2021 BUSINESS PLAN UPDATE

MARCH 2021

Table of Contents

Acronyms and Abbreviations

CAR	Capital Adequacy Ratio
CECL	Current Expected Credit Losses
CMF	Crisis Management Facility
DELTA	Development Effectiveness Learning, Tracking and Assessment
DFI	Development Finance Institution
DRA	Development Related Assets
FDI	Foreign Direct Investment
FI	Financial Institution
GDP	Gross Domestic Product
IDB	Inter-American Development Bank
LAC	Latin American and the Caribbean
LCR	Liquidity Coverage Ratio
MSME	Micro, Small, and Medium Sized Enterprise
NSG	Non-Sovereign Guaranteed
RAC	Risk Adjusted Capital
RVC	Regional Value Chain
S&I	Small and Island
S&P	Standard & Poor's
SCF	Supply Chain Finance
TFFP	Trade Finance Facilitation Program

Executive Summary

When considering that aggregate annual investments by Development Finance Institutions (DFIs) have rarely surpassed 3% of their respective region of influence's GDP, prioritization has always been an imperative as well as an ever-growing and often discouraging challenge.

At their inception in the 1950s and 1960s, DFIs were called to rebuild a world emerging from war. ***Physical Capital***, namely infrastructure, was the clear priority. The following decades called first for ***Human Capital*** as health and education became new and urgent priorities and later for ***Social Capital*** translated into security, stronger institutions, policy lending and transfers as the calls to action. Finally, the privatization trends of the 1990s focused the attention on the ***Private Sector*** and its capacity to transform and mobilize. Interestingly, new trends did not substitute old trends. They became instead, co-existing layers of a more complex mandate. Today DFIs are still working on all of these priorities while grappling with the devastating effects of a pandemic in a scale not seen for one hundred years.

Although for IDB Invest, the Renewed Vision defined a clear set of objectives for the period 2016 to 2025, a new IDB Group Administration provides an invaluable opportunity to revisit, rethink, refocus and propose priorities to face the challenges ahead.

As agreed with the Board of Executive Directors, IDB Invest Management met on several occasions with the Office of the President, including an extensive workshop that included the full leadership of the IDB Group[1]. Conclusions emerged from these conversations and are reflected in this document:

<u>First</u>, the IDB Group, and therefore IDB Invest will ***continue supporting the region*** to address the dire consequences of the Covid-19 pandemic.

<u>Second</u>, it is time to plan and act on the next stage. As the region's economies reopen, *Protect, Alleviate, and reignite* will transition into *Recovery*. To achieve this goal, ***a renewed focus on employment generation*** will become an overarching objective to address the harshest long-term consequence of the crisis.

Measuring jobs created is challenging because it is necessary to establish a counterfactual. IDB Invest is part of the Harmonized Indicators for Private Sector Operations initiative through which multilaterals are working in establishing a harmonized definition for jobs created. IDB Invest is chairing this working group and will pilot the definition later in 2021.

<u>Third</u>, in addition to the existing Governor-level priorities to which Management remains fully committed, ***two new areas of focus*** -strengthening regional value chains and digitalization- have enormous potential to contribute to the overarching objective of employment generation while at the same time preparing the region for the "new normal". These new areas of focus will include clear definitions, instruments, and, tracking and reporting mechanisms.

<u>Fourth</u>, This level of activity -although a significant operational effort- optimizes the use of capital while maintaining IDB Invest's capacity to deliver on its long-term sustainable lending level. As is always the case, the final business volume targets—including long-term commitments and short-term average outstanding—will reflect the outcome of the dialogue with the Board on this matter.

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1 The President of the Bank, the Chief of Staff, the IDB's Executive Vice-President, all IDB's Vice Presidents, IDB Lab's General Manager and IDB Invest's Chief Executive Officer accompanied by IDB Invest's Senior Management Team were all in attendance for the full duration of a three-hour workshop held in early January of 2021.

Management looks forward to another productive dialogue with the Board, to continue improving the quality of our interventions and to strive for meaningful impact, always at the center of our efforts to achieve better days for the people of Latin America and the Caribbean.

I. Introduction

1.1 This document includes a review of IDB Invest's crisis response and a revised, expanded, and enhanced set of priorities for 2021 that reflect the priorities of the new administration which are in turn fully aligned with clear and pressing needs in the region we serve. Management reaffirms its commitment to deliver on the five Governor-level priorities that lie at the center of the Renewed Vision, (1) Small and Island (S&I) countries, (2) C&D countries, (3) Gender and Diversity, (4) Climate Finance, and (5) Micro, Small, and Medium Size Enterprises (MSMEs).

II. Delivering on the 2020-2022 Business Plan

2.1 The 2020-2022 Business Plan laid out the medium-term priorities to achieve growth for sustainable impact. This chapter provides an update on progress achieved during 2020.

2.2 Management identified four key priorities for 2020 related to ***pursing smart growth***: building the backbone[2], enhancing the capacity to manage non-financial risk, taking advisory and mobilization to the next level, and maximizing the deployment of available capital.

Strengthening the Backbone

2.3 Significant progress has been made on ***strengthening the backbone***, even in the context of the disruptions of day-to-day activities due to the pandemic and diversion of resources to support the immediate needs of the pandemic response, focusing on three areas: execution of capital projects, improvement of internal processes, and reinforcement of human resources.

2.4 In terms of processes and human capital, the formation of the Operations Division (OPD) in June of 2020 consolidates several backbone functions improving back-office capacity, promoting efficiencies, and enhancing the mitigation of operational risks. Management places a high priority on strengthening OPD and an early 2020 workforce planning exercise, allocated a significant portion of new positions to backbone functions to be able to support and compensate for the significant increase in the volume and especially complexity of operations since the merge-out. Hiring has continued under remote work conditions with several of the vacancies successfully filled and onboarded. Likewise, ongoing work on the consolidation of the Trade Finance Facilitation Program (TFFP) and Supply Chain Finance (SCF) team has improved efficiency and supported the increase of operations as a vital part of the Covid-19 response.

2.5 Process enhancements have contributed to back-office efficiency and effectiveness. For example, the elimination of task duplication and enhanced accountability in the disbursement process has created greater efficiency and decreased operational risk in a key institutional process. The client onboarding process has also been improved to better capture critical information, thereby also mitigating operational risk.

