity Approvals

Millions of US\$



Operations Approved by IIC in 1997

(In millions of US\$)

Country	Sector	Project Cost	IIC Participation			Co-financing	Annual Foreign Exchange Generation	Annual Value-Added	Number of New Jobs	Procurement US\$ millions by Country	Total
			Loan	Equity	Total						
NEW PROJECTS APPROVED											
A&M INDUSTRIES	HT Industry	4.8	1.0	0.0	1.0	—	2.0	3.2	388	US 2.0	2.0
ACCRA BEACH*	BB Tourism	21.7	0.0	4.0	4.0	—	6.3	5.8	480	NA	0.0
BANCENTRO	NI Multipurpose Bank	19.8	3.3	0.0	3.3	—	3.0	6.0	—	NA	0.0
BANCO CREDIBANCO	BR Multipurpose Bank	60.0	10.0	0.0	10.0	—	—	—	—	NA	0.0
BANCO HIPOTECARIO	SV Multipurpose Bank	15.0	0.0	2.5	2.5	—	—	—	—	NA	0.0
BANCO BANEX	PE Multipurpose Bank	36.0	3.0	3.0	6.0	—	6.3	50.0	300	NA	0.0
BARING PRIVATE EQUITY FUND	Venture Capital Fund	50.0	0.0	5.0	5.0	—	150.0	300.0	450	NA	0.0
CORFISANTANDER	CO Develop. Finance	10.0	10.0	0.0	10.0	—	5.0	40.0	600	NA	0.0
DOMINION NONWOVENS	AR Industry	42.3	10.0	0.0	10.0	5.0	24.4	14.7	50	DE 24.4 / IT 3.0	27.4
ELDON PANAMERICAN PARTNERS	Venture Capital Fund	100.0	0.0	8.0	8.0	—	—	—	—	NA	0.0
FONDELEC ESSEENTIAL SERVICES	Venture Capital Fund	100.0	0.0	5.0	5.0	—	20.0	20.0	150	NA	0.0
HIDRONHUIL	AR Energy	32.0	10.0	0.0	10.0	10.0	3.1	7.5	10	AR 8.7 / RU 7.4 / DE 3.0	19.1
HOLIDAY INN	NI Tourism	15.5	5.1	0.0	5.1	—	5.0	9.7	724	NI 0.3 / US 1.0 / MX 0.6 / GT 0.6	2.5
INJEPET	BR Industry	24.0	8.0	0.0	8.0	6.0	21.2	49.0	—	BR 7.4 / FR 4.0 / CA 8.8 / JP 0.8 / MX 1.5	22.5
INVERSIONES SELVA	VE Industry	16.0	8.0	0.0	8.0	—	3.0	7.1	200	DE 1.7 / US 6.2 / IT 1.5 / VE 7.3 / CH 1.0	17.7
LATIN HEALTHCARE FUND	Venture Capital Fund	50.0	0.0	5.0	5.0	—	—	—	—	NA	0.0
LEASING BOLÍVAR	CO Leasing Co.	36.0	0.0	6.0	6.0	—	25.0	200.0	300	NA	0.0
MG-FUNDO MUTUO DE INVERSIÓN	Venture Capital Fund	40.0	0.0	4.0	4.0	—	25.0	25.0	300	NA	0.0
MIRAFLORES PARK PLAZA	PE Tourism	16.4	6.5	0.0	6.5	—	6.0	4.1	560	PE 7.2 / US 7.2	14.4
NEWBRIDGE ANDEAN PARTNERS	Venture Capital Fund	160.0	0.0	5.0	5.0	—	200.0	600.0	600	NA	0.0
POLYPODRUCTOS-MACEN	REG Industry	7.1	3.5	0.0	3.5	—	10.3	7.9	190	TW 3.0 / US 0.8 / GT 0.4 / NI 0.3	4.5
PUERTO DE CARTAGENA	CO Transportation	30.0	8.0	0.0	8.0	—	15.6	13.6	35	CO 10.4 / DE 7.8 / FI 5.8 / US 7.4	31.4
SAN JACINTO	PE Agribusiness	16.0	4.0	1.0	5.0	3.0	6.1	17.7	—	IL 1.0 / US 4.1 / PE 2.0	7.1
SOUTH AMERICAN PRIVATE EQ. F.	Venture Capital Fund	70.0	0.0	10.0	10.0	—	200.0	600.0	600	NA	0.0
ZIP CHOLOMA - II	HN Industrial Parks	2.0	1.5	0.0	1.5	—	4.6	0.4	1,400	HN 2.0 / US 0.2 / CA 0.1	2.3
ADDITIONAL INVESTMENTS IN EXISTING PROJECTS											
BANCO DE GALICIA	AR Multipurpose Bank						27.0				
TOTAL		974.6	91.9	58.5	150.4	51.0	741.9	1,981.7	7,337		150.9
AVERAGE							29.7	79.3	293		

* Withdrawn after approval

Financial Statements

December 31, 1997 and 1996

Report of Independent Accountants

Board of Governors
Inter-American Investment Corporation

In our opinion, the accompanying balance sheets and related statements of income and retained earnings and of cash flows present fairly, in all material respects, the financial position of the Inter-American Investment Corporation at December 31, 1997 and 1996, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Corporation's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

