

INDES

Leasing for Micro and Small entrepreneurs in Chile

*An answer to mid-
& long-term funding needs*

**This study was conducted by Cecilia Campero, consultant, in October 1999.
Up-dated information to year-end 2000 provided by INDES has been incorporated.**

Published by SIDI in August 2001

T hanks

INDES, leasing in Chile
INDES, leasing in Chile

SIDI wishes to warmly thank the following persons for their contribution to the study. Their availability and accurate knowledge of INDES and microfinance specific issues allowed us to draw-up the following document.

v At INDES

- INDES' Directors, and particularly, Mr Humberto Molina, Chairman of the Board and Mr. Felipe Rioseco, from the Fundación para el Desarrollo
- Mr. Luis Alvarez, Chief Executive Officer, who returned to Banco del Desarrollo, in July 2000, after years of commitment and dedication to INDES
- Mr. Carlos Rojas, who has taken over the position of Chief Executive Officer, and who participated in the finalisation of the study
- The staff of INDES, and especially the persons in the main office of Santiago
- Mr. Jose Veloso C., from Banderarrollo Leasing, a subsidiary from Banco del Desarrollo
- Mr. Mauricio Rojas M. and Mr. Alvaro Retamales C., from Banderarrollo Microempresa, a subsidiary from Banco del Desarrollo
- Mr. Juan Carlos Accorsi, who has represented SIDI in the Board of Directors for many years, and actively participates in the strategic decision-making process at INDES. He paved the way for the consultant to meet appropriate individuals and organised field visits.

v At other microfinance and SMMEs development organisations

- Mr. Jaime Gonzalez S., from FOSIS
- Mrs. Mariela Barrenechea P., from the Superintendencia de Bancos e Instituciones Financieras (SBIF)
- Mr. Rafael Bertini, from the Ministerio de Hacienda
- Mr. Rafael Millán, from the Inter-American Development Bank
- Mr. Luis Magallon M., from Sur Profesionales

Contents

Introduction: Getting to know about the ideas behind the study	9
A. About the background of the study	11
B. And its objectives	11
C. The methodology we chose	12
1 st Part: INDES, Getting to know about the Chilean Institution	13
A. Institutional antecedents	15
B. Mission and objectives	16
C. General aspects of its financial products	16
D. Comparative analysis of the financial products	20
2 nd Part: EXTERNAL FACTORS, Getting to know on how the Chilean environment impacts on INDES' life	25
A. Economic environment	27
B. Micro and small enterprise sector	28
C. Government policy in support of micro and small enterprises	32
D. The Chilean financial system	35
E. The Chilean legal and regulatory framework	39
3 rd Part: INTERNAL FACTORS Getting to know on the inner side of INDES	41
A. Property and governance	43
B. Organisational structure	45
C. Human resources	50
D. Clients	52
E. Financial structure	57
F. Financial situation and portfolio	59
4 th Part: CONCLUSION, Discussing the idea of replication and getting to know about INDES' coming challenges	61
A. Advantages of INDES' leasing	63
B. Determinants of the INDES experience	64
C. Elements for replication	66
D. Challenges for the coming period	67
APPENDICES	69

I *ntroduction*

Getting to know about the ideas behind
the study

A. ABOUT THE BACKGROUND OF THE STUDY

Created in 1987, Inversiones para el Desarrollo S.A. (INDES) was closely monitored the various stages in the development, by the Société d'Investissement et de Développement International (SIDI), a shareholder and one of the founding members. The original orientation of INDES in venture capital operations, was followed by a change in strategy, with the innovation and implementation, in 1992, of leasing for micro-enterprises, implemented through financing from the Fondo de Solidaridad e Inversion Social (FOSIS). Today, INDES offers a variety of loan and leasing products aimed at the segment of upper strata of micro- and small enterprises.

In the process of growth, INDES has faced a series of challenges, particularly relating to its management of resources. At present, however, with the satisfactory renegotiation of the FOSIS line, access to short term credit lines from the local banks, the possible agreement of the Inter American Development Bank (IADB) to provide support for technical assistance, and the negotiation with the Corporación de Fomento a la Producción (CORFO) for a long-term credit line, INDES appears to be well-engaged in the process of consolidating its financial resources for a medium-term development plan.

Consequently, INDES currently presents a set of characteristics from the perspective of its market niche, its activities and its financial structure that lead SIDI to envisage the possibility of a gradual process of capital withdrawal as soon as this process seems feasible to both institutions¹. However, it should be noted that as an investor committed to development, SIDI would only divest itself of its participation in INDES, if it considers that the institution has attained a stage of financial maturity which will enable it to access alternative resources.

B. AND ITS OBJECTIVES

In this way, SIDI is interested to capitalise on the experience of INDES, and to gain a better understanding or “know-how” of its financial leasing service for a possible dissemination of information and the incorporation of this type of service in other microfinance institutions (MFIs) who want to increase the range of products for the micro and small enterprises sector.

As part of this capitalising process, the present study sets out more specifically to:

- v Identify the determining external elements of the Chilean environment, and internal elements proper to INDES, which have contributed to its institutional expansion.
- v Constitute a technical report on micro leasing which allows this instrument to be presented to other MFIs on the basis of the compiled information.
- v Through an analysis of the information and on the basis of the results obtained in the first stage, to propose various hypotheses for the eventual replication of the experience.

¹ To the extent that the financial support from SIDI is, within limits, presented in a temporal manner, given that certain legal matters concerning the drawing down of capital are complex to execute, the association with the local institution can continue for a longer period, on a new basis.

C. THE METHODOLOGY WE CHOSE

In the first stage, an evaluation was carried out of the principal Chilean institutions besides INDES that could serve as sources of information; then manuals or questionnaires were developed that could form a basis for interviews; and finally, visits were made to the institutions concerned to carry out interviews with people who were informed of the theme of the study, and compilations of existing research papers, studies and documents were collected.².

The principal mechanism for the collection of basic information internally was through reading available documents and interviews with the staff of INDES, particularly with the members of the Board of Directors as representatives of the shareholders, of the Executive Committee, General Manager, commercial executives, systems operators and others.

Similarly, interviews were carried out with a representative sample of micro and small entrepreneurs (24 in total) who are currently active clients of INDES, and a few (2) who are no longer linked with the institution. The objective of these interviews was to discover, on one hand, the clients' perception of INDES, its products, services and image in the sector, and on the other, the effects of financing on their activity.

Starting with these objectives and procedures, it was possible to make a compilation of general data and elaborate various others, which would form the basis for the present report. The latter is divided into 4 sections. The first part begins with an explanation of the institutional background of INDES, followed by a description of its products, and ends with a comparative analysis of these. The second and third parts proceed by putting into context and evaluating various external and internal factors that have had an influence on the performance of INDES. The fourth part concludes this study with an analysis of the potential for the replication of the leasing product for micro and small enterprises in other contexts, ending with an evaluation of the challenges and perspectives for INDES in the future.

² Appendix 1: List of the institutions and people interviewed (See page 71).

1st Part

INDES

Getting to know about the Chilean institution

A. INSTITUTIONAL ANTECEDENTS

INDES was founded in 1987 with the support of the Foundation for Development, an institution of the Santiago Archbishopric of the Chilean Catholic Church, and SIDI of France. Under the law, it is a private profit-making stock company, and does not form part of the formal and regulated financial sector.

INDES first started to operate in the area of venture capital, switching its orientation after four years of operation with a few difficulties, to the provision of services for which there appeared to be a greater demand, lesser risk, and which benefited a larger number of people. In this way, from 1992, INDES started to expand in the micro and small enterprise sector with leasing, a product which this sector had previously not had access to, primarily because such enterprises did not meet administrative requirements or because the services or conditions offered - instalment rates, amounts, guarantees, payment methods and flexibility - did not coincide with their requirements. Since then, the institution has developed a comprehensive programme of support for the formal micro-enterprise sector, and small enterprises that did not have access to formal banking, while also offering various types of loans.

With initial support from FOSIS, which provided INDES with readjusted resources (equal to inflation rate) on flexible terms, which were directed at micro-entrepreneurs qualifying as such, leasing has become a principal product of INDES, representing 69 % of the portfolio, as of October 2000, while loans represent 31%.

Between 1992 and 2000, INDES carried out approximately 980 leasing operations, for a total amount of US\$ 9.4 million, with an average of US\$ 9,500 per operation. During the same period, the organisation bestowed more than 3,710 loans, for an average individual amount of US\$ 2,500 and a total value of US\$ 9.2 million.³

As of October 2000, INDES had an active loan portfolio of approximately US\$ 2.9 million in leasing operations with 309 clients, and a loan portfolio of approximately US\$ 1.4 million with 352 clients.⁴

INDES' investment portfolio and assets in general are financed from various sources: 40 % from private capital, 20 % from FOSIS resources, 34 % with local banking credit, and 6 % from other liabilities.

It is also worth indicating that the growth rate in real terms of the INDES portfolio between 1996 and October 2000 was 80.2 %, while the rate of devaluation during the same period was 33.9 %, and annual inflation at 4.8 %.