2.6 In terms of capital projects—which are considered in further detail later in this document—significant progress contributing to backbone efficiency includes improvements in the automation of daily cash transactions through the development of a Cash Management System, which is indispensable to scale up local currency capacity. Other critical projects include the establishment of swift message connectivity with partner banks, custodians, and counterparties, the

[2] The reference to the organization's backbone at IDB Invest is understood as the back and middle office area activities that enable and support the administration of the operations financed by IDB Invest, which can be further described from three clearly defined elements: people, processes, and systems.

strengthening of the payment reconciliation process, and the implementation of a Supply Chain machine learning process to increase efficiency.

Non-Financial Risk Management

2.7 IDB Invest also made significant progress to strengthen ***non-financial risk management***, a key part of our value proposition and brand. Management finalized the new IDB Invest Environmental and Social Sustainability Policy[3], which was approved by the Board on April 10, 2020, and shared with the Board a draft Implementation Manual for the IDB Invest Environmental and Social Sustainability Policy[4] which will undergo public consultation and is planned to be finalized by December 2020. Further, in coordination with the Office of Institutional Integrity, Management presented its approach to integrity and reputational risk management through a detailed technical briefing to the Board.[5] Managing non-financial risks during portfolio supervision has also been a key focus in 2020, with increased transparency through quarterly reporting of integrity matters to the Portfolio Supervision Committee and to the Board. In addition, Information Technology (IT) improvements to IDB Invest's operational system, Maestro, will further enhance environmental, social, and corporate governance supervision efforts. Finally, IDB Invest carried out initiatives aimed at building capacity internally for IDB Invest and externally for clients, including lessons learned from operations in special assets and a compliance training program targeting business conflicts of interest, integrity and reputational risks. Several new tools, good practice notes—including the Gender Risk Assessment tool—and guidance documents related to Covid-19[6] will develop intellectual capital and transfer best practices.

Mobilization

2.8 For 2020 Management proposed, and the Board approved, an ambitious ***core mobilization*** target of US$2.0 billion representing an increase of 66% compared with 2019. Current projections indicate this objective will be met.

2.9 The increase in resource deployment related to the Covid-19 Response contributed to the mobilization volume by increasing the amount of bankable assets originated. Mobilization is a ratio of the assets IDB Invest originates and structures. IDB Invests goal is always to distribute as much as possible of a transaction, which is limited by co-investor's requirement that IDB Invest also have skin in the game, and by financial sustainability concerns.

2.10 A second factor playing an important role in the increase in mobilization are the new instruments and products connecting assets to investors. Unfunded Credit Protection (UCP) played an important role in achieving this growth. The volume of mobilization via UCP has grown from US$74 million in 2019 to US$372 million as of September 30, 2020. To accommodate for the growth in this product IDB Invest has continued to broaden the base of insurance companies who are counterparties to UCP transactions.

2.11 In five years, IDB Invest has gone from being an untested concept to becoming a recognized mobilization partner in the region. However, a lot remains to be done. To continue scaling up its mobilization capacity, IDB Invest has built a comprehensive investor map of 467 partners all over the world, has closed at least one transaction with over half of those investors, and has developed core relationships with more than 25% of them. Going forward, to maintain and enhance those relationships, IDB Invest must increase the number of the projects it finances in order to increase

[3] CII/GP-16-15. IDB Invest Environmental and Social Sustainability Policy. Fifth revised version.
[4] CII/GP-16-17. IDB Invest Environmental and Social Sustainability Policy. Draft Implementation Manual.
[5] CII/PP-377. Integrity Aspects of IDB Invest Operations. Non-Financial Risks Roadmap.
[6] See the complete list of publications at http://idbinvest.org/en/publications

the number of assets to distribute. Mobilization will always be a function of productivity in origination and backbone capacity.

2.12 Increasing mobilization requires continuing to develop more instruments, onboarding more investors, and structuring transactions with a view towards distribution. To that end, mobilization is expanding its team to include a senior staff that will be exclusively dedicated to product development. This person will work to improve processes and systems to drive mobilization, thus freeing the existing mobilization team to dedicate more time towards bankable assets, instruments and relationship with investors. A steady and sizeable market presence will be critical to maintain and expand these relationships.

Non-Financial Value Proposition

2.13 In order to continue strengthening our ***non-financial value proposition***, IDB Invest is expanding its capabilities and knowledge on digital and technological transformation to deliver advisory services to clients across all sectors and products. As a result, IDB Invest aims to support clients in the process of advancing digital and technological transformation.

2.14 Efforts targeting intellectual capital continued with the elaboration of knowledge products related to supporting clients and the region through the pandemic, and work began on the Knowledge Roadmap. Synergies with other members of the IDB Group have been a necessity through the pandemic, has and have highlighted the strength of the existing institutional structure as described in the next section.

III. Responding to the Covid-19 Crisis

3.1 Following the spread of the Covid-19 pandemic to the Western Hemisphere, Management and the Board worked together to define and execute an action plan (CII/GN-419) built around six pillars:

i. Using a Covid-19 lens to **focus** support to the region: protect, alleviate and reignite.

ii. Creating **faster** lanes to deploy resources during the crisis through a narrowly defined Covid-19 delegated facility.

iii. Deploying **more** resources to the region via an expanded plan of operations and trade finance program.

iv. Going further by going **together**, leveraging the strength of the IDB Group, and strengthening partnerships with multilaterals and other co-investors.

v. Actively monitoring the financial **sustainability** of IDB Invest and the response to Covid-19.

vi. **Adapting** to the crisis through temporary governance modifications.

3.2 The key elements, including the specific actions proposed for Board approval,[7] were driven by the shocking speed at which the crisis unfolded, the scale of its impact on financial markets, and—perhaps most importantly—the great uncertainty of the moment. The Covid-19 Response measures enabled the institution to adapt, react and support the economies of LAC to face the difficulties in financial markets, to address the impact on private sector clients, to tackle the needs of people struggling to cope and to closely monitor and protect the portfolio of IDB Invest.