Price Waterhouse LLP

Price Waterhouse LLP
Washington, D.C.
February 5, 1998

INTER-AMERICAN INVESTMENT CORPORATION

Balance Sheets

(Expressed in thousands of United States dollars)

	DECEMBER 31,	
	1997	1996
ASSETS		
CASH AND DUE FROM BANKS.....	\$ 38	\$ 10
MARKETABLE SECURITIES.....	69,602	60,927
LOAN AND EQUITY INVESTMENTS		
Loan Investments.....	207,594	230,469
Less Allowance for Losses.....	(26,041)	(24,018)
	181,553	206,451
Equity Investments.....	58,624	42,145
Less Allowance for Losses.....	(5,354)	(2,941)
	53,270	39,204
Total Investments.....	234,823	245,655
FIXED ASSETS.....	282	336
RECEIVABLES AND OTHER ASSETS.....	6,383	9,145
TOTAL ASSETS.....	\$311,128	\$316,073
LIABILITIES AND EQUITY		
ACCOUNTS PAYABLE.....	\$ 2,290	\$ 2,123
ACCRUED INTEREST AND COMMITMENT FEES.....	246	300
BORROWINGS.....	85,000	95,000
Total Liabilities.....	87,536	97,423
CAPITAL		
Authorized: 20,310 shares (Par value \$10,000)		
Subscribed: 20,310 shares.....	203,100	200,000
Less Subscriptions Receivable.....	(1,550)	—
	201,550	200,000
RETAINED EARNINGS.....	22,042	19,900
UNREALIZED LOSS ON EQUITY INVESTMENT AVAILABLE-FOR-SALE.....	—	(1,250)
Total Equity.....	223,592	218,650
TOTAL LIABILITIES AND EQUITY.....	\$311,128	\$316,073

The accompanying notes are an integral part of these financial statements.

INTER-AMERICAN INVESTMENT CORPORATION

Statements of Income and Retained Earnings

(Expressed in thousands of United States dollars)

	YEARS ENDED DECEMBER 31,	
	1997	1996
INCOME		
Marketable Securities	\$ 4,288	\$ 2,955
Loan Investments		
Interest	19,046	18,087
Commitment Fees	124	125
Front-end Fees	310	97
Other Loan Investment Income	641	754
	<u>20,121</u>	<u>19,063</u>
Equity Investments		
Gain on Sale of Equity Investments	3,976	2,890
Dividends	806	299
Other Equity Investment Income	130	315
	<u>4,912</u>	<u>3,504</u>
Advisory Service, Cofinancing and Other	4,234	2,358
	<u>33,555</u>	<u>27,880</u>
EXPENSES		
Administrative	12,051	10,708
Provision for Loan and Equity Investment Losses	13,676	10,838
Borrowing	5,686	5,326
	<u>31,413</u>	<u>26,872</u>
NET INCOME	2,142	1,008
RETAINED EARNINGS AT BEGINNING OF YEAR	19,900	18,892
RETAINED EARNINGS AT END OF YEAR	<u>\$ 22,042</u>	<u>\$ 19,900</u>

The accompanying notes are an integral part of these financial statements.

INTER-AMERICAN INVESTMENT CORPORATION

Statements of Cash Flows

(Expressed in thousands of United States dollars)

	YEARS ENDED DECEMBER 31,	
	1997	1996
CASH FLOWS FROM INVESTING ACTIVITIES		
Loan and Equity Investments		
Loan Disbursements	\$ (25,707)	\$ (28,036)
Loan Repayments	42,245	31,865
Equity Disbursements.....	(23,398)	(13,032)
Sales of Equity Investments	5,266	3,677
	<u>(1,594)</u>	<u>(5,526)</u>
Purchases of Fixed Assets	(205)	(126)
NET CASH USED IN INVESTING ACTIVITIES.....	(1,799)	(5,652)
CASH FLOWS FROM FINANCING ACTIVITIES		
Borrowings		
Loan Proceeds	—	10,000
Loan Repayments	(10,000)	—
Capital		
Payments of Capital Subscriptions	1,550	481
NET CASH PROVIDED BY FINANCING ACTIVITIES	(8,450)	10,481
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	2,142	1,008
Marketable Securities		
Purchases	(4,725,855)	(2,023,940)
Repayments at Maturity	4,717,126	2,006,809
	<u>(8,729)</u>	<u>(17,131)</u>
Adjustments to reconcile net income to net cash provided by operating activities:		
(Decrease) Increase in accrued interest and commitment fees	(54)	72
Provision for loan and equity investment losses	13,676	10,838
Unrealized loss (gain) on marketable securities.....	54	(72)
Decrease (Increase) in receivables and other assets.....	2,762	(580)
Increase in accounts payable	167	639
Depreciation and amortization expense.....	259	270
	<u>16,864</u>	<u>11,167</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES.....	10,277	(4,956)
NET INCREASE (DECREASE) IN CASH	28	(127)
CASH AT BEGINNING OF YEAR	10	137
CASH AT END OF YEAR.....	<u>\$ 38</u>	<u>\$ 10</u>
SUPPLEMENTAL DISCLOSURES		
Interest paid during the year	\$ 5,694	\$ 5,199

The accompanying notes are an integral part of these financial statements.