The net profitability of the equity in dollar terms, since 1996, has been approximately 19,7 %, annually. In the last five years (1996 through 2000), INDES has generated profits of US\$ 1,7 million that have been re-invested to increase its networth to US\$2.6 million, with a leverage of 1.5, measured as the relation between debt and net equity.

Furthermore, the institution has been attending clients from Valparaiso, Los Andes and Rancagua in addition to those from Santiago, which allows for a wider distribution of services in these three new regions.

The growth rate and results achieved by INDES in recent years suggest that it is an institution with a good understanding of the market, and a good business sense, which give it favourable

³ Pre balance as of 31/10/2000, INDES

⁴ Pre balance data as of 31/10/2000, INDES.

prospects for growth. In this respect, INDES finds itself at an interesting point in its institutional life.

B. MISSION AND OBJECTIVES

INDES' mission is to be an efficient financial institution that is sustainable and profit-making, and which - through the provision of leasing and loans - aims to support the development and growth of investment projects of enterprises which are marginalised from the traditional financial sector.

C. GENERAL ASPECTS OF THE PRODUCTS

Following an experience in the area of venture capital, unprofitable for several reasons including the high cost of supervision, in 1992, with the financial support of FOSIS, INDES decided to carry out leasing operations which would contribute to the development of micro-entrepreneurs as well as the financial sustainability of the institution.

In this way, INDES has gradually taken possession of these segments of the market, and subsequently, in parallel to this, it has designed new products to meet the demands of its clients and diversify its package of financial services.

v Leasing and lease-back

Leasing is a medium or long term financing technique (in terms of microfinance standards) for the procurement of machinery, equipment, vehicles and/or properties. It is based on the proposition that the financial entity is the proprietor of the good(s) being financed, which it then rents to the client for a given period (usually between 36 and 60 months) through a leasing contract, with an option to buy, endorsed by a public notary.

The financial institution maintains the property of the good until the sum of the instalments paid is equivalent to the value of the acquisition (initial value + interest + expenses). At this point, with the payment of an additional quota equivalent to a supplementary instalment payment, the client can exercise his option to buy, and acquire legal ownership.

Leasing is based on the notion that profits are earned from the *use* as opposed to the *ownership* of assets. The basic principle in medium to long term lending is that "cash generated by investment that is partly financed should be the primary source of repayment and the collateral taken as security for the loan serves as a secondary source of repayment, in the event that the borrower is unable to repay the loan from business operations".⁵

Moreover, in general, leasing is regarded as a fiscal concession, since the client is able to register quota payments in his accounts as expenditure, and only the value of the last quota or purchase option (which results in the increase of the company's assets and its

⁵ Gallardo, Joselito « Leasing to Support Small Businesses and Micro-enterprises » Policy Research Working Paper N°1857, World Bank, 1997.

networth), as the new fix asset. Furthermor all quota payments are liable for VAT payment.

Lease back is a facility that allows companies' fixed assets to become liquid through the buying and selling of fixed assets. Basically, the entrepreneur sells his fixed asset to the financial institution, which then rents it back to him through a leasing contract with an option to buy back. In a similar way to traditional leasing, once the entrepreneur has repaid his loan, he can buy-back the fixed asset and continue to be the owner.

At INDES, leasing operations offer micro and small entrepreneurs an asset, machine or vehicle (new or used), which has previously been selected and requested by the client, to stimulate the modernisation of his enterprise, improve production and/or sales and increase his earnings. It includes, for example, industrial machines, working vehicles, printing presses, etc.

To resume, the leasing programme guarantees access to a loan through an asset or piece of equipment rental mechanism with the option to buy (*financial leasing*), and also with the sale and simultaneous rental of an asset to its seller (*leaseback*).

v *Direct loans*

Apart from leasing, over the years, INDES has developed complementary types of loans to meet the need of its clients and diversify its package of services. In general, loans offered by INDES are used to finance investment and working capital for clients who may or may not have a leasing engagement with the institution.

These loans are aimed at the sector for micro and small enterprises who must have endorsements or have real collateral, given that, unlike with leasing, no assets are involved which can act as a guarantee. The average loan size at INDES is US\$ 2.500, and as such, loans are not in direct competition with the micro-loans being offered by Microfinance Institutions (MFIs), which have an average loan size of US\$ 1000, as will be explained in greater detail below.

At present, INDES tends to offer larger loans in Pesos with mortgage guarantees, which entail less risk, are more profitable and serve to finance the expansion or development of a business. INDES is discontinuing its long-term development loans since it no longer counts on the Endorsement and Guarantee Fund that allowed it to cover a large part of the risk.⁶ Similarly, the institution is also ceasing to operate with UF loans since it has not get long term funding to match loans periods; and also due to the fact that the spread between the cost of funds and the maximum legal threshold is too narrow⁷.

v *Factoring (Invoices documented with cheques)*

⁶The endorsement and guarantee fund was created by a subsidiary of the Fundacion para el Desarrollo called Desarrollo Rural SA (*Rural Development Ltd.*). Its purpose was to offer guarantees for agricultural operations. The same fund was used to guarantee several of INDES' operations where the clients lacked collateral and thus it financed between 40 and 70% of the debt, for which the client paid a fee of 5% to 7% of the loan. The administering company ceased operations in August 1996.

⁷The maximum legal rates in Chile, laid down by the superintendency of banks and financial institutions (SBIF) to prevent usury at December 2000, are as follows:

Up to 5.000 UF (approx. 137.500 US\$) period <90 days	Max. 2,6% / month in pesos
Above 5.000 UF <90 days	Max. 1,3% / month in pesos
Less 200 UF (less approx. 5,500 US\$) period >90 days	Max. 4,0% / month in pesos
Between 200 and 5.000 UF – period >90 days	Max. 2,8% / month in pesos
Above 5.000 UF – period >90 days	Max. 1,8% / month in pesos
UF loans without limits	Max. 10,2% / annually in UF

This line was first introduced in 1995 and serves to convert into immediate cash capital invoice documented with cheques. It is directed at entrepreneurs who receive cheques with a term of 30, 60, 90 or more days, and who have difficulties with their liquidity and/or working capital.

In the factoring, the General Manager or the Credit Committee approves a maximum rotating line of credit based on the monthly sales of the entrepreneur recorded over a twelve-month period, in relation to the sum of the cheques which are retained as a guarantee, and other elements of analysis. Each line also has an associated guarantee factor, which represents the proportion of the sum of the cheques which is retained as guarantee and which, in general, is equivalent to between 10 and 20% of each operation.

The line is operational for one year from the date of approval and the approved sums of each line cannot be increased less than six months after the beginning of the operation. A maximum permitted concentration is also defined for the factoring, which signifies that the client cannot leave cheques from a single issuer for a sum higher than 25 % of the line.

v *Operational leasing*

INDES also has operational leasing, mainly vehicles, which consists in buying vehicles and vans and renting them to other enterprise for use by some of their managers and branches.

v *Conditions of these different financial products delivered by INDES*

Table A - Conditions of Leasing and Lease-Back Products

Product / Market	Average Size	Maximum Size (UF) ⁸	Average Term	Maximum Term	Interest Rate %	Minimum Collateral
FOSIS Leasing to Micro – Enterprises	3.050 US\$	UF 700 (Aprox. US\$. 21.000)	36 months	60 months	UF+12% annual	10 to 20% cash down payment + asset
Leasing to small and medium enterprises (SME)	13.800 US\$	As per evaluation of project	30 months	60 months	UF+18% annual	10 a 20% cash down-payment + asset

Source – INDES

At INDES, leaseback operations are counted as traditional or financial leasing, which is the reason why there is no desegregated information on them.

The average amount is equal to the total amount of the instalments the clients are committed to pay to INDES. It then includes interest, monthly payments, and buying option.

Table B - Conditions of Direct Loan Product

Product / Market	Average Size (US\$)	Maximum size (US\$)	Average term	Maximum term	Interest rate (%)	Minimum guarantees
Pesos Loans	1.829	90.000	18 months	36 months	Average monthly rate as Chilean market	1 endorsement & mortgage guarantee
Operations Loans (working capital)	4.500	50.000	12 months renewable	24 months	Average monthly rate as Chilean market	1 endorsement & mortgage guarantee
Loans in UF	6.650	26.000	18 months	36 months	UF +18%	1 endorsement

Source – INDES

⁸The Unidad de Fomento (UF) is a unit of currency that takes into account the effect of inflation. It is a “hard” local currency, which is calculated on the basis of the variation in the consumer price index (CPI), one month later.

Table C- Conditions of Factoring (Invoice documented with cheques)

Market / Product	Average amount	Maximum amount	Average term	Maximum term	Interest rate %	Minimum guarantees
Factoring / Micro and small enterprises	US\$ 5.000	Depends on collateral and sales	12 months	12 months	Average monthly rate as Chilean market	Cheques for 110 or 120% of the operation.