3.3 Over the course of 2020 Management exercised prudential use of the crisis measures granted by the Board. As the consequences of the crisis became better known, Management returned to the

[7] The elements of the Covid-19 response were approved via resolutions CII/DE-20/20, CII/DE-21/20, CII/DE-22/20, CII/DE-23/20, CII/DE-24/20, CII/DE-25/20, and CII/DE-26/20.

Board for a mid-term review[8] of the Covid-19 Response, recommending the recission of measures that were no longer relevant given the progression of the crisis including: the reduced distribution period for projects submitted under standard procedure, the higher threshold for submitting projects via streamlined procedure, the eligibility of non-operational documents for short procedure, and the extended authority for portfolio support.

3.4 Operationally the Covid-19 lens focused on operations that would *protect & alleviate*—having an impact on a timeline aligned with the expected duration of the health crisis and the measures to contain it—and those that would *reignite*—such as capital expenditures that would otherwise be delayed due to the scarcity of financing in the short-term. Of nearly US$5.5 billion approved after the Covid-19 Response was approved, 100% qualifies as part of the crisis response with 67% qualifying as *protect & alleviate,* 63% qualifying as *reignite,* and 30% qualifying as both.

3.5 The increased Plan of Operations targets helped to meet demand from the region as commercial lenders retreated from emerging markets during the crisis. The execution of both long and short-term commitments in 2020 was over 50% above the original Plan of Operations[9] but slightly below the Covid-19 Response Plan of Operations revised four months later. The long-term commitment target increased from US$3.3 billion to US$3.8 billion; IDB Invest executed US$3.5 billion in long-term commitments. The short-term target increased from US$1.0 billion to US$3.0 billion; IDB Invest executed US$2.7 billion in short-term commitments. Two factors explain this difference: First, IDB Invest was able to mobilize more than anticipated, with mobilization reaching US$2.3 billion or US$300 million above the target. Second, the surge in demand experienced in the early stages of the pandemic subsided as markets partially recovered, both due to a recovery in financial markets and businesses exercising caution on taking out new debt. Ultimately, the increased Plan of Operations created flexibility in ensuring IDB Invest could meet the borrowing needs of clients through the critical stages of the crisis. While own commitment execution was slightly below the executed targets, planning for a potentially higher lending volume was prudent given the magnitude of the crisis and the level of uncertainty.

3.6 As part of the expanded Plan of Operations, the Board also approved a US$500 million delegated Crisis Management Facility (CMF) for lending to existing clients. Through the end of 2020 US$246 million of this amount was committed. Demand for this facility was below the level expected due to the restrictive nature of the eligibility conditions (e.g. limited to existing clients and operations). Nonetheless the reduced time from business development to disbursement was valuable in select cases. Management expects to continue approving projects under the CMF through the end of the eligibility period.

3.7 The 2021 Business Plan process presents the opportunity for a review of the relevance operational focus of the Covid-19 lens. The Covid-19 lens was developed to contribute to maintain the incomes of individuals and the productive capacity of the economy as both employment and incomes declined due to the restrictive shutdowns required to control the pandemic. The health dangers posed by pandemic are ongoing as the loss of life continues to mount, however the economic direction has shifted as most economies in LAC began a rebound in both GDP, and at a slower rate, employment in the third quarter of 2020.[10]

8 IDB Invest Response to Covid-19. Review of Covid-19 Flexibility Measures. Revised version. (CII/GN-419-4).

9 Approved in December of 2019.

10 IMF. 2020. *Regional economic outlook. Western Hemisphere: pandemic persistence clouds the recovery.* Washington, DC, October.

IV. Expanded and Enhanced Priorities for 2021

A. Fighting Covid-19 in 2021

4.1 The path to a post-Covid world remains uncertain. While signs of economic recovery are starting to appear, significant challenges lie ahead. Vaccination campaigns, the true game-changers, have begun in some countries and, after a drop of 7.4% in GDP in 2020, the region is expected to grow by 4.1% in 2021.[11] The beginning of inoculation and the return to growth are positive signs for the region, however the timeline for achieving herd immunity is expected to be longer than in developed economies,[12] furthermore both the 2020 recession and job losses are deeper than in other emerging market regions and the recovery projected to be slower.

4.2 As the IDB Vice Presidency for Sectors clearly described in *Emerging from the Pandemic Tunnel with Growth and Equity: A Strategy for a New Social Compact in Latin America and the Caribbean – Covid-19* (PP-1072-1), 2020 was the year that we entered the pandemic tunnel, navigating unknown terrain with little visibility, great uncertainty and high human and economic costs. Consequently, all IDB Invest efforts were focused on *protecting* livelihoods, *alleviating* human and economic distress, and supporting those investments that would retain the productive capacity of the economy through the crisis and *reignite* recovery.

4.3 As countries across the world face renewed shutdowns, the risk of further job loss remains relevant entering the year and the financing needs addressed by *protect & alleviate* and *reignite* will remain. Likewise, the need to respond to sudden increases in demand for short-term products can support liquidity needs as financial markets remain volatile. If Latin America is to avoid another lost decade, concerted action to address the effects of the pandemic will need to continue in 2021.

4.4 While still addressing the consequences of the pandemic, it is imperative to plan and prepare for the next stage. As economic activity returns, IDB Invest will need to think beyond *protect, alleviate, and reignite* and increase its focus on operations that support *recovery* and contribute to sustained growth.

B. Targeting Employment for Impact

4.5 The employment contraction in LAC resulting from the Covid-19 pandemic was larger than in other emerging markets and advanced economies.[13] Total employment fell by 30% on average between January and May 2020. Employment started to bottom-out in May in most countries. However, the level of employment remains below its pre-Covid-19 level and the gap relative to January levels is larger in LAC than in other regions. In addition to job losses, there was a significant reduction in weekly worked hours. The International Labour Organization (2020) estimates that LAC lost the equivalent of 55 million full-time employees in the second quarter of 2020.

4.6 Lockdowns and the evolution of the pandemic affected supply and demand and the economic activity through several factors: (i) Containment policies and social distancing mandates prevented workers in some sectors from participating in productive activities. (ii) Reduced mobility and fear of contagion also hindered demand for contact-intensive sectors (hospitality, entertainment, and tourism). (iii) The initial direct impact was amplified by intersectoral linkages.

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11 International Monetary Fund. 2021. *World Economic Outlook Update: January 2021*. Washington, DC, October.