Notes to the Financial Statements

December 31, 1997 and 1996

Note A — Significant Accounting Policies

The financial reporting and accounting policies of the Inter-American Investment Corporation (the Corporation) are in conformity with generally accepted accounting principles in the United States. The Corporation conducts its operations only in U.S. dollars. The following is a summary of the significant accounting policies.

USE OF ESTIMATES

The preparation of the financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expense during the reporting period. Actual results could differ from these estimates.

RECLASSIFICATION

Certain reclassifications have been made in the amounts presented for the prior year to conform with the 1997 presentation.

MARKETABLE SECURITIES

The Corporation classifies its liquid investment portfolio as trading, reporting investments at estimated market value and including unrealized, as well as realized, gains and losses in net income.

The Corporation has investment guidelines approved by the Board of Directors that include duration, credit, single issuer, and single country concentration limits.

LOAN AND EQUITY INVESTMENTS

Loan and equity investments are committed when the loan or equity agreement is signed. Loan investments are carried at the principal amounts outstanding. The Corporation's practice is to obtain collateral security such as, but not limited to, mortgages and third party guarantees. Equity investments without a readily determinable market value are carried at cost. Equity investments with a readily determinable market value are carried at market value. See Note C.

Interest and all fees except front-end fees are recognized as income in the periods in which they are earned. Front-end fees are not amortized since the net of these fees is considered immaterial. Incremental direct costs associated with the origination of loan and equity investments are recognized when incurred. They are not capitalized because the net of these costs is considered immaterial.

The Corporation follows the policy of periodically reviewing the collectibility of outstanding receivables for principal, interest, and other charges and establishing an allowance based on that review. The Corporation ceases to accrue income when any loan is in arrears for 90 days or when sufficient doubt exists as to the timely collection of principal or interest; previously accrued and uncollected income is reversed, and income is recorded thereafter only as it is collected.

The Corporation recognizes loan impairment when it is probable that it will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impairment is measured as the excess of the recorded investment in the impaired loan over the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. Once a loan is considered impaired, income is recognized thereafter on a cash basis.

Notes to the Financial Statements

December 31, 1997 and 1996

ALLOWANCE FOR LOSSES

The allowance for losses is maintained at a level that, in management's judgement, is adequate to absorb estimated losses in the loan and equity portfolio. Management's judgement is based on the risk ratings and performance of individual investments, the size and diversity of the Corporation's portfolio, economic conditions, and other factors considered significant by management. The calculation of the allowance for losses includes the use of estimates of collateral values and other potential sources of cash flow. The allowance for losses is established through periodic charges to income. The write-off of investments, as well as subsequent recoveries, are recorded through the allowance account. Management believes the year-end allowance for losses adequately reflects the risk of loss in the Corporation's portfolio.

TRANSFER AND SERVICING OF ASSETS

In fiscal year 1997 the Corporation adopted the Financial Accounting Standards Board (FASB) SFAS 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." Recognition and measurement requirements pertaining to the servicing of cofinanced loans and options embedded in the Corporation's equity investments that allow it to put the investment back to the investee have been analyzed. Given the nature of the servicing and equity agreements, the adoption of SFAS No. 125 had no impact on the Corporation's fiscal year 1997 financial statements.

FIXED ASSETS

Fixed assets are carried at cost less accumulated depreciation. Depreciation is computed and expensed on a straight-line basis over the estimated useful lives of the assets, which range from three to seven years. Developmental costs associated with the development of systems are capitalized and amortized over the useful lives of the systems once placed in service.

OTHER INCOME

Other income includes fees collected for cofinancing activities, administrative commissions, and miscellaneous fees. These fees are recognized as income when received. The Corporation performs advisory services and recognizes these fees in the periods in which they are earned.

Notes to the Financial Statements

December 31, 1997 and 1996

FAIR VALUE OF FINANCIAL INSTRUMENTS

Statement of Financial Accounting Standards No. 107, "Disclosures about Fair Value of Financial Instruments" (SFAS107), requires entities to disclose information about the estimated fair value of their financial instruments, whether or not those values are recognized on the balance sheet. For many of the Corporation's financial instruments it is not practicable to estimate the fair value, and therefore, in accordance with SFAS107, additional disclosures pertinent to estimating the fair value, such as the carrying amount, interest rate, and maturity, are provided.

The following methods and assumptions were used by management in estimating the fair value of the Corporation's financial instruments:

Cash and Due from Banks: The carrying amount reported in the balance sheet approximates fair value.

Marketable Securities: Fair values for marketable securities are based on quoted market prices. See Note B.

Loan Investments: The Corporation provides custom-tailored financing to small and medium-size enterprises operating in its developing member countries. There is no comparable secondary market for these types of loans. For all loans and related commitments, management is of the opinion that due to the Corporation's unique position in its lending operations and the absence of an established secondary market, it is not practicable to estimate a fair value for the Corporation's lending portfolio at this time. See Note C.