Source: INDES

D. COMPARATIVE ANALYSIS OF THE PRODUCTS

Although each product has a specific function, it should be noted, however, that these have been developed with a great deal of flexibility, in response to the needs of the sector, without a true analysis of the market having been carried out previously to assess the products and the conditions being offered by other financial institutions and subsequently, of its efficiency and productivity. Therefore, a cost and profitability analysis for each of INDES' products would not be relevant.

With this consideration in mind, the following is a comparative analysis of certain aspects of the products.

v Portfolio

As was mentioned above, at the outset INDES only offered leasing, but several clients simply needed working capital, required financing through loans. As a result, offering services to this sector merely through the provision of leasing had its limitations. The provision of equipment did not solve the problems of working capital and, in some cases, the effectiveness of leasing was mitigated without the support of loans. Consequently, INDES started to diversify the range of products and began to grant loans .

Even though they emerged as complementary products, loans are in their majority independent operations and serve by their nature to finance certain types of operation where leasing is not an appropriate option. As the table below specifies, for a total of 784 operations, INDES has 661 clients, of which 123 clients have recurring operations. Accordingly, 13 clients have more than one leasing and 110 clients have more than one loan.⁹

⁹ INDES data, as of 31/08/99

Table D - Number of Operations, Clients and Portfolio (as of December 31, 2000)

Product	Loans		Clients		Amount	
	In number	In %	In number	In %	In US\$	In %
• Leasing FOSIS	159	20.3%	156	23.6%	616,500	14.3%
• Leasing SME	163	20.8%	153	23.2%	2,309,906	53.5%
Total Leasing	332	41.1%	309	46.8%	2,925,986	67.8%
• Loans in UF	23	2.9%	20	3.0%	99,068	2.3%
• Loans in Peso	247	31.5%	244	36.9%	943,088	21.9%
• Working capital	24	3.1%	14	2.1%	114,671	2.7%
• Factoring	168	21.4%	74	11.2%	231,529	5.3%
Total Other Loans	462	58.9%	352	53.2%	1,388,356	32.2%
TOTAL	784	100.0%	661	100.0%	4,314,342	100.0%

Source: INDES

As shown in the above table, as of the end of December 2000, INDES had a total portfolio of US\$ 4,314,342 with 784 operations and an average loan of US\$ 5,503 per client. Furthermore, 68% of the portfolio corresponds to leasing with only 47% of the clients and 32% of the portfolio is concentrated in various types of loans with 53% of total clients. Finally, the majority of the portfolio is SME Leasing (53 %) and the majority of clients obtain loans in pesos (37 %).

v Clients

The market niche for loans and leasing is the same, consisting of micro-entrepreneurs and small businesses. Only FOSIS Leasing operations are subject to restrictions through an agreement to lend only to micro-entrepreneurs who meet certain requirements regarding the number of employees and the value of their sales and assets, as is described in greater detail later on in this report.

It is worth noting, nonetheless, that 70 % of leasing clients work in the production sector, and 45% of loan clients work in the commercial sector. In other words the type of service and the corresponding activities in which clients are engaged are different.

v Conditions

The amortisation period for loans is shorter, they are provided in Pesos and the interest rates are higher than those for leasing. In practice, the minimum and maximum amount limits are established internally within INDES on the basis of individual evaluations.

The amortisation period for leasing is longer and the interest rates are real, because the leasing operations are financing in UF, due to the type of operation they finance. In the case of FOSIS leasing operations, these are limited in their amounts, the period of

amortisation and interest rates established by means of an agreement, as described in Table A on general conditions.

v Collateral

It is important to point out that INDES does not have a fixed structure of collateral and even the minimum collateral which has been mentioned is merely referential and not the object of parameters, given that the collaterals which are solicited depend on an individual assessment of each client.

In general, for the leasing of movable assets, apart from the leased good (which is the property of INDES), the client is expected to make a cash down payment deposit of 20 % of the cost of the asset (or at least cover the cost of VAT which is equivalent to 18 %), an endorsement is requested from the spouse, or the partner(s) (in case of a business), as also other types of collateral, in exceptional cases.

In the case of leaseback, the property tends to be sold to INDES at a cost below the market rate, given that in general the client does not need the total liquid value of his assets, and in this way, the financial institution has a better value for its collateral.

The collateral requested for loan operations also varies according to the evaluation of each client. When a loan is given in addition to a leasing, the leased asset also serves as collateral and, depending on the evaluation, additional guarantees may be requested. In the case of factoring, the main guarantee is through the documents presented for discounting which can be taken at 120 through 130 % of the amount of each operation.

Nonetheless, as a principle, loans must have stronger collateral than leasing operations since there is no asset that can act as a security. Hence, in general, loans require the client to have additional guarantees, such as a mortgage, pledge of other assets, etc.

v Procedures

The flowchart, explanation of procedures and necessary documentation for the different products can be found in Appendices 2 & 3 (see page 72 and 74).

The procedure for obtaining a loan is much faster than for leasing and requires much less transaction time and documentation (except when it concerns real estate, in which case the duration is longer since it requires another series of transactions involving lawyers, solicitors to sign the deeds, inscription in the central mortgage registry (etc...), which can take up to two months). In normal circumstances, from the date of request for financing to the time of disbursement, there is a delay of 7 working days for a loan and an average of 20 working days for a leasing contract.

In fact, the procedures (and sub-stages) could be standardised and analysed in such a way that they are administratively more efficient and profitable for INDES. Also, a reappraisal of each one of the forms and documents required from the clients would make it possible to check that there is no duplication, making it more functional.

v Fees & charges

Fees and other charges that the client must pay on top of the interest rate are greater in the case of leasing because the costs related to legal matters are higher and because of the necessity to pay the cost of an insurance policy.

Indeed, it is considered that the leasing system is not the most appropriate when the financing sums are small, as the transaction costs render the operation over-expensive.

The table below details the fees charged for each of the products, that is to say which are transferred to the clients in the repayment quotas.

Table E- Fees and Charges by Products

Leasing	Loans
<ul style="list-style-type: none"> ▪ General insurance (in the case of machinery and equipment : insurance against fire and theft ; for vehicles : special comprehensive insurance, and for fixed assets : only fire insurance) ▪ Death Insurance (approx. 0.6%) (varies according to the age of the borrower) ▪ Tax on the loan (0.1% monthly up to 1.2%) according to the law ▪ Solicitor: US\$ 50 ▪ Evaluation: US\$ 50 ▪ Commission Flat: US\$ 20 ▪ Other expenses: US\$ 250 per real state leasing operation or mortgage loan (study, inscription of the real estate, valuation etc.) ▪ Option to buy: 1 additional quota considered by INDES as income. 	<ul style="list-style-type: none"> ▪ Death Insurance (approx. 0.6%) (varies according to the age of the borrower) ▪ Tax on the loan (0.1% monthly up to 1.2%) according to the law. ▪ Solicitor: US\$ 4 ▪ Evaluation: US\$ 50 approx. ▪ Commission Flat: US\$ 10 ▪ Register of 2 endorsements: US\$ 40¹⁰

Source: Elaborated during the present study

v Growth

The balance of all the business portfolios at the end of 2000 reached US\$ 4.3 million for a total of 784 operations. These figures, in comparison to 1999, reveal an annual growth rate of 4% in the number of investments and 18.5% in the number of operations. In particular, they reveal a low growth in the number (1%) and a significant growth in the size (49%) of loan operations, and the increase in the number (7%) and the growth in the size (37%) of leasing operations.

This growth in the number of leasing operations can be partly explained by the recover of the Chilean economy.

¹⁰This additional commission for the registering of two endorsements is being used to pay notary fee.

v Profitability

Despite the growth in the number and size of loans, the loan portfolio accounts for 32% of the total portfolio (vs. 68% for leasing). But it generates operational income of US\$ 171,240, while those of leasing generate US\$ 192,300¹¹, which would seem to suggest that loans are more profitable than leasing operations, and which itself might be tempting INDES to give more emphasis to loan products.

However, there are several reasons why INDES has a comparative advantage in leasing and should concentrate its efforts on this type of operation.

- v Leasing operations have a smaller default rate and are more secure because they are guaranteed by the very object of the leasing, becoming a response, at the same time, to the lack of collateral in this sector. For the leasing client, it is an attractive operation given that it avoids the necessity of additional collateral. And INDES can, as the "lessor" and proprietor of the rented asset, if the client defaults, recuperate the asset of which it is the proprietor and re-rent it or sell it.
- v Through the leasing mechanism, the client decides what and where to buy the asset he needs for his business activity. In addition, the asset can be new or used, and it is insured during the whole operation.
- v Through leasing, INDES knows exactly where the investment has been made, which is not always possible with other loans.
- v It is easier to execute a leased asset (which is part of the leasing operation) than an asset which is merely pledged or has some other form of guarantee, since the leased asset is under the name of the financial institution. Moreover, the conceptual model and the norms of leasing in Chile are slanted in favour of the lessor. This becomes apparent when the client does not pay his lease and breaks the contract. The lessor can then seize the leased asset (of which he continues to be the proprietor) and demand that the remaining quotas be paid in full under the terms of the contract. However, the problem of this model is that although it favours the lessor, it does not provide him with the instruments to transfer assets onto third parties, particularly when it concerns machinery where the fall in value is marked because of depreciation.¹² Thus, in institutions such as INDES, in numerous cases where the client cannot continue making payments, a transaction is agreed through refinancing or rescheduling.
- v The risk is less than in the case of traditional loans given that, in general, the lessor does whatever is necessary so as not to lose his asset, as he needs this asset to produce and generate income.