12 https://www.thedialogue.org/analysis/how-well-are-covid-vaccinations-going-in-latin-america/

13 IMF. 2020. *Latin American Labor Markets during Covid-19, ch 2 in Regional Economic Outlook 2020.* International Monetary Fund: Washington, DC.

4.7 The intensity in which these factors affected the level of activity and employment is related to the labor market characteristics and the economic structure of each country. The impact of lockdowns is less pronounced in countries where workers are employed in occupations that are amenable to remote work. The shocks caused more disruption in countries where contact-intensive occupations accounted for a large share of employment and production prior to the pandemic. Finally, in countries with low savings and weak safety nets, the Covid-19 shock affected aggregate demand as households experienced an erosion of their purchasing power.

4.8 The costs in terms of employment losses have been unevenly distributed across LAC's population. Employment has fallen more steeply for women, workers with only primary education, and employees working for MSMEs or informal firms. The link between job losses, education attainment, and informality show the regressive nature of the shock.[14] The effect through the labor market could cause that 23 to 30 million additional people fall into poverty in Argentina, Brazil, Colombia, and Mexico.[15]

4.9 Large uncertainty remains over the path to recovery. On the short-term, the recovery will be determined by the ability of countries to control the virus and reopen their economies. Job creation will also be affected by frictions in the search and matching process. On the long run, it remains unclear if Covid-19 will have a permanent effect on employment. There are several factors that need to be considered: (i) The longer the duration of the pandemic and/or lockdown, the higher the risk of permanent layoff as firms are unable to operate. (ii) Firms might find it profitable to accelerate the automation of certain jobs. (iii) Labor force participation may fall as more housework is needed. (iv) A quick rebound in informal jobs pose risks to the region´s progress towards formality.

4.10 As the essential source of employment, the private sector will play a key role during the recovery. To create more and better jobs firms need to invest and grow. One of the main constraints faced by LAC firms, and in particular MSMEs, is lack of adequate financing. IDB Invest will support growth of LAC firms through equity, guarantees, long-term financing for their capital expenditures, and indirectly through financial institutions and funds to facilitate long-term financing for MSMEs.

4.11 The investment in infrastructure—transportation, energy, and communications—improves the business environment and also support the growth of firms and employment creation by reducing costs and complementing private sector investments. Additionally, in the short-term, these investments usually create temporary employment. IDB Invest will support infrastructure investments like ports, roads, energy production and distribution, and telecommunications that will improve the business environment in the region.

4.12 The Covid-19 recession also created the opportunity to facilitate resource reallocation towards low-carbon activities and incentivize energy efficiency. IDB Invest will support this process by financing renewable energy projects and energy efficiency investments.

4.13 The IDB Group measures the number of jobs supported as part of its Corporate Results Framework.[16] The "jobs supported" indicator (Level 2, Indicator 8) is the number of direct jobs

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14 Busso, M., J. Camacho, J. Messina, and G. Montenegro, 2020. "The Challenge of Protecting Informal Households during the Covid-19 Pandemic: Evidence from Latin America", *Covid Economics Vetted and Real-Time Papers*, Issue 27, CEPR Press.

15 Lustig, N., Martinez Pabon, V., Sanz, F. and Younger, S. (2020). "The Impact of Covid-19 Lockdowns and Expanded Social Assistance on Inequality, Poverty and Mobility in Argentina, Brazil, Colombia and Mexico." *CEQ Working Paper* 92.

16 CII/GN-406-1. IDB Group Corporate Results Framework 2020-2023. Revised version.

supported in operations and maintenance—these include the number of workers working for the company or investment project at the end of the reporting period.[17] From 2016 to 2019 IDB Invest supported 470,000 jobs and 45,000 new jobs. Measuring jobs created is challenging because it is necessary to establish a counterfactual. IDB Invest is part of the Harmonized Indicators for Private Sector Operations initiative through which multilaterals are working in establishing a harmonized definition for jobs created. IDB Invest is chairing this working group and will pilot the definition after 2021.

4.14 ***A renewed focus on employment as an overarching objective and an essential for recovery*** is the first conclusion reached as part of the reassessment of priorities with the IDB Group's new administration.

C. Expanding and Enhancing Priorities

4.15 While transmission, hospitalization, and death rates remain persistently high entering 2021, vaccinations signal a turning point in the health crisis. As the world prepares to carefully exit the pandemic tunnel the world at the other end will be poorer, more unequal, with constrained public resources and weakened growth engines.

4.16 The impact of LAC's economic downturn has been disproportionately higher on women and on the poor and vulnerable middle class. As mentioned in the previous section, there has been an increase in both unemployment and poverty. Countries that rely on tourism for a large share of GDP and employment—including many of the Small and Island (S&I) countries—have suffered the most significant productivity and job losses.

4.17 Emergency fiscal measures by governments have contributed to mitigate the impact of the crisis on citizens, but as the region looks to recovery many governments will face significant and binding fiscal constraints. Given these constraints, the private sector must take the lead in the recovery to come. Reviving the productive sector through employment-generating investments will be critical for LAC.

4.18 As the region shifts from immediate response to recovery, IDB Invest must also shift its support to target operations that will follow this trend. To address the overarching objective of employment generation, ***two areas with high potential to reach that goal*** conform the second conclusion reached as part of the reassessment of priorities with the IDB Group's new administration:

- *Regional Value Chains:* The supply chain disruptions resulting from the pandemic have highlighted to companies the inherent risk of relying in disperse suppliers in global value chains. This presents a unique opportunity for countries in LAC to host goods or services export production for Western Hemisphere consumers. IDB Invest has a range of financial products available to support investment in regional value chains directly, indirectly through supply chains, or indirectly by enhancing competitiveness.
- *Digitalization:* The social distancing measures implemented to mitigate contagion amid the Covid-19 pandemic have accelerated the global trend towards digitalization. The public and private sectors will need to work together to position the people and businesses of LAC to not only prepare for, but to take advantage of this trend. IDB Invest will clarify, enhance, and track its work on supporting digitalization in the private sector.

4.19 Targeting operations that support *employment* will play a central role in IDB Invest's effort to support recovery in the region. Management will continue to work with other Multilateral

[17] Both measured in terms of full-time equivalent to properly consider part-time, temporary, and seasonal workers.