Equity Investments: The Corporation purchases the capital stock of small and medium-size private sector enterprises in Latin America and the Caribbean. In most cases, market prices are not available and alternate valuation techniques are not practicable. See Note C.

Borrowings: The carrying amount reported in the balance sheet for borrowings approximates fair value. See Note E.

Note B — Marketable Securities

The Corporation had a \$54,000 unrealized loss at December 31, 1997, and a \$72,000 unrealized gain at December 31, 1996, included in income from marketable securities.

Notes to the Financial Statements

December 31, 1997 and 1996

Note C — Loan and Equity Investments

The Corporation's operations are limited to its twenty-four regional member countries. At December 31, 1997, there was no concentration of credit exposure in any single country. See the Summary of Projects by Country as of December 31, 1997, in Note M.

In accordance with the nonaccrual policy discussed in Note A, loans placed in nonaccrual status at December 31, 1997 and 1996, totaled \$34,242,000 and \$40,077,000, respectively. Allowances for losses against nonaccrual loans at December 31, 1997 and 1996, totaled \$18,114,000 and \$16,100,000, respectively. During the year ended December 31, 1997, two projects were transferred to nonaccrual status, while seven projects were transferred for the same period ended December 31, 1996.

Income reversals for nonaccrual loan investments were \$3,771,000 and \$4,908,000 for the years ended December 31, 1997 and 1996, respectively. Cash collections on reversed income totaled \$1,846,000 and \$974,000 for the same periods resulting in a net income reversal of \$1,925,000 and \$3,934,000 for the years ended December 31, 1997 and 1996, respectively.

Investments approved by the Board of Executive Directors but not signed as investment commitments, and commitments signed for which disbursements have not been made (net of cancellations) are as follows:

	DECEMBER 31, (IN THOUSANDS)	
	1997	1996
Investments Approved but not Committed		
Loan	\$ 84,050	\$ 32,850
Equity	27,150	34,983
Total	\$111,200	\$ 67,833
Investments Committed but not Disbursed		
Loan	\$ 18,809	\$ 20,036
Equity	34,837	15,838
Total	\$ 53,646	\$ 35,874

During 1995, the Corporation obtained control over a company in which it had previously made an equity investment, by purchasing in a public auction all remaining outstanding stock of the company in order to protect the Corporation's financial interest. At the date of acquisition, management decided to dispose of its interests in the company in an orderly manner and has a plan for and reasonable expectation of disposition. As of December 31, 1997 and 1996, all loan and equity investments related to this company have been adjusted to the net realizable value pending sale.

The Corporation's loans accrue interest at one, three, and six-month London Inter-Bank Offered Rate (LIBOR) plus a spread ranging from 2.25% to 5.00% at December 31, 1997. At December 31, 1997 and 1996, the six-month LIBOR was 5.84% and 5.69%, respectively.

INTER-AMERICAN INVESTMENT CORPORATION

Notes to the Financial Statements

December 31, 1997 and 1996

MATURITY STRUCTURE OF LOANS

	DECEMBER 31, (IN THOUSANDS)			
	1997		1996	
	PRINCIPAL OUTSTANDING	AVERAGE SPREAD OVER LIBOR	PRINCIPAL OUTSTANDING	AVERAGE SPREAD OVER LIBOR
Due in one year or less	\$ 63,908	3.54%	\$ 42,711	3.56%
Due after one year through five years	122,194	3.68%	157,472	3.60%
Due after five years through ten years	21,492	3.89%	30,286	3.79%
Total	\$207,594		\$230,469	

The total investment in impaired loans at December 31, 1997 and 1996, totaled \$23,969,000 and \$23,937,000, respectively. Allowances for losses against impaired loans at December 31, 1997 and 1996, totaled \$16,734,000 and \$14,233,000, respectively. The average recorded investment in impaired loans for the years ended December 31, 1997 and 1996, was \$24,302,000 and \$16,146,000, respectively. Loan interest income recognized from impaired loans at December 31, 1997 and 1996, totaled \$641,000 and \$970,000, respectively. Cash collections relate to interest earned in current and prior years.

Activity in the allowance for loan and equity losses was as follows:

	DECEMBER 31, (IN THOUSANDS)			
	LOANS		EQUITY	
	1997	1996	1997	1996
Balance at beginning of year	\$ 24,018	\$16,422	\$ 2,941	\$ 2,702
Investments written off	(5,415)	(1,250)	(2,902)	(1,753)
Recoveries	(923)	—	—	—
Provision for losses	8,361	8,846	5,315	1,992
Balance at end of year	\$ 26,041	\$24,018	\$ 5,354	\$ 2,941

Investments in equity securities that have a readily determinable fair value have been classified as available-for-sale and are recorded at their market value, with unrealized holding gains and losses excluded from earnings for the period and recorded as a separate component of equity. During 1997, the available-for-sale investment held by the Corporation has been adjusted to the net realizable value pending sale. At December 31, 1996, the Corporation held one equity investment in its available-for-sale portfolio with a cost of \$2,849,000 and a market value of \$1,599,000.