Finally, INDES' greatest comparative advantage is to carry on providing leasing operations where there are not the restrictions of the additional collateral guarantee, and where INDES is at present the only institution providing this type of service to the micro and small enterprise sector in Chile. In this respect, it could be said that it has an exclusive market niche, and constitutes a monopoly institution.¹³

¹¹ INDES data as of 12/31/2000

¹² Depreciation plays an important role in leasing given that when the client has finally finished paying for the good, its has depreciated in value.

¹³ It is important that INDES is aware of the ever-present possibility that other MFIs will develop leasing products aimed at the same market niche. Moreover, as it occupies an advantage position in the market, it does not have any points of reference or comparison with other institutions; consequently changes to improve the productivity of the institution tend to be slow.

2nd Part

EXTERNAL FACTORS

Getting to know on how the Chilean environment impacts on INDES' life

To better understand the context in which INDES has developed and operates, a more detailed analysis will be given of the external factors which, in one way or another, have had some consequence on the development and/or performance of the institution.

A. ECONOMIC ENVIRONMENT

Between 1982 and 1997, the Chilean economy grew at an annual average rate of 6%. This growth rate was due predominantly to the boom in exports especially concentrated in primary products and resources such as copper, fresh fruits, and forestry and fishing products; the diversification and demand of such products in markets in Asia, Europe and the United States; the growth of telecommunication industries and the financial sector. All of which was accompanied by an increase in external and internal investment.

This vigorous economic growth has led to the creation of new sources of employment, and a rise in salaries in real terms of approximately 20% since 1992. The annual income per capita in 1999 was US\$ 4,235.¹⁴ Likewise, 25% of Chilean families live below the poverty line, versus 45% in 1980, according to sources from the Ministry of Finance.¹⁵ The appreciation of the Chilean Peso has contributed to a fall in the inflation rate since 1990, with rates lower than 7% per annum (4.7% in 2000) and the rise in foreign investment has had a positive impact on the balance of payments and a resulting increase in international reserves.

The maintenance of macro-economic stability, high investment and savings ratios, political stability and commercial liberalisation, continue to be the elements which in addition to guaranteeing an adequate development of the national economy, have also made it possible for the sector of micro, small and medium sized enterprises (SMMEs) to develop and have increased access to financing through sustainable financial institutions, such as INDES.

Nevertheless, over the past year and a half, the Chilean economy has confronted a complex international scene, exemplified in the decline in the growth of activities and world trade, the fall in international prices for primary goods, and in the flows of financing for emerging economies, all of which has plunged the country into a recession with negative growth of - 1,1% for 1999. However for year 2000 the growth is above 5% (preliminary data indicated a rate of growth of 5,4%), but the rate of unemployment was above 10%.¹⁶

During 1999 and the first semester of this year, the majority of Chilean companies (in all sectors) failed to register any profits. Likewise, the micro and small enterprise sector has been affected by the crisis, reflected in the considerable decline in sales and its behaviour in the financial system, including INDES, has led them to increase their default rate (in the case of INDES: from 10.1% in 1998 to 14% by June 2000).

Notwithstanding, the financial sector has benefited from the policy of the Central Bank of Chile to reduce interest rates, and companies like INDES have seen an increase in the demand for financial resources, reflected by the investment in loans.

The policies of adjustment, which were applied during 1998, have started to bring about results and the Chilean economy is beginning a phase of recuperation with inflation under strict control. At the same time, it is expected that the impact on unemployment will be mitigated once the

¹⁴ Banco Central de Chile , Anuario 1999

¹⁵ Equivalent to 2 basic baskets or 180 thousand Pesos = 340 US\$ per family.

¹⁶ Banco Central de Chile, Anuario 1999 and preliminary data for year 2000

recuperation of economic activities is under way and nominal salaries have increased to levels that are synonymous with the trend in inflation and productivity.¹⁷

In this way, the prospects of recuperation are positive and during the year 2000 Chilean economy has achieved a growth rate of 5.4 % of GDP.¹⁸

B. MICRO AND SMALL ENTERPRISE SECTOR

v Definition & size

Different sources provide inconsistent data on the number of micro and small enterprises in Chile. According to CORFO – Corporación de Fomento, the Chilean development bank (1998), it is estimated that the micro-enterprise sector comprises 430 thousand families, and the small enterprises sector 78 thousand, defined by the volume of sales and number of employees, as is revealed in the table below.¹⁹

Table F- Number and Characteristics of Enterprises

Enterprise size	Number of Enterprises (97)	Sales in UF	Sales in US\$	Number of employees
Micro-enterprises	432,431	From 0 to 2,400	From 0 to 71,250	1 to 9
Small enterprises	78,805	From 2,401 to 25,000	From 71,251 to 745,000	10 to 49
Medium enterprises	10,870	From 25,001 to 100,000	From 745,001 to 2,980,000	50 to 199
Large enterprises	4,814	Above 100,001	Above 2,980,001	> 200
TOTAL	526,920			

Source: CORFO 1998

¹⁷ Interview with Rafael Bertini, Advisor of Finance Ministry.

¹⁸ Preliminary results year 2000, "Banco Central de Chile".

¹⁹ Other sources suggest that the micro-enterprises recognised by the CORFO only include those in the formal sector. Therefore, the actual number, including those who do not pay VAT and do not have a municipal patent, may approximately be 800 000 throughout Chile.

For a better understanding of the micro-enterprise segment targeted by INDES, a more detailed definition is used based on the accumulation pattern, savings capacity and insertion in the Chilean economy:²⁰

- v *Survival or subsistence micro-enterprises* do not have a savings capacity, generate low revenues and have a tendency to draw down capital. They share many characteristics with the informal sector of the economy.
- v *Micro-enterprises with the capacity for simple reproduction* cannot make significant savings, although they are able to support themselves in a sustainable manner. In general, however, this stops them from being able to innovate and extend their installed capacity.
- v *Micro-enterprises with the potential for stock accumulation* are those which can generate savings. This category is generally associated with small enterprises or the "modern" micro-enterprise sector (upper strata). However, they have difficulties in accessing the financial system, particularly to carry out technology innovations and/or investments in the medium to long term.

The table below shows some of the characteristics of the different types of micro-enterprises:

Table G - Characteristics and types of micro-enterprises in relation to their level of accumulation

Type of micro-enterprise	Assets	Annual sales	Number of workers (Manuf. & Construction Industries)	Number of workers (other activities)
Subsistence Micro-enterprises	Max. US\$ 8,000	Up to US\$ 6,000	1 (plus family group)	1 (plus family group)
Simple Reproduction Micro-enterprise	Max. US\$ 16,500	Up to US\$ 40,000	From 1 to 9	From 1 to 5
Advanced Accumulation Micro-enterprise	Max. US\$ 33,000	Up to US\$ 80,000	Up to 9	Up to 5

Source: CORFO, 1998

In Chile, the sectors of advanced capital-accumulation micro-enterprises and small enterprises (in general) at which INDES is directed, have particular characteristics regarding education, degree of formality and levels of sales and assets, which are higher than those corresponding to the same niche in other countries. In addition, a widely observed practice in Chile, which has a strong effect on employment, is the subcontracting of goods or the provision of services, where part of the production process is externalised to small workshops that require financial services, especially in the form of capital goods.

²⁰ "Credit Programmes for Small Producers and Micro-entrepreneurs in Chile" Juan Carlos Accorsi, BILANCE, Sept. 1997.

Consequently, it could be suggested that INDES has made effective use of the particularities of the sector which it serves, and of the market created by these chains of providers between the micro, small and larger enterprises, which is not always the case in other contexts.

v Sectors

As the table below illustrates, the majority of micro-enterprises (41%) and SMEs (36%) are engaged in the commercial sector. This indicator is important as this concentration in the commercial sector does not coincide with the concentration in the manufacturing sector (70%) of INDES' leasing clients and it evidently implies that the market for leasing is smaller than that for loans.

Table H - Sectors according to size of enterprise at national level (number of units):

Sector	Micro	SME	Large	Total
▪ Commercial	179,320	32,462	1,765	213,547
▪ Agricultural production	54,174	8,762	121	69,967
▪ Transport	33,727	7,956	234	41,917
▪ Personal and home-based services	33,407	3,626	41	37,074
▪ Technical and professional services	21,954	6,654	230	28,838
▪ Restaurants and similar	22,355	3,480	62	25,897
▪ Construction	15,407	6,618	587	22,612
▪ Other activities	102,087	20,117	1,775	123,979
Total	432,431	89,675	4,815	526,920

Source: CORFO, 1998

v Dynamism & limitations

The total employment generated by urban-based micro and small enterprises touches 1.3 million people (800,000 in the micro-enterprises and 500,000 in small enterprises). This sector also generated 40% of job creation during the period 1986 – 1995.²¹

In this way, the main social impact of this sector is derived from its capacity to generate jobs. Although these are precarious and of a low standard, they constitute a source of employment for a significant section of the poor population and lowest income earners.