Development Banks to enhance their shared capacity to measure, track and report on the impact of private sector investments on employment.

4.20 IDB Invest has experience but does not currently have an existing proactive and comprehensive approach to strengthening regional value chains and digitalization. This document outlines how they will be implemented as priorities, how they will be measured, and proposes tracking indicators as part of the 2021 Plan of Operations. These focus areas complement the existing five Governor-level geographical and impact targets[18] which will remain as cross-cutting priorities for the portfolio including operations that contribute to the new targets.

4.21 To achieve the same objective, management will also reaffirm its focus on MSMEs. MSMEs employ over 60% of the workers in LAC[19] and were among the hardest hit by the economic downturn in 2020. Supporting access to credit for MSMEs will be central to ensuring an equitable recovery. The three pillars defined by the MSME Action Plan (CII/GN-364-1) approved by the Board will continue to define IDB Invest's approach.

D. Seizing the Opportunity to Strengthen Regional Value Chains

4.22 For decades manufacturers and technology companies have pursued increasingly globalized production processes and outsourced services which leverage low shipping rates and/or national variation in factor costs to bring a final product or provide a service to consumers at the lowest price possible. The Covid-19 pandemic caused extensive disruption to supply chains in the immediate onset of the pandemic and has continued to affect shipping rates from Asia to Europe and the Americas into 2021.[20] The ongoing disruptions and price volatility have brought newfound attention to operational risk inherent in production processes that are both disperse and distant from the final consumer. To ensure greater resilience to future disruptions, as well as to reduce their environmental impact and costs by shortening transit distance, global companies are increasingly taking actions to move supply chains closer to consumers or to diversify their supply chains.

4.23 This incipient trend presents an historic opportunity for LAC to increase its participation in global value chains**.** Historically, LAC's participation in global value chains has been less than that Asia and the European Union[21]. The shift in the supply chains creates new opportunities for countries in LAC—which have long sought to attract FDI as a means of job creation and knowledge transfer—as locations to regionalize global value chains of production destined for markets in North America or within LAC. The Region can also provide a destination for the outsourcing of services. Business Process Outsourcing is a key employment opportunity across some LAC countries, which benefit from the same time zones as the United States and a large population fluent in the two most spoken languages in the United States (English and Spanish). Investment, employment, productivity, and exports would all grow as a result of strengthening regional value chains—for LAC companies newly integrated in global value chains as well as their upstream networks of suppliers.

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18 The five targets are gender and diversity, climate finance, MSMEs, C&D countries, S&I countries.

19 OECD/CAF. 2019. *Latin America and the Caribbean 2019: Policies for Competitive SMEs in the Pacific Alliance and Participating South American countries, SME Policy Index*. OECD Publishing, Paris.

20 George Steer and Valentina Romei. January 19, 2021. "Shipping costs quadruple to record highs on China-Europe 'bottleneck'". *Financial Times.*

21 See Blyde, J. S., & Trachtenberg, D. (2020). *Global Value Chains and Latin America: A Technical Note*. Inter-American Development Bank. Washington, DC.

4.24 The IDB Group is in a unique position to help the countries of LAC regionalize global value chains by addressing the market gaps and to maximize the development impact of shifts to regional production. The IDB Group is leading a coordinated approach to support LAC countries' efforts to enhance their participation in regional value chains. The IDB Group can play a key leadership role supporting the agenda, deploying financial resources, providing technical assistance, and coordinating regional initiatives as an impartial interlocutor. In order to ensure consistency and coordination in the measurement of its contribution to strengthening regional value chains, the IDB Group has defined regionalization of global value chains in LAC as:

> *The decision of a company to locate part of the supply chain of a product (a good or a service) in a LAC country, either through the opening or expansion of subsidiaries (FDI) in LAC or with a new regional supplier (export in the region).*

4.25 Within the context of the shared IDB Group definition, this Business Plan Update provides additional detail for how efforts to regionalize global value chains will be interpreted and implemented in the context of IDB Invest private sector operations and sets the tracking indicators for 2021.

4.26 Support for regional value chains is in line with the objectives of the Second Update of the IDB Group Institutional Strategy (AB-3190-2) of reducing poverty and inequality and achieving sustainable growth and is part of the pillar of economic integration. For IDB Invest, regional value chain support is in line with three of the priority business areas of the Renewed Vision (CII/GN-296-1): (i) increasing access of micro, small, and medium-sized enterprises to financing and technical assistance, through access to financing for the promotion of regional value chains; (ii) the promotion of infrastructure for development, through investment in trade infrastructure, connectivity, and competitiveness; (iii) support for innovation and technological development, through contribution to innovation and technology transfer; and with the cross-cutting theme of enabling environment.

4.27 Support to regional value chains will be incorporated in IDB Invest's Impact Management Framework to guide the origination, tracking, and reporting on projects related to this area. To support the origination and selection of projects, strengthening of regional value chains will be embedded in the strategic selectivity framework. IDB Invest operations will support regional value chains through the financing of activities that contribute to (i) increasing FDI from regional countries and locally owned production of goods or services for export to nearby countries; (ii) increasing trade between countries in the region as part of international value chains.

4.28 IDB Invest has a broad suite of financial and non-financial products to help LAC-based companies strengthen regional value chains and encourage international companies to develop new production or services facilities in the Region. IDB Invest can provide direct financing of capital expenditures for companies doing investing in regional production and can support adjacent industries that support the regionalization of global value chain operations (e.g. the financing of office parks to house companies that form a part of a regional value chain).

4.29 IDB Invest will also support MSMEs that can become local providers of firms that are part of international value chains through direct financing or supply chain solutions through anchor firms that are part of a regional value chains. Trade finance operations can also contribute to support trade of intermediate and final goods that are part of an international value chain.

4.30 In terms of non-financial products IDB Invest will leverage its expertise to generate knowledge products to identify gaps in the enabling environment, or market opportunities and support decisions to regionalize global production and processes through advisory services.

4.31 To track progress on implementation of strengthening regional value chains as a focus area, ***Management will calculate and report a tracking indicator for the US Dollar volume of operations supporting the strengthening of regional value chains.*** Management has considered a snapshot of operations from previous years and sector and tenor mix in the proposed 2021 Plan of Operations, considering this information Management projects this tracking indicator may reach 10% in 2021.