Adjustments resulting from the recognition of unrealized holding gains and losses on equity investments classified as available-for-sale consist of the following:

	DECEMBER 31, (IN THOUSANDS)	
	1997	1996
Cumulative Adjustment, beginning of year	\$ (1,250)	\$ 32
Valuation Adjustment for the year	1,250	(1,282)
Cumulative Adjustment, end of year	\$ —	\$ (1,250)

Notes to the Financial Statements

December 31, 1997 and 1996

Note D — Fixed Assets

Fixed assets represent furniture, office equipment, computer hardware and software, and capitalizable systems development costs.

Fixed assets and the related accumulated depreciation and amortization balances are as follows:

	DECEMBER 31, (IN THOUSANDS)	
	1997	1996
Furniture and Office Equipment	\$ 1,030	\$ 1,007
Computer Hardware, Software and Systems Development.....	1,806	1,626
Accumulated Depreciation and Amortization	(2,554)	(2,297)
Total	\$ 282	\$ 336

Unamortized computer software costs of \$77,000 and \$119,000 relating to internally developed computer software are included in fixed assets as of December 31, 1997 and 1996, respectively. Amortization expense on internally developed software of \$58,000 and \$62,000 respectively, is included in results of operations for the years then ended.

Note E — Receivables and Other Assets

Receivables and other assets are summarized below:

	DECEMBER 31, (IN THOUSANDS)	
	1997	1996
Accrued Income on Marketable Securities	\$ 1,268	\$1,315
Accrued Income on Loan Investments	4,492	5,269
Receivable on Equity Sale	—	2,386
Recovered Assets, net.....	600	—
Other	23	175
Total	\$ 6,383	\$9,145

During 1997, the Corporation recovered assets securing a loan investment with an estimated fair value of \$923,000. At December 31, 1997, a valuation allowance of \$323,000 was recorded against recovered assets.

Notes to the Financial Statements

December 31, 1997 and 1996

Note F — Borrowings

Borrowings consist of the following:

	DECEMBER 31, (IN THOUSANDS)	
	1997	1996
Fuji Bank	\$75,000	\$75,000
Deutsche Bank Luxembourg, S.A.	10,000	20,000
	<u>\$85,000</u>	<u>\$95,000</u>

In 1997, the Corporation and the IDB executed a loan agreement allowing the Corporation to borrow up to \$300,000,000 until November 2001. No funds were drawn under this loan agreement during 1997.

The Corporation has an outstanding balance of \$75,000,000 under a credit agreement with Fuji Bank. The loan is fully drawn and accrues interest at a variable rate, which was 6.09% at December 31, 1997, and is payable semiannually. The principal balance of the loan is due in full in 2001.

Under a \$75,000,000 revolving line of credit agreement with Deutsche Bank Luxembourg, S.A. the Corporation had an outstanding balance of \$10,000,000 at December 31, 1997. Interest accrues on the outstanding balance at a variable rate, which was 5.95% at December 31, 1997. Borrowings under the credit agreement are due six months after disbursement and can be renewed. Additionally, the Corporation accrued commitment fees at 0.1% of the average daily unused balance as of December 31, 1997. The Corporation paid Deutsche Bank Luxembourg, S.A. \$40,000 in commitment fees during 1997. The credit agreement terminates in 2000.

The weighted average cost of borrowings during 1997 and 1996 was 5.94% and 5.87%, respectively.

Notes to the Financial Statements

December 31, 1997 and 1996

Note G — Capital

The following table lists the capital stock subscribed and subscriptions receivable for each member country at December 31, 1997 (in thousands):

	CAPITAL STOCK SUBSCRIBED		SUBSCRIPTION RECEIVABLE FROM MEMBERS
	SHARES	AMOUNT	
Argentina	2,327	\$230,270	
Austria.....	100	1,000	
Bahamas.....	43	430	
Barbados	30	300	
Bolivia.....	187	1,870	
Brazil.....	2,327	23,270	
Chile	690	6,900	
Colombia	690	6,900	
Costa Rica.....	94	940	
Denmark	310	3,100	1,550
Dominican Republic	126	1,260	
Ecuador.....	126	1,260	
El Salvador	94	940	
France.....	626	6,260	
Germany.....	626	6,260	
Guatemala	126	1,260	
Guyana.....	36	360	
Haiti	94	940	
Honduras	94	940	
Israel	50	500	
Italy.....	626	6,260	
Jamaica.....	126	1,260	
Japan	626	6,260	
Mexico.....	1,498	14,980	
Netherlands.....	310	3,100	
Nicaragua.....	94	940	
Panama	94	940	
Paraguay	94	940	
Peru.....	420	4,200	
Spain.....	626	6,260	
Switzerland.....	310	3,100	
Trinidad and Tobago.....	94	940	
United States.....	5,100	51,000	
Uruguay	248	2,480	
Venezuela	1,248	12,480	
Total 1997.....	20,310	\$ 203,100	\$1,550
Total 1996.....	20,000	\$200,000	—

Notes to the Financial Statements

December 31, 1997 and 1996

Note H — Participations

The Corporation mobilizes funds from commercial banks and other financial institutions through loan participations, which are sold by the Corporation without recourse but are administered and serviced on behalf of the participants. The Corporation called and disbursed \$36,647,000 and \$97,220,000 of participants' funds during 1997 and 1996, respectively. The undisbursed participants' commitments were \$53,000,000 and \$28,647,000 at December 31, 1997 and 1996, respectively.