However, although this segment of micro and small enterprises generates significant employment and represents 97% of the establishments, it contributes little to the overall national productive capacity with 18.4% of total reported sales, as the table below shows.

²¹ CORFO, 1997.

Table I - Sales according to size of enterprise

Size of enterprise	1997 (Millions UF)	% Sales
Micro enterprise	201	2.90
Small enterprise	570	15.50
Medium enterprise	515	5.80
Large enterprise	3,287	75.80
TOTAL	4,573	100.00

Source: CORFO 1998

v Access to loan

Unfortunately, only sources from SBIF and CORFO are available which relate to regulated institutions. However, it can be asserted that given that the Banco del Estado and the Banco del Desarrollo are the largest MFIs, and both are from the formal sector, these figures are relevant.

When reviewing the role of these sectors in the total indebtedness of enterprises with the financial sector, the conclusion can be drawn that of the total number of loans granted to enterprises by the commercial bank, 28% were directed to SME enterprises that obtained 30% of the amounts disbursed, and 69% of the operations were directed towards the micro-enterprise sector with only 10% of the total amount, as the following table shows.²²

Table J – Distribution of loan granted by the banking sector according to size of enterprises (1997).

Enterprise size	Number of operations in 1997	%	Bank loans in UF in 1997	%
Micro enterprise	314,138	69	97,585,850	10
SMEs	125,374	28	292,797,488	30
Large enterprise	13,654	3	587,622,712	60
TOTAL	453,166	100	978,006,050	100

Source: CORFO and SBIF

In general, subsistence micro-enterprises, which account for the largest number, are not formalised (they do not pay VAT and do not pay municipal licences)²³ and do not have access to loan programmes in the private sector.²⁴

²² CORFO and SBIF, 1997.

²³ The micro-entrepreneurs' greatest advantage is their informality, given that as soon as they become "formalised" they must increase their overheads, systematise their management structures, make declarations of earnings and pay taxes, obtain a municipal patent, and their premises must be approved by hygiene and other inspectors, they must complete accounts registers, and keep forms to make out receipts and other costs, etc., all of which can lower competitiveness.

²⁴ This segmentation or distortion of the market which negatively effects the mentioned sectors, is due in part to the high transaction costs of operations directed at micro and small enterprises and to the difficulty of the commercial platforms to evaluate the credit risk (including moral risk) and the problems of "adverse selection" related to the absence or poor quality of the financial or technical information to determine the payment capacity of the prospective client.

Therefore, it is the tertiary level (or upper strata) of micro-enterprises that have the capacity to engage in the process of capital accumulation and investment. They have good possibilities to achieve sustainability, and are those more likely to access sources of credit from the state bank or private institutions such as INDES.

To conclude, the sector which INDES is serving is very large, and while the upper strata of micro-enterprises and the small formalised enterprises is being served by various financial institutions, they have not achieved full penetration of the market. INDES has not had any problems of demand given that the tertiary level of micro-enterprises and small enterprises require financing for equipment and additional machinery with a view to increasing production, and these financial needs correspond to larger amounts and longer amortisation periods, hence the attractiveness of INDES' leasing offer.

If INDES needs to further increase demand, it might offer loans to lower-level micro-enterprises that require working capital for the acquisition of primary inputs, but for whom leasing is inappropriate because their needs and payment capacity are characterised by short-term cycles and repeated loan draw-downs and repayments.

C. GOVERNMENT POLICIES IN SUPPORT OF MICRO AND SMALL ENTERPRISES

The importance and magnitude of the sector of micro and small enterprises, as described above, justifies the government's interest in supporting this sector. However, the political context in 1986 and 1987, when INDES was founded, coincided with the era of the military dictatorship when the establishment and functioning of institutions that supported the social development of micro and small enterprises was considered inappropriate, and even more so if they were managed by institutions or people considered to be in "opposition". This explains the incorporation of INDES as a private, for-profit company.

From 1991, with the arrival of the first democratic government of "Concertacion" led by President Patricio Aylwin, systematic action was started in support of the micro, small and medium enterprises, with the intention of fostering the modernisation of production methods, raising levels of competitiveness, and allowing after a period of transition of state support, its autonomous development in competitive markets and the process of globalisation.

These initiatives were achieved through various programmes of support aimed at these sectors, which were accompanied by various state organisations such as the Solidarity and Social Investment Fund (FOSIS), the Institute for Agricultural Development (INDAP) and the CORFO which channelled resources to third parties so that they could become the executors of projects.

In the remainder of this report, a description is made of the government programme established through FOSIS, which directly affects INDES. The other programmes are summed up in Appendix 5 of this report (See page 78).²⁵

²⁵ It is worth mentioning that while there is a more positive appreciation of the need to work with and support this sector, in general, government programmes support micro-enterprises of accumulation, and small and medium enterprises, leaving out lower strata micro-enterprises. Moreover, the state policies in respect to this sector tend to be socially motivated with a view to combating poverty as opposed to development policies, and as such there are no instruments for the promotion of enterprise, technical support, the opening of markets and others. Finally, since Chile no longer qualifies for non-reimbursable international aid, there are practically no programmes of international support that are directed at this sector.

v FOSIS support programme for micro & small enterprises

FOSIS defines as beneficiaries of its support programmes the micro-enterprises, self-employed workers, family companies, and others with the following characteristics:

- v Maximum number of 10 workers, including the owner and family members who participate in the activity of the micro-enterprise.
- v Monthly sales averaging 200 UF (Approx. US\$ 5,500)
- v Fixed production assets of 1,000 UF (Approx. US\$ 27,500)

The services offered to micro-entrepreneurs by FOSIS as part of the various types of financial support are the following:²⁶

a - Subsidy auctions for banks and financial institutions:

FOSIS' action consists in subsidising the loans granted by banks and other institutions to the micro-enterprise sector. Loan ranges between 10 and 40 UF (between 270 and 1,100 US\$), loans are in Pesos, with the maximum standard rate (approx. 3% per month in Pesos) depending on the financial institution, and the amortisation periods vary between 3 and 24 months, depending on the institution and the number of loans. The requirements for obtaining these loans are based on having the characteristics of a micro-enterprise, and not being indebted to the financial system. The collateral demanded varies depending on the financial institution and on its evaluation of the needs of the micro-enterprise.

Banks and financial institutions bid for these subsidy programmes and, in turn, have to commit themselves to putting their own resources upfront for the provision of loans to the sector. The bidding programme consists in discounting the operational cost which the bank incurs by granting a small subsidy of between 2.5 and 3 UF (between 70 and 80 US\$) for each operation. For FOSIS, this programme is one of the most innovative in the field, given its capacity to mobilise large loan resources from the private financial sector in support of small producers and micro-entrepreneurs. Eventually, the objective is that this sector will be "bankable" and able to be incorporated into the financial market where it will be able to support itself and compete according to the rules of the market.²⁷

²⁶ FOSIS also carries out complementary programmes in capacity building and technical assistance under agreements with organisations like SERCOTEC and the Centres for Entrepreneurial Initiatives, which will not be covered in this study.

²⁷ BILANCE, September, 1997

b - FOSIS - INDES Programme

The leasing and technical assistance programme for micro-enterprises was endorsed by INDES and FOSIS by means of an agreement signed in 1991, in accordance with which FOSIS provided financial resources to INDES, while the latter made a commitment to grant an annual average of over 80 leasing operations to micro-entrepreneurs.

In 1993, INDES and FOSIS jointly carried out a successful evaluation of the programme, which allowed modifications to be made to the original agreement with the signature of a new agreement in 1994, to increase the number of operations and extend the validity of the contract until the end of 1998. With this opportunity, an agreement was also made to constitute a Rotating Fund for the programme with a view to facilitating the financing of programme activities during a period of 5 years, until 1998. In September 1998, FOSIS agreed to renew this Rotating Fund for a further period of five years (1999 to 2003), on the understanding that INDES would carry out another 300 operations.

FOSIS' objective is to have a leasing programme consisting in the acquisition of fixed assets (new and/or used machinery) on behalf of small producers and manufacturing and service-providing micro-enterprises in the country, and at the same time, to support their insertion into formal markets. The beneficiaries are the micro-entrepreneurs who do not have access to traditional banking loans and who fall into the following categories, established by FOSIS :²⁸

- ∨ Personnel: Up to 10 people, including the proprietor or producer
- ∨ Fixed production assets: maximum UF 1000 (approx. 30,000 US\$), excluding real estate (home)
- ∨ Sales: Maximum monthly sales UF 250 (approx. 7,500 US\$)

The conditions for operations are as follows :

- ∨ Maximum loan: 700 UF (Re-adjustability : UF)
- ∨ Interest rate: must not exceed 12% per annum
- ∨ Maximum term: 30 months

According to FOSIS, the expectations of the agreement have been reached in full, and for this reason it has been renewed on two occasions with the same conditions. The rationale behind the rate of UF+0 is that the target population benefits, and that the margin serves to consolidate INDES' resources in a long-term perspective.