E. Supporting the Digital Transformation of LAC

4.32 The Covid-19 pandemic has accelerated the trend towards digitalization of the global economy while also exposing the extent of the digital divide and its potential impact on inequality. In 2019, approximately 270 million people in LAC were still unconnected to broadband[22] and rural connectivity is equivalent to 32% of the average urban connectivity[23]. At least 77 million rural inhabitants in Latin America and the Caribbean are unable to access internet services that satisfy minimal quality standards[24]. This broadband gap affects 46% of the population including people that are not covered by mobile broadband 3G or 4G (latest account for 6% of LAC population) and people that live in geographic areas with broadband access but do not subscribe to mobile service (42%). Another barrier to access the internet is the lack of devices: smartphone penetration is 69% in LAC. Affordability is also a challenge as the high cost of internet connections limits access to telecommunication services. In terms of quality, LAC's internet speeds are below the global average both in mobile and fixed broadband which reinforce exclusion as they prevent the use of digital teleworking and distance learning solutions[25]. Data usage increased three-fold during 2015-2020 and demand has increased even more since the pandemic.

4.33 Digital infrastructure is the backbone of the digital economy and a crucial enabler for digitalization. Innovation across sectors is increasingly driven by digital technologies that require digital connectivity infrastructure. It is expected that the gap between LAC and faster 5G-adopter regions will increase as previous mobile technologies become obsolete. The financing gap for telecommunications infrastructure (crucial enabler for the digital transformation) in the Region is estimated in a range from US$8 to US$28 billion per year[26] and the proportion of investments made by the private sector in this sector was 80% in the last ten years.

4.34 The involuntary digitalization imposed by the pandemic can be a way to accelerate the digital transformation of the LAC region, leveraging digital technologies is key to boosting employment and growth and enhancing social inclusion. The digital transformation of companies can result in efficiency and productivity improvements, as well as a new source of innovation and competitiveness that will support formal job creation. A 10% increase in broadband penetration is associated with a 3% increase in GDP per capita and a 2% increase in productivity[27]. Digital online platforms could increase global GDP through improved productivity, greater employment, and

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22 See *Connecting humanity* (2020). International Telecommunication Union.

23 See Garcia Zaballos, A., Iglesias, E. et.al. (2020), The Impact of Digital Infrastructure on the Consequences of Covid-19 and on the Mitigation of Future Effects. Inter-American Development Bank.

24 See *Rural Connectivity in Latin America and the Caribbean – a Bridge to Sustainable Development During a Pandemic* (2020). Inter-American Institute for Cooperation on Agriculture (IICA), Inter-American Development Bank (IDB) and Microsoft

25 See *Universalizing Access to digital technologies to address the consequences of Covid-19* (2020). ECLAC.

26 See Puig Gabarró (2020). Digital Connectivity: The Infrastructure of the Future. Inter-American Development Bank and see García Zaballos, A. & Iglesias, E. (2019). The Impact of Digital Infrastructure on the Sustainable Development Goals: A Study for Selected Latin American and Caribbean Countries. Inter-American Development Bank.

27 See Garcia Zaballos, A. and R. Lopez-Rivas (2012). *Socioeconomic Impact of Broadband in Latin American and Caribbean Countries*. Inter-American Development Bank.

higher labor market participation. Up to 540 million people could benefit from online job intermediation platforms by 2025[28]. The Covid-19 pandemic has also shown that digital solutions can enhance the resilience of businesses and they can also have positive environmental impacts. Digitalization could help reduce global carbon emissions through innovative solutions in energy, agriculture and land use, and transportation.

4.35 The support of digitalization is in line with the two objectives of the Second Update of the IDB Group Institutional Strategy (AB-3190-2) of reducing poverty and inequality and achieving sustainable growth and it addresses the development challenges of social exclusion and inequality and low productivity and innovation. Digitalization support is in line with four of the priority business areas of the Renewed Vision (CII/GN-296-1): (i) Infrastructure for development; (ii) Innovation and technological development; (iii) Private provision of basic goods and services, income generating opportunities and social mobility; (iv) Green growth.

4.36 IDB Invest will continue fostering coordination and synergies with IDB and IDB Lab to maximize its impact. The IDB Group has a comparative advantage to support the Region as it can deploy financing for the private sector, support the strengthening of the institutional, regulatory and policy frameworks as well as help in the international coordination required to address existing cross-border digital connectivity infrastructure gaps. The IDB Group can help countries develop an enabling digital ecosystem. IDB Invest will continue doing regular pipeline review meetings with IDB Lab and exploring opportunities to scale-up innovative and tested digital business models.

4.37 In order to reduce the digital divide in the Region and to help businesses leverage the advantages of digitalization and keep up with changes in how transactions are performed, IDB Invest will continue (i) supporting the development of faster and more inclusive broadband access across the region, (ii) identifying and investing in companies with innovative digital business models, and (iii) working with established and more traditional corporates and financial institutions to develop digital channels and adapt to market trends.

4.38 Transactions that effectively narrow the digital gap, such as the 2020 financing for Phoenix Tower International, a company dedicated to developing the independent telecommunications infrastructure market in Ecuador and promote a more efficient expansion of this sector in the country, will be an important part of IDB Invest focus in 2021. IDB Invest will continue investing in towers and shared infrastructures to increase efficiency and reduce costs; fixed and mobile last mile; submarine, satellite, and fiber connection; data centers and wholesale networks. IDB Invest will continue exploring equity and quasi-equity investments to support tech-enabled solutions such as fintech, Agtech, distance learning, e-health and other platforms; and will finance the adoption of digitalization in the infrastructure sector, including health and education.

4.39 To strengthen its non-financial value proposition, IDB Invest is expanding its advisory service capabilities to provide knowledge and support to clients in the process of advancing digital and technological transformation.

4.40 To track progress on implementation of strengthening regional value chains as a focus area Management, ***will calculate and report a tracking indicator for the US Dollar volume of operations supporting digitalization.*** Management has considered a snapshot of operations from previous years and the sector mix in the proposed 2021 Plan of Operations, considering this information, Management projects this tracking indicator may reach 10% in 2021.