Note I — Related Party Transactions

The Corporation is affiliated with the Inter-American Development Bank (IDB). In accordance with a 1995 amendment to the Agreement Establishing the Inter-American Investment Corporation, shareholders of the Corporation are no longer limited to shareholders of the IDB. Historically, not all shareholders of the IDB have been shareholders of the Corporation.

The Corporation obtains some administrative and overhead services from the IDB in those areas where common services can be efficiently provided by the IDB. The Corporation has a lease agreement with the IDB for office space that expires in 2002. Payments for office space may vary based on actual usage.

The Corporation paid the following amounts to the IDB for office space and certain administrative support services:

	DECEMBER 31, (IN THOUSANDS)	
	1997	1996
Office Space.....	\$ 1,049	\$ 741
Support Services.....	613	593
Total	\$ 1,662	\$ 1,334

Accounts payable and accrued expenses due to the IDB were \$62,000 and \$258,000 at December 31, 1997 and 1996, respectively.

In 1997 and 1996, no amounts were outstanding to the IDB under an existing loan agreement. See Note F.

Note J — Retirement Plan

The IDB sponsors a defined benefit retirement plan (the Retirement Plan) covering substantially all of the staff of the Corporation and the IDB. Under the Retirement Plan, benefits are based on years of service and average compensation, with the staff contributing a fixed percentage of remuneration, and the Corporation and the IDB contributing the remainder of the actuarially determined cost of future Retirement Plan benefits. The total contribution is based upon the aggregate funding method. All contributions to the Retirement Plan and all other assets and income held for purposes of the Retirement Plan are separated from the other assets and income of the Corporation and the IDB. They can be used only for the benefit of the Retirement Plan participants and their beneficiaries, until all liabilities to them have been paid or provided for. Information regarding the accumulated benefit obligation and related assets attributable to the Corporation is not maintained. The total allocated expense to the Corporation for the purposes of the Retirement Plan was \$915,000 and \$934,000 for the years ended December 31, 1997 and 1996, respectively.

Notes to the Financial Statements

December 31, 1997 and 1996

Note K — Non-Pension Postretirement Benefits

The Corporation also provides certain health care and other benefits to retirees. All current staff who participate in the Retirement Plan and who meet certain requirements are eligible for these postretirement benefits when they retire under the Retirement Plan.

The Corporation contributes its annual actuarially determined expense to the IDB's Postretirement Benefits Plan (the Plan). The Corporation's portion of total assets is prorated to the Plan based upon the Corporation's funding rate and the rate of return on the assets, net of any payments to employees for postretirement benefits. During 1997, the Corporation funded \$962,000 to the Postretirement Benefits Plan. The following table summarizes the Plan's investments:

	DECEMBER 31, (IN THOUSANDS)			
	1997		1996	
	COST	FAIR VALUE ¹	COST	FAIR VALUE ¹
Common stock fund	\$409,398	\$474,876	\$332,547	\$366,833
Fixed income fund	110,664	112,608	89,433	90,412
Cash and short-term investments.....	5,253	5,253	3,339	4,883
Total.....	\$525,315	\$592,737	\$425,319	\$462,128

¹ Does not include accrued income, accounts receivable and accounts payable in the amount of \$3,499,000 and \$3,016,000 as of December 31, 1997 and 1996, respectively.

As of December 31, 1997 and 1996, \$3,814,000 and \$2,240,000 respectively, of the above assets had been allocated to the Corporation.

The annual actuarial cost for the year ended December 31, 1997, was \$962,000. Future funding contributions to the Postretirement Benefits Plan are projected to equal the annual actuarial cost.

The net periodic postretirement benefits cost includes the following components:

	DECEMBER 31, (IN THOUSANDS)	
	1997	1996
Service cost	\$ 653	\$ 661
Interest cost	334	268
Amortization of unrecognized obligation	587	335
Less: Actual return on Plan assets.....	(612)	(261)
	\$ 962	\$1,003

Notes to the Financial Statements

December 31, 1997 and 1996

Reconciliation of Plan assets based on the December 31, 1997, valuation of the Plan (in thousands):

Obligation at December 31, 1997	
Accumulated postretirement benefits obligation:	
Retirees	\$ 0
Fully eligible active Plan participants	1,532
Other active Plan participants	4,495
	<u>6,027</u>
Plan assets at December 31, 1997	3,814
Accumulated postretirement benefit obligation in excess of Plan assets	(2,213)
Unrecognized items:	
Net transition obligation	2,968
Net actuarial gain	(761)
	<u>(6)</u>
Accrued postretirement benefits cost	(6)

Actuarial gains and losses that exceed 10% of the accumulated postretirement benefit obligation are amortized over the average remaining life of active participants of approximately 14.2 years.