Within the policies of support for this sector, good relations with FOSIS and the specific agreement that INDES has benefited, were determinant factors in the first stage of consolidation and evolution of the institution. Not only because they allowed the emergence of a new product (leasing to micro-enterprises), but also because INDES has, since 1992, been able to count on the only source of long term funding at an interest rate of UF+0 (inflation rate) for the financing of leasing operations and other operations to SMMEs, which allowed the institution to grow and diversify its portfolio.

²⁸ In the leasing operations funded with FOSIS resources, INDES must fulfil at least 2 out of the 3 parameters indicated.

In this process, it is important to highlight that as in all negotiations, the actors involved have played a vital role, and that INDES has been fortunate to count on people who were able to lobby and negotiate the renewal of these resources, with the consequent benefits.

D. THE CHILEAN FINANCIAL SYSTEM

In Chile, different types of financial intermediaries directed at various sections of the economy, co-exist. For the purpose of this study, they are regrouped into 4 groups:

v *Regulated institutions*

As of 2000, a total of 28 banks and 1 financial institution operate in the Chilean financial sector, of which 9 are national private institutions, 18 are foreign and 1 (the Banco del Estado) belongs to the state. The total assets of the banks at the end of December 1999 was US\$ 68,000 million, with US\$ 48,700 million in loans portfolio, US\$ 11,850 million in investments, US\$ 1,850 million in fixed assets and US\$ 5,600 million in other assets. On the other hand the total debts consist of US\$ 5,800 million in capital, US\$ 38,400 million in deposits and US\$ 23,800 million in other debts.

The banking sector finds itself in a period of consolidation in so far as the banks are merging in order to achieve economies of scale which allow them to compete internationally. The largest Chilean bank is the Banco de Chile and the largest foreign banks are the Banco Santiago and the Banco Santander-Chile. Besides, there is one financial institutions namely Conosur which is under the supervision of the SBIF, although their investments represent only 1% of all investments in the financial system.

This traditional financial system is principally serving the needs of the sector of medium and large enterprises. The Banco del Desarrollo and Banco del Estado, through their associated enterprise and subsidiary, respectively, are both operating with micro-enterprises, as is explained below.

a - Bandesarrollo Microempresa:

Bandesarrollo Microempresa started operating in 1990 and was one of the pioneers in the provision of loan services to the micro-enterprise sector in its first two levels (simple reproduction and extended reproduction), as much in the formal as in the informal sector, although the majority of its clients belong to the latter category.

The loan policy is adjusted to the commercial activity of the micro-entrepreneur, initially with small sums which increase depending on the end- use and type of payment. Bandesarrollo Microempresa uses various kinds of collateral: up to 60 UF (US\$ 1,650) for group loans (or solidarity group collateral) or individual loans (certified guarantee or endorsement from the spouse) and in addition, real collateral (pledged or mortgage). Capacity-building and training are carried out through partnership with specialised NGOs for each type of activity.

As of December 2000, Bandesarrollo Microempresa had 40 branches (also called micro-enterprise centres), 15,030 active clients and an average loan size of US\$ 1,050; an average term of 12 months, and an average interest rate of 2.7% per month in Pesos. The highest loans were US\$ 4,000. Total value of loans granted to this date was US\$ 70.8 million, with a portfolio of US\$ 15.6 million, with 12,539 operations and a default rate of 14.3%. The allocation of the portfolio by sector is as follows: commercial – 52.5%; manufacturing – 28.6%; and services – 18.9%.

Considering Bandesarrollo Microempresa does not offer leasing services and that its average loans are smaller than the loans offered by INDES (US\$ 2,750 Aprox.), it does not constitute direct competition and tend, on the contrary, to complement its services. With the growth of both institution, a certain overlap may arise with some of the small clients of INDES and other bigger clients of Bandesarrollo Microempresa. This would probably need to be addressed in concertation.

b - Microempresa Banco del Estado

Banco del Estado is a state-owned bank in Chile, ranking fourth in investment, with approximately 13 % of deposits and 10 % of the capital and reserves of the entire regulated private financial system.

Banco del Estado, through its microfinance subsidiary Microempresa Banco del Estado, has been operating in this sector since 1992. As of December 1998, it had approximately 10 000 loan operations with an average individual value of US\$ 1,000, and a portfolio of US\$ 10 million.

This micro-enterprise subsidiary is being subsidised by the parent bank in two ways. First the subsidiary does not have to pay its medium costs to contribute to the general expenses of the Microempresa Banco del Estado, according to the use which it makes of the resources (cash, checks, etc.) and marginal use costs. Secondly, it manages the only fiscal account and as such has access to free funds, affording to subsidise its loan interest rates (1.6 % a month in Pesos) and its fixed expenses (personnel, premises and others), thus creating distortions in the market.

At present Microempresa Banco del Estado is not in competition with INDES since it targets another market niche and does not offer leasing services. It may eventually constitute disloyal competition on direct loans as it has done with other MFIs.

It should also be pointed out that the advantages of these two institutions are that they can count on the endorsement and operational support of the head office banks. They have a national presence and are operational in all the regions of the country where the Banks are present and count on resources and funding enabling them in addition to participate in bidding for subsidies of FOSIS without much difficulty in financing their growth.

v *Microfinance Institutions (MFIs)*

In this field there are various private microfinance institutions, including INDES, although their products and niche market are not exactly the same:

- v Cooperativa de Ahorro y Crédito Liberación
- v Corporación de Promoción para la Pequeña Empresa (PROPESA)
- v Fundación Contigo, Financiamiento y Crédito Solidario
- v Fundación SOINTRAL
- v FINAM, affiliated to Women's World Banking

The original objectives of these institutions are similar in that they consist in providing support to micro and small enterprises and independent workers on the basis of a package of services including credit, technical assistance and capacity building. In general, their activities are directed at beneficiaries in the informal sector, who have smallholdings, a low technological level and up to three workers.

All the MFIs listed here have reduced their operations (except INDES) and many are concentrating on the provision of technical assistance, capacity building, training and associativity.²⁹ Subsequently, most of them withdrew from delivering financial services. The complicated situation which they are currently facing is due to several factors. Firstly, as non-profit-making foundations or as corporations, they have not been able to make increases in capital and have been dependent on development assistance funds. Secondly, the government, through FOSIS, has broken off its support via credits at UF+0% rate of interest and non-reimbursable development assistance funds³⁰. Therefore, MFIs were forced to access bank loans by using real estate as mortgage (which generally belonged to its Directors) and were not able to survive given that the financing costs were excessively high and the intermediation spread (given the maximum conventional ceiling rates fixed by the SBIF) were not able to cover the costs of such small operations. Thirdly, international, bilateral and multilateral development assistance resources have been considerably reduced in Chile, and are currently being channelled through the CORFO towards regulated institutions. Finally, many of these institutions counted on low levels of capital, small portfolios, few investments, low levels of coverage, high costs and they did not contribute to the risk portfolio.

The default rate in the MFIs' portfolio is much higher (approx. 10%) than that of banks and financial institutions (4 to 6%). At the end of 1997, the average interest rate with which they operate was 2.7% per month in Pesos, with average loan sizes of US\$ 1,000 and they served about 110,000 clients with a total of US\$ 118 million.³¹

v *Leasing companies and Factoring*

The Chilean Association of Leasing Companies (ACHEL), in year 2000, comprises 16 companies and the Chilean Association of Factoring Companies (ACHEF) has a membership base of 11 companies, including bank subsidiaries and other non-banking, non regulated institutions that offer leasing and/or factoring with a view to the exchange of information, having a risk centre for leasing and factoring operations, and carrying out studies and evaluations on the themes that are relevant to its members.

²⁹ Interview with Luis Magallanes, Manager of Sur Profesionales.

³⁰ This makes the FOSIS-INDES programme even more attractive and unique.

³¹ BILANCE Study, Sept. 1997.

The total assets of the member companies of ACHEL amount to US\$ 1,450 million. At September 2000 leasing companies had 23.243 leasing contracts of a value of US\$ 1,884 million, signifying an average amount per contract of US\$ 81,000. Otherwise, the classification of the portfolio by type of asset reveals that 51.9% of the operations are for real estate, 20% for transport equipment and 9.3% for industrial equipment.

A default rate of more than 30 days, for traditional leasing institutions, is in the order of 7% under normal circumstances, but can rise to 20% in bad periods .

At June 2000 Factoring Companies had granted operations for an amount of US\$ 339 million with 3,604 clients, with an average amount per client of US\$ 94,000. However, Factoring Companies granted, on annual basis, operations for an amount of US\$ 2,200 million.

In this way, the users of leasing companies in Chile are the medium and large enterprises, partly because of the tax advantages and the security which these type of operations represent.

Leasing Banco del Desarrollo:

INDES is a shareholder with 3.3 % participation in the Bandedesarrollo Leasing. Since November 2000, it is a Division of Banco del Desarrollo.