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[28] AB-3190-2. Second Update to the IDB Group Institutional Strategy.

F. A Stronger Focus on Employment through MSMEs

4.41 The Covid-19 pandemic has had a disproportionate effect on MSMEs. Smaller businesses have relatively little working capital to withstand a sustained period of decreased revenue. Furthermore, a significant share of MSMEs are industries that require consumer contact and are most affected by the shutdowns. Supporting MSMEs will be critical to an effective recovery. MSMEs account for 60% of employment in LAC and 25% of the region's GDP.[29] Even before the Covid-19 crisis MSMEs faced a substantial financing gap.

4.42 Providing support to MSMEs is a charter mandate for IDB Invest and one of the priority business areas identified in the Renewed Vision (CII/GN-296-1). IDB Invest prioritizes investment and advisory services that support MSMES because of their importance to growth, job creation, and poverty reduction in LAC countries. To guide its activities, IDB Invest presented to the Board an action plan that was approved in 2018.[30] The MSME Action Plan is anchored in three strategic pillars: i) promoting the spread of knowledge and innovations that expand MSME access to finance, ii) targeting gaps in MSME support through financial intermediaries, and iii) increasing access to finance, markets, and innovation for MSMEs through value chains. Following the approval of the MSME Action Plan, financing to MSMEs increased from 25% in 2018 to 37% in 2020.

4.43 As IDB Invest's FI clients and the MSMEs they support face ongoing tight credit conditions and increased risk during the pandemic and recovery, IDB Invest will work with clients to:

- Enable continued access to finance to recover from short-term impacts and continue long-term growth;
- Facilitate the creation and expansion of the thematic bonds market, with an emphasis on social bonds aimed at responding to MSMEs financial needs;
- Support clients in the creation of differentiated sustainable finance solutions for MSMEs, thus promoting improved practices and models in these market segments; and
- Enable clients' efforts to deepen MSME financial inclusion through digital solutions.

4.44 IDB Invest will also work with corporate clients to support MSMEs through the crisis and recovery to:

- Strengthen the integration of MSMEs in local and regional value chains, build supply chain resilience, and enhance competitiveness;
- Drive sustainability and inclusive practices throughout clients' value chains by engaging and rewarding MSMEs that adopt sustainable behavior; and
- Improve working capital management for both buyers and suppliers, and contribute to the strengthening of the supply chain through new value chain products.[31]

4.45 In addition, in line the Renewed Vision (CII/GN-296-1) transversal priority of Gender and Diversity, IDB Invest seeks to bring a gender lens in work with MSMEs. While all MSMEs face

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29 Diego Herrera. 2020. *MSME Financing Instruments in Latin America and the Caribbean During Covid-19.* Inter-American Development Bank: Washington, DC.

30 CII/GN-364-1. *IDB Invest Action Plan for the Micro, Small, and Medium Enterprises. Revised version*.

31 Based on reverse factoring solutions, value chain products enable suppliers – most of which are MSMEs, are able to discount (i.e., monetize) their invoices payable by big anchor buyers through financial intermediaries, enabling them to access immediate liquidity.

barriers to reach their full potential, those owned or led by women face additional barriers. A combination advice and investment to supports clients in the development and deployment of financial and non-financial products to increase integration and/or access to finance for women-owned MSMEs, for instance through Results Based Incentives—incentives programs based on the accomplishment of pre-identified gender outcomes.

4.46 As part of its efforts to support the Covid-19 recovery and contribute to employment generation in LAC, IDB invest will continue support MSMEs as outlined in the MSME Action Plan. Management will maintain the 30% target for MSMEs in 2021.

G. Corporate Priorities

4.47 The institution will face the continuing need to manage the crisis while executing long-term institutional priorities and planning for a post-Covid-19 world.

4.48 Credit Agencies reaffirmed IDB Invest ratings. Early in 2020, Moody's confirmed IDB Invest's Aa1 long-term issuer default rating reflecting the organization's intrinsic credit profile underpinned by liquidity and solvency, with stable outlook. In June 2020, Standard & Poor's affirmed IDB Invest's AA credit rating with a positive outlook and upgraded the enterprise risk profile from adequate to strong. In February 2021, Fitch Ratings affirmed the Long-Term Issuer Default Rating of IDB Invest at AAA, with reference to its "excellent capitalization and low risk profile" and revised the rating outlook from stable to negative, reflecting the challenging macroeconomic environment in Latin America and the Caribbean and the rise in leverage of IDB Invest driven by the portfolio growth following IDB Invest's pandemic response.

4.49 Managing crisis-related risk and uncertainty to ensure the financial sustainability of the institution will remain a primary focus. Close monitoring of market conditions and capital utilization to ensure sustained balance sheet strength will continue including regular updates of stress testing on the portfolio; as well as monitoring and reaching out to clients individually on an as-needed basis to proactively manage any potential deterioration risk in the portfolio and adjust scope of projects to maximize development impact.

4.50 Over the course of 2021 Management will, in coordination with IDB Vice Presidency for Finance, continue to monitor health and safety conditions in headquarters and each of the country offices and implement the return to office framework.

4.51 Delivering on medium and long-term priorities as outlined in the Business Plan will continue in 2021 including:

i. Efforts to strengthen the backbone.
ii. Knowledge production focused on a resilient and sustainable recovery.
iii. Ongoing efforts to deploy critical capital projects; and
iv. Strengthening of IDB Group synergies at the strategic, corporate, and operational level.

4.52 Progress on Key Initiatives included in the 2020-2022 Business Plan remains on track. Management expects to bring the Poverty and Vulnerability Roadmap, the Gender and Diversity Roadmap, and the Knowledge Roadmap to the Board in 2021.

V. Proposed Plan of Operations

5.1 The proposed plan of operations is the result of discussions with the Board in November of 2020, the review of the Covid-19 Response, and discussions with the Office of the President at the beginning of the year.

5.2 The proposed targets reflect a continued counter-cyclical increase in commitments during 2021 in line with 2020 activities to support the private sector in LAC through a time of crisis, while also considering the long-term stability and financial sustainability of the institution. The proposed plan would maintain a long-term commitment level of US$3.0 billion and a short-term average outstanding target of US$1.62 billion. The core mobilization target of US$2.5 billion will also be maintained.