Actuarial assumptions:	
Weighted average assumed discount rate	6.00%
Weighted average expected long-term rate of return	7.25%
Weighted average rate of salary increases	6.00%

For measurement purposes, an initial annual rate of increase in the per capita cost of covered health care benefits ranging from 10.3% to 13.2% was used for those participants assumed to retire in the United States. The rate was assumed to decrease gradually to 6.0% in 2011 and thereafter. For those participants assumed to retire outside of the United States a 13.2% increase was assumed. Increasing the assumed health care cost trend rates by one percentage point would increase the accumulated postretirement benefits obligation as of December 31, 1997, by \$745,000 and the net periodic postretirement benefits cost for the year then ended by \$273,000.

Note L — Restructuring Costs

In 1994, the Board of Executive Directors of the Corporation approved a restructuring plan that resulted in the termination of 16 professional and administrative employees. Termination benefits accrued and charged to 1994 administrative expense as a result of the restructuring aggregated \$1,213,000.

During 1997 and 1996, the actual termination benefits paid and charged against the liability for the 1994 restructuring totaled \$8,000 and \$58,000, respectively. During 1997, the liability for the restructuring was eliminated to reflect expired repatriation benefits.

Notes to the Financial Statements

December 31, 1997 and 1996

Note M — Summary of Projects by Country

The following tables list the outstanding loan and equity investments by country at December 31, 1997 (in thousands):

LOAN INVESTMENTS

MEMBERS IN WHOSE COUNTRY LOANS HAVE BEEN MADE	LOANS APPROVED AND COMMITTED	CANCELED BALANCE	UNDISBURSED BALANCE	REPAYMENTS AND WRITE-OFFS	LOAN INVESTMENTS OUTSTANDING	
					1997	1996
Argentina.....	\$ 63,600	\$ —	\$ 1,248	\$ 12,572	\$ 49,780	\$ 43,696
Bahamas	1,000	—	—	—	1,000	—
Bolivia.....	14,350	2,528	—	8,357	3,465	4,991
Brazil.....	54,800	6,870	—	9,306	38,624	40,360
Chile.....	26,348	5,000	2,275	8,448	10,625	12,321
Colombia.....	28,215	660	1,590	10,653	15,312	19,172
Costa Rica.....	25,000	5,000	—	2,118	17,882	16,988
Dominican Republic.....	13,500	1,580	5,000	2,511	4,409	5,654
Ecuador.....	8,000	1,000	111	4,173	2,716	3,747
El Salvador.....	4,000	—	—	1,092	2,908	3,636
Guatemala.....	14,050	7,000	—	2,349	4,701	4,988
Guyana.....	3,300	2,500	—	236	564	654
Honduras.....	10,900	4,900	991	1,790	3,219	3,759
Jamaica.....	11,700	6,141	—	3,003	2,556	4,650
Mexico.....	30,988	5,113	594	17,268	8,013	13,729
Nicaragua.....	4,000	—	—	1,279	2,721	2,800
Panama.....	6,500	—	—	4,318	2,182	6,227
Paraguay.....	7,000	263	—	1,699	5,038	2,718
Peru.....	23,950	3,050	3,000	6,283	11,617	14,778
Regional.....	3,500	—	3,500	—	—	—
Trinidad & Tobago.....	5,000	783	500	1,717	2,000	—
Uruguay.....	24,937	97	—	13,383	11,457	19,312
Venezuela.....	13,750	6,000	—	417	7,333	7,333
Less the effect of restructured interest....	—	—	—	—	(528)	(1,044)
TOTAL 1997.....	\$398,388	\$58,485	\$18,809	\$112,972	\$207,594	
TOTAL 1996.....	\$365,733	\$50,309	\$20,036	\$63,875		\$230,469

INTER-AMERICAN INVESTMENT CORPORATION

Notes to the Financial Statements

December 31, 1997 and 1996

EQUITY INVESTMENTS

MEMBERS IN WHOSE COUNTRY EQUITY HAS BEEN INVESTED	EQUITY APPROVED AND COMMITTED	CANCELED BALANCE	UNDISBURSED BALANCE	SALES AND WRITE-OFFS	EQUITY INVESTMENTS OUTSTANDING	
					1997	1996
Argentina	\$ 8,872	\$ 74	\$ —	\$ 2,370	\$ 6,428	\$ 7,426
Bolivia.....	1,925	600	—	1,325	—	1,325
Brazil.....	17,963	1,031	4,000	2,968	9,964	9,964
Chile	10,826	1,708	—	2,118	7,000	2,893
Colombia	3,550	45	—	2,954	551	3,398
Costa Rica.....	500	—	—	—	500	500
Ecuador	2,500	698	—	860	942	942
El Salvador.....	2,000	—	—	—	2,000	—
Honduras.....	1,000	1,000	—	—	—	—
Jamaica	1,518	1,518	—	—	—	—
Mexico.....	15,472	198	4,930	2,105	8,239	6,575
Nicaragua	1,400	500	—	—	900	900
Peru.....	4,734	250	3,000	—	1,484	1,484
Regional	38,050	50	22,907	—	15,093	2,465
Trinidad & Tobago	598	—	—	—	598	598
Uruguay.....	6,350	303	—	1,122	4,925	6,047
Venezuela	1,000	1,000	—	—	—	—
TOTAL 1997	\$118,258	\$8,975	\$34,837	\$15,822	\$58,624	
TOTAL 1996	\$71,174	\$4,286	\$15,838	\$ 6,533		\$44,517