The Subsidiary started to operate in 1995 and at present occupies the 11th position in ACHEL's ranking of companies, a portfolio of US\$ 48.5 million with 740 contracts, and an average amount of US\$ 65,500 per leasing operation. In addition, it has the largest part of its portfolio invested in real estate leasing operations (58.5%)

Bandedesarrollo Leasing targets sectors or niche-market different from that of INDES. The leasing operations financed are for higher amounts therefore its portfolio is much bigger as well as the average amount of leasing operations.

v Informal loan sharks

As in most economies, there are a diversity of informal loan providers who grant loans to sectors that lack access to the traditional financial sector, to the MFIs or leasing companies and other non-regulated financial institutions, because they have a bad credit history, or require rapid loans, with a minimum of transactions and procedures. The average interest rate for loans is 10 % per month in pesos. However, as the number of financial services from the above-mentioned institutions increases, the number of usurers has been in decline, to the extent that it is considered insignificant in Chile.

E. THE CHILEAN LEGAL AND REGULATORY FRAMEWORK

In Chile, the legal and regulatory framework of the financial sector only affects banks and financial institutions regulated by the SBIF, which is contingent on the Ministry of Finance. There is a separate legal and regulatory framework that affects leasing companies and banks that offer leasing, either directly or through specialised branches.

Consequently, INDES benefits from a set of regulations that recognises the existence of leasing, and does not limit its practice merely to regulated institutions. The legal framework in Chile also contains clear rules of the game in respect of the “lessor”, regarding its rights as proprietor of the commodity being leased, and the procedures for the repossession of the commodity if necessary, in cases where the contract is broken. It also provides the “lessee” with clear rules, regarding the possibility of having uninterrupted use of the commodity during the leasing period, so long as payment obligations are complied with, and subsequently being able to exercise his or her option to buy.

Concerning tax regulations, on one hand the lessor can depreciate the commodity (the period of depreciation is less or equal to the duration of the leasing contract) and discount the tax on the purchase of the commodities being leased, and on the other, the lessee can deduct payments and monthly quotas from his or her tax obligations. However, for the sector of micro and small enterprises, the tax advantages do not constitute the main source of attraction of leasing (rather the possibility of gaining access to a source of financing) given that, in general, their financial statements are incomplete, precisely to avoid tax on income and, in other cases, they are informal and do not make contributions anyway.³²

Regarding the regulations for credit operations which affect microfinance institutions in Chile, although there are significant differences with traditional financial institutions (e.g. in relation to the number of clients, type of guarantees, method of payment, documentation and analysis of the credits, amounts, the diversification of risk, default rates, repayments terms and institutional structure) these operations are, for the most part, treated either as small consumer credit operations, or larger commercial credit operations.

Nowadays INDES is going through a new stage in its own development which will allow it to maintain a strong position within the MFI sector in Chile.

However, INDES faces new challenges as, there are more regulated and non regulated financial institution offering finance services to micro and small entrepreneurs. While not being regulated nor supervised by the Chilean’s SBIF, INDES fulfils the general regulatory and legal norms set up for such institutions which grant credit and leasing operations.

During the last years governmental institutions (Ministry of Finance and Economy), the SBIF and micro and small enterprises’ associations have been discussing about the necessity to have a regulatory framework especially tailored to the needs of microfinance institutions due to the higher risk and costs incurred by their specific activities. Some steps have been made regarding the maximum legal rates: in the past there was a single maximum legal rate, regarding the credit amount and its payment period.

³² This type of tax incentive can, however, be interesting for some of INDES’ leasing clients with larger operations.

3rd Part

INTERNAL FACTORS

Getting to know on the inner side of
INDES

What factors contributed to INDES' institutional performance ?

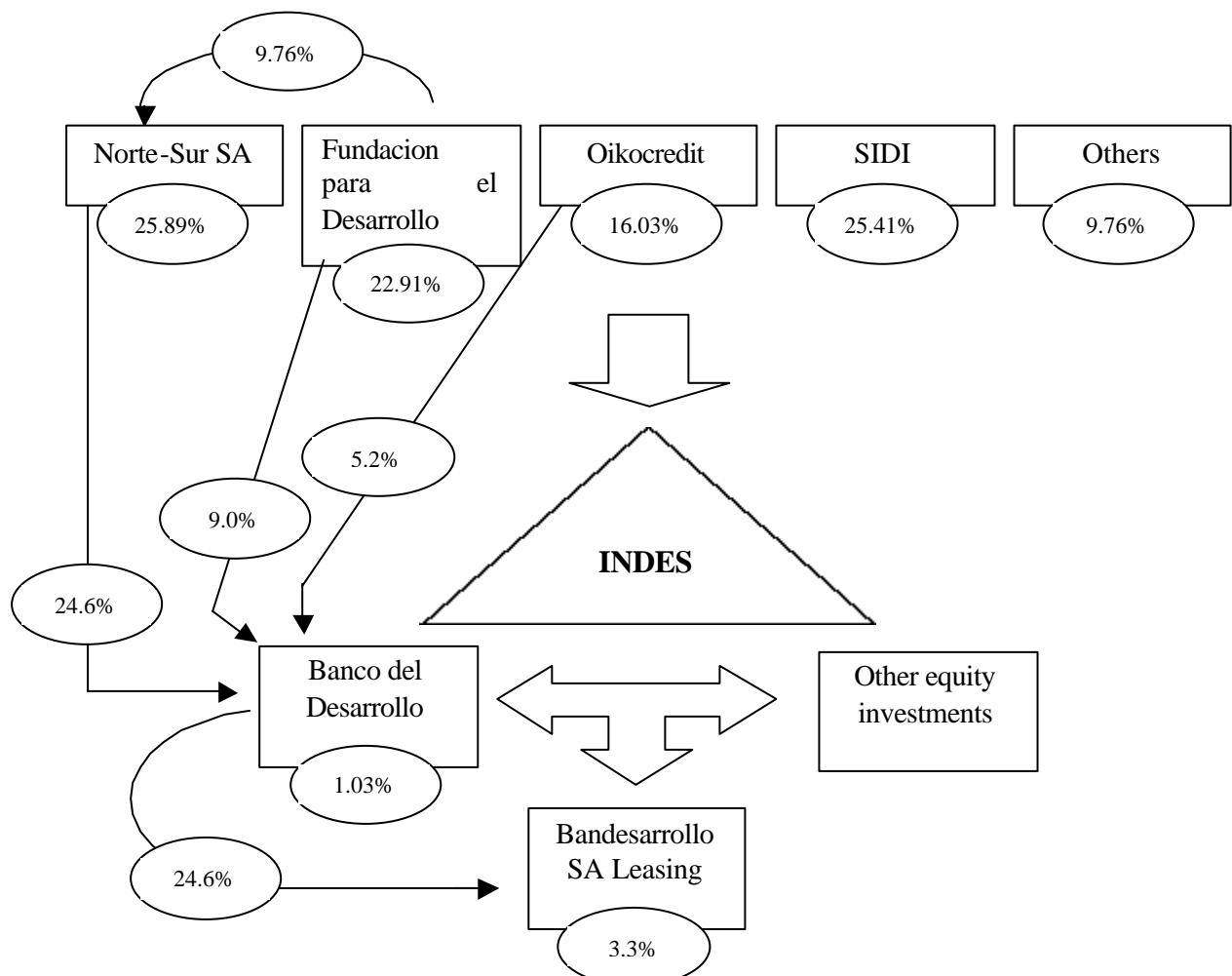
A. PROPERTY AND GOVERNANCE

The Fundación para el Desarrollo and SIDI were the largest shareholders when INDES started operations in venture capital. Later, despite being one of the major shareholders, SIDI assumed a more passive role in this partnership. The Fundación and Norte-Sur who own 48.2% of shares in INDES, and constitute the link with Banco del Desarrollo (with a 33.6% shareholding), have played a determining role in its consolidation. These two shareholders together with small ones linked to Banco del Desarrollo, have a majority shareholding (57.96%). The three main shareholders (SIDI, Inversiones Norte-Sur and the Fundación para el Desarrollo) are all represented at the Board of Directors and Executive Committee of INDES, thus having an active participation in the management of the company.

INDES, in turn, has investments in the Banco del Desarrollo (1.2%), in the leasing subsidiary of the same Bank (3.3%), and other investments corresponding to venture capital operations which are a legacy of past years.

The following diagram has been developed to give a better understanding of INDES' shareholding and investment structure and in particular its relation with the Banco del Desarrollo.

Diagram A - Shareholding and investment relations of INDES:



As this diagram shows, INDES is not an enterprise which exists on its own, rather it is backed up with a group of companies which are inter-linked, and which coincide in their mission to achieve a balance between social and economic returns. This link between companies can be seen not only at the level of shareholders but also at the level of the personnel which has a power of decision in various related companies.³³

In spite of the proximity of relations, there is a vacuum in matters related to governance and accountability. This is due, in part, to the fact that so many institutions are linked together and, in this way, it is not always easy to identify the actual decision-makers. Banco del Desarrollo which is at the centre of the structure is not a shareholder in INDES. The latter being small and profitable, the Bank commitment to its members is minimal, especially since these do not have minimum profits and performance requirements.

v *Focus on the relationship with Banco del Desarrollo*

Although Banco del Desarrollo is not a direct shareholder in INDES, it deserves a descriptive section, given that it is located at a central point in the inter-relations between companies, and the matter of governance cannot be analysed without some consideration being given to the Bank.