Figure 1. Proposed Plan of Operations for 2021

	US$ million
Own Account Commitments by Segment	
Financial Institutions (30%)	925
Corporates (30%)	925
Infrastructure and Energy (40%)	1,200
Own Account Long-Term Commitments	3,050
Short-Term Average Outstanding	1,620
Short-Term Commitments	2,800
Core Mobilization	2,500

5.3 Management renews its commitment to the main five Governor-level objectives. Management recommits to the target of reaching 40% of DRAs in C&D countries by 2025. For S&I countries, as part of the Update to the S&I Action Plan (CII/GN-354-2) Management set targets of 10% of commitments for both short-term and long-term operations separately; future updates for S&I targets will be considered as part of the business plan process. Management will maintain the target of 30% of commitments supporting MSMEs and 30% of the number of long-term commitments supporting gender or diversity by the end of the planning period in 2022. Management will maintain the target of 30% of commitments supporting Climate Finance, considered as a floor, in line with the IDB Group Corporate Results Framework (CII/GN406-4)[32].

5.4 In addition to the existing targets, Management proposes two new tracking indicators associated with the priorities identified for supporting the recovery: The US Dollar volume of operations that support the strengthening regional value chains and the number of long-term operations supporting digitalization. The indicators will track progress implementing the corresponding priorities.

5.5 Management proposes maintaining a similar indicative sector mix as the one targeted in 2020 with 30% of long-term commitments in Corporates, 30% in Financial Institutions, and 40% in Infrastructure.[33] Building on the practice started in 2018, Management will continue to deploy anti-bunching measures, such as quarterly targets linked to staff incentives, aiming at a smoother delivery of the program of operations throughout the year.

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32 Management will also report an additional Climate Finance indicator (Long Term Climate Finance %).

33 IDB Invest works with clients in the strategic sectors of Agribusiness, Manufacturing, Telecommunications, and Tourism (grouped into the Corporate segment); Energy, Social Infrastructure, Transport, and Water and Sanitation (grouped into the Infrastructure and Energy segment); and Financial Institutions and Investment Funds (grouped into the Financial Institutions segment).

ANNEX I: 2021 Administrative Budget Proposal

	2020 Approved Budget	2021 Proposed Budget	Increase (decrease) Over 2020 Approved US$	%	Real Increase %
Workforce					
Salaries & Bonuses	45,006,230	47,390,099	2,383,869	5.3%	
Staff Benefits	16,078,781	16,952,089	873,308	5.4%	
Complementary Workforce	10,695,261	11,266,295	571,035	5.3%	
Total	**71,780,272**	**75,608,483**	**3,828,211**	**5.3%**	**5.0%**
Consulting					
Project Consulting	3,255,000	3,100,000	(155,000)	-4.8%	
IT Consulting	1,820,000	1,820,000	-	0.0%	
Other Corporate Consulting	3,905,515	2,537,585	(1,367,930)	-35.0%	
Outsourced Support	1,633,000	1,924,000	291,000	17.8%	
Litigation	1,000,000	1,200,000	200,000	20.0%	
Total	**11,613,515**	**10,581,585**	**(1,031,930)**	**-8.9%**	**-9.2%**
Administrative					
External Relations & Annual Reporting	800,000	686,500	(113,500)	-14.2%	
Business Meetings	345,500	262,193	(83,307)	-24.1%	
Translations	268,000	342,500	74,500	27.8%	
External Auditing	450,000	450,000	-	0.0%	
Funding - Capital Markets	1,117,200	1,167,200	50,000	4.5%	
Business Development & Travel	5,121,120	3,839,000	(1,282,120)	-25.0%	
Sponsorships, Conferences & Events	1,334,000	976,900	(357,100)	-26.8%	
Communications	897,537	1,023,455	125,918	14.0%	
Sustainability & Environmental Outreach*	-	-	-	100.0%	
General Maintenance	732,600	450,000	(282,600)	-38.6%	
IT Software & System Maintenance	3,230,000	3,300,120	70,120	2.2%	
Subscriptions & Memberships	917,012	954,402	37,390	4.1%	
Staff Development	2,389,200	1,353,617	(1,035,583)	-43.3%	
Total	**17,602,169**	**14,805,888**	**(2,796,281)**	**-15.9%**	**-16.2%**
Discretionary Expenses Total	**100,995,956**	**100,995,956**	**(0)**	**0.0%**	**-0.3%**
IDB Services and Others					
Office Occupancy	5,530,000	5,530,000	-	0.0%	
Service Level Agreement	11,868,115	11,868,115	-	0.0%	
Total	**17,398,115**	**17,398,115**	-	**0.0%**	**-0.3%**
Board of Governors/Executive Directors					
BOG/Executive Directors	1,116,077	1,116,077	-	0.0%	
Total	**1,116,077**	**1,116,077**	-	**0.0%**	**-0.3%**
Non-Discretionary Expenses Total	**18,514,192**	**18,514,192**	-	**0.0%**	**-0.3%**
Administrative Budget GRAND TOTAL	**119,510,148**	**119,510,148**	**(0)**	**0.0%**	**-0.3%**

*Note that the Sustainability & Environmental Outreach event takes place every other year.

ANNEX II: 2021 Capital Budget Proposal

(US$ million)	Initiatives	USD
STRENGTHEN BACKBONE	Treasury Management	1.83
	Middle and Back-offices	1.84
	Maestro Supervision Module Enhancements	0.72
	Financial and Budgeting System	0.25
	Legal for Non-Financial Risk initiatives	0.10
	Capacity For Fair Value Project	0.25
	Moody's/Risk Control/Project Finance Scorecard	1.09
	Computers & Conference Rooms	0.10
	Subtotal	**6.18**
DIGITAL INTEGRATION	Client 360 View	2.66
	Maximize Data Assets Utilization	0.90
	Knowledge	0.70
	Subtotal	**4.26**
NON-DISCRECIONARY / COMPLIANCE	Libor replacement	1.90
	AML/CFT Legal Advice	0.70
	MD&A	0.25
	Subtotal	**2.85**
FACILITIES	Infrastructure Improvements	0.50
	Subtotal	**0.50**
	Total	**13.79**