Governors and Alternate Governors

Country	Governor	Alternate Governor
Argentina	Roque B. Fernández	Pedro Pou
Austria	Rudolf Edlinger	Hans Dietmar Schweisgut
Bahamas	William C. Allen	Ruth Millar
Barbados	Owen S. Arthur	Erskine Griffith
Bolivia	Edgar Millares Ardaya	Miguel López Bakovic
Brazil	Antônio Kandir	Gustavo Henrique de Barroso Franco
Chile	Eduardo Aninat	Manuel Marfán Lewis
Colombia	Antonio J. Urdinola	Cecilia López
Costa Rica	Francisco de Paula Gutiérrez	Leonardo Garnier Rimolo
Denmark	Ellen Margrethe Loej	Peter Bruckner
Dominican Republic	Héctor Valdez Albizu	Luis Manuel Piantini Munnigh
Ecuador	Marco A. Flores	Galo Pérez Granja
El Salvador	Manuel Enrique Hinds	Eduardo Zablah-Touché
France	Dominique Strauss-Kahn	Jean Lemierre
Germany	Klaus-Jürgen Hedrich	Klaus Regling
Guatemala	José Alejandro Arévalo Alburéz	Edín Homero Velásquez Escobedo
Guyana	Bharrat Jagdeo	Michael Shree Chan
Haiti	Jean Erick Deryce	Fred Joseph
Honduras	Guillermo Bueso	Juan F. Ferrera
Israel	Jacob Frenkel	Shay Talmon
Italy	Carlo Azeglio Ciampi	Vincenzo Desario
Jamaica	Omar Davies, MP	Shirley Tyndall
Japan	Hiroshi Mitsuzuka	Yasuo Matsushita
Mexico	Guillermo Ortiz	Martín Werner
Netherlands	Gerrit Zalm	J.P. Pronk
Nicaragua	Noel Sacasa	David Robleto
Panama	Guillermo Chapman	Miguel Heras
Paraguay	Miguel Angel Maidana Zayas	José Ernesto Buttner Limprich
Peru	Jorge Camet Dickmann	Germán Suárez Ch.
Spain	Rodrigo de Rato y Figaredo	José Manuel Fernández Norniella
Switzerland	Nicolas Imboden	Adrian Schläpfer
Trinidad and Tobago	Trevor Sudama	Carlyle Greaves
United States	Robert E. Rubin	—
Uruguay	Luis Mosca	Ariel Davrieux
Venezuela	—	Teodoro Petkoff

Information as of December 1997

Executive Directors and Alternate Executive Directors

Name	Country
Orlando Bareiro Aguilera Antonio Soruco	Bolivia, Paraguay, and Uruguay
Moisés A. Pineda Ernesto Selman	Dominican Republic and Mexico
Mario Marcel	Chile and Ecuador
Atsuo Nishihara Marina Barda	Israel, Japan, and Spain
L. Ronald Scheman Lawrence Harrington	United States of America
Antonio Cláudio Sochaczewski Mauro Marcondes Rodrigues	Brazil
Barry Malcolm George L. Reid	Bahamas, Barbados, Guyana, Jamaica, and Trinidad and Tobago
Maritza Izaguirre Rogelio Novey	Panama and Venezuela
Julio Angel Alberto Yagui	Colombia and Peru
Bruno Mangiatordi Maria Kronsteiner	Austria, Denmark, Italy, and The Netherlands
Marco Ferroni Georges Cahuzac	France, Germany, and Switzerland
A. Humberto Petrei José María Cartas	Argentina and Haiti
María Antonieta Del Cid de Bonilla Edgard A. Guerra	Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua

Information as of December 30, 1997 - CII/DR-171-9

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IIC Management

General Manager, ad interim, and Manager, Operations Department	John C. Rahming
Division Chief, Operations Department	Roldán C. Trujillo
Division Chief, Finance, Risk Management and Administration Division	Jean-Olivier Fraisse
Division Chief, Legal Division, and General Counsel	Raúl Herrera
Special Operations Unit Coordinator	Mario Mahler
Chief Engineer	Carlos Aguilar
Chief Economist	Jorge Roldán

Operations Department

REGION I

(Argentina, Bahamas, Barbados, Bolivia,
Brazil, Chile, Dominican Republic, Guyana,
Haiti, Jamaica, Paraguay, Trinidad and Tobago,
Uruguay)

Coordinator	Steven L. Reed
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REGION II

(Colombia, Costa Rica, Ecuador, El Salvador,
Guatemala, Honduras, Mexico, Nicaragua,
Panama, Peru, Venezuela)

Coordinator	Jean Philippe Prosper
-------------	-----------------------

Support Staff

Chief Accountant	Shane L. Bateman
Personnel and Administration Officer	Mildred Arroyo
Sr. Portfolio Officer/Sr. Credit Officer	Candace Smith
External Relations	Magaly R. Hamm
Treasurer	Barbara D. McGowan

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Carlos Ferdinand	Armando Chuecos
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