Banco del Desarrollo was set up in 1983 by the Fundación para el Desarrollo, with a social mission to support the development process through the provision of private financial services, directed at sectors of the population with the economic potential and capacity to set up viable activities, but who found themselves on the margin of the traditional financial system.

At the end of 2000, Banco del Desarrollo occupied the tenth position in the ranking of the financial system in Chile, with a loan portfolio of US\$ 1,700 millions that represent 3,5% of the Chilean Financial Market. At present, the institution has 65 branches throughout the country and 7 subsidiaries or partner companies including Bandedesarrollo Leasing and Bandedesarrollo Microempresa, which have already been described in this report.

Since its beginning Banco del Desarrollo has played an important role in INDES development. Between 1986 and 1987, the professionals associated with the Bank and its principal shareholder at the time, the Fundación para el Desarrollo, were the instigators of the idea behind INDES and the strategy for setting it up, with the objective of having a complementary financial operator in the field of venture capital. Moreover, through the Foundation, the Bank has been directly involved in the entire process of consolidation and growth at INDES, providing assistance and general support. Due to the fact that Banco del Desarrollo aims at financing a segment of micro and small enterprises, INDES benefits from a kind of synergy servicing all those micro and small entrepreneurs whom Banco del Desarrollo and its subsidiaries do not.

Financing from Banco del Desarrollo

At the present Banco del Desarrollo has granted two revolving credit lines on annual period:

- a) Line for operational capital for an amount around US\$ 1.5 million, at an interest rate of UF+8.5% per annum which is a normal rate for the Chilean Financial Market.
- b) Line for leasing operations (vehicle and van rental) for an amount of US\$ 600,000 at an interest rate of UF+8% per annum, which is somehow lower than the market)

Investments and commercial operations (October 2000)

³³ For example, the president and member of the Board of Directors and Executive Committee of INDES, is at the same time, Advisor of the Banco del Desarrollo and Finance Manager of Norte-Sur. The General Manager of INDES used to work in the Bank

INDES has diversified its investments and at present owns 1.28% of the shares of Banco del Desarrollo and 3.31%³⁴ of the shares of its leasing subsidiary. These investments are equivalent to 32% of INDES' assets and to three-quarters of its net capital stock. INDES has a commercial rental contract with Banco del Desarrollo for about 45 vans and 28 vehicles. This contract is financed with the credit line defined above (letter b). In general terms, this contract allows INDES to obtain a normal profit.

Support

In the past Banco del Desarrollo supported INDES through the payment of a percentage of the salary of the General Manager. Since October 2000, this salary is entirely being paid out by INDES.

Due to the synergy mentioned above, subsidiaries from Banco del Desarrollo (Leasing and Microempresas) send to INDES all clients that can not be serviced by them. In the same way INDES' clients can make their payments in any one of the 65 branches of Banco del Desarrollo.

To summarise, INDES and Banco del Desarrollo act independently of each other and their relation is not formalised by means of an agreement or contract. However, informal arrangements work and implicitly generate a certain synergy, which is beneficial to both institutions. On the one hand, INDES is an institution with a good name, which tends to complement the services offered by the Bank through its Micro-enterprise and Leasing subsidiaries. On the other hand, INDES benefits from a set of support, activities and evaluations which are carried out by the Bank, as mentioned, and the image of security and confidence which the Bank generates in the eyes of INDES' clients, especially for those who leave their property in mortgage for lease-back operations.

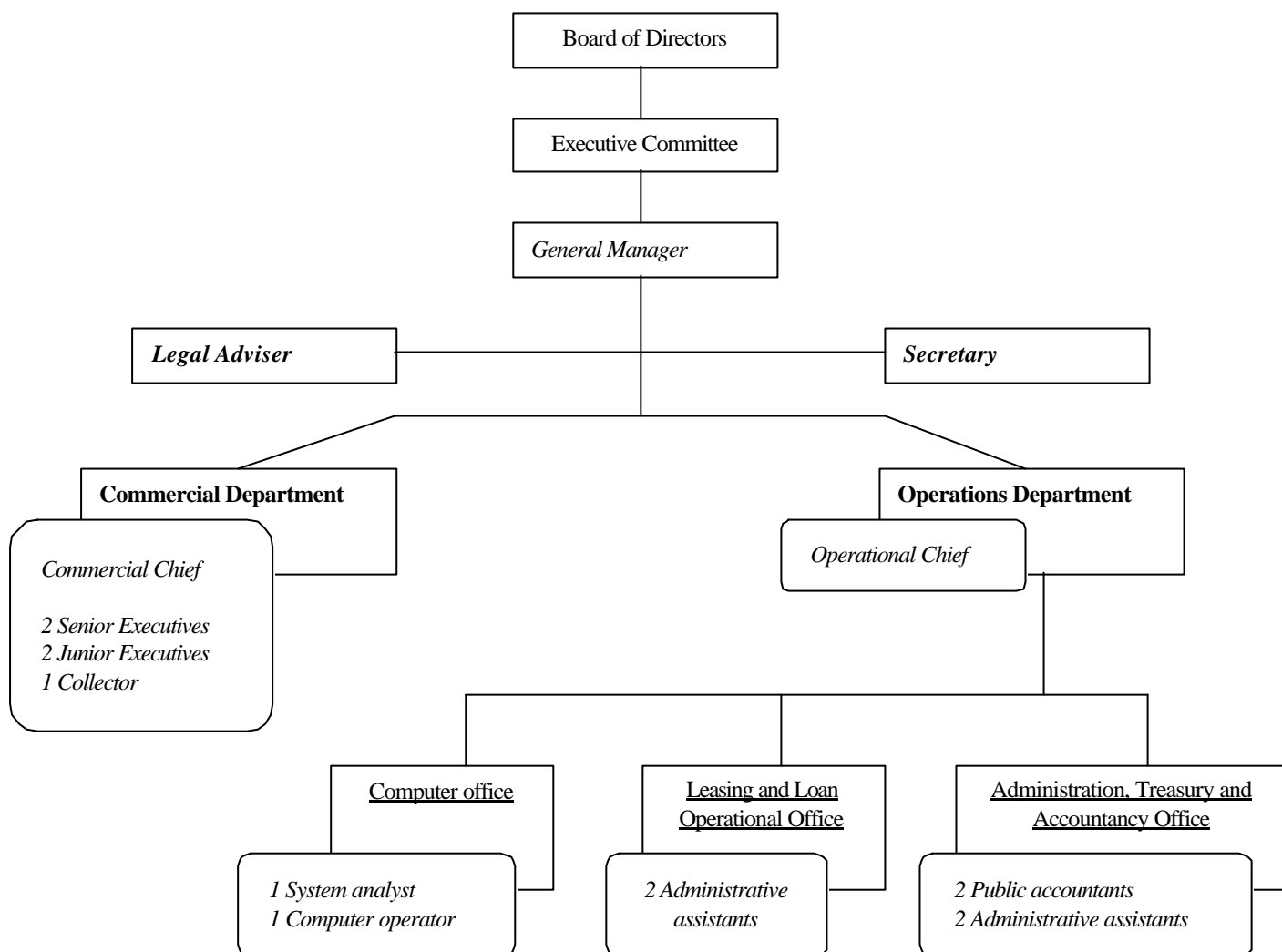
B. ORGANISATIONAL STRUCTURE

The organisational structure of INDES is not rigid and has not been predetermined. Principally, it has been adapted in line with the changes and progress of the institution. In the past the structure was centralised at the level of the head office and at the level of the general management. Nowadays this structure is through significant changes.

The following diagram is a summary of the different levels of the organisation.

³⁴ This participation has since been sold to Banco del Desarrollo.

Diagram B – Organisational structure of INDES



v Board of Directors

A Board of Directors consisting of 4 people who represent the following shareholders, manages INDES:

- | | | |
|---|------------------------------|-------------|
| v | SIDI | 1 director |
| v | Fundación para el Desarrollo | 1 director |
| v | Norte – Sur S.A. | 2 directors |

In addition, an advisor to the Ministry of Finance participates in the Board of Directors as a guest, without representing a shareholder.

The Board of Directors meets on quarterly basis and is the body responsible for endorsing policy proposals and strategies, ratifying reports and agreements presented by the Executive Committee, electing the General Manager, and other actions and matters which are specific to their task.

In INDES' case, the role of the Board of Directors is not overarching given that three of its five members also participate in the Executive Committee, which has a vital and highly committed role in management and, especially, in the process of granting credits. However, the members of the Board of Directors have been able to steer INDES as a profitable entity which is administered according to the directives for a Stock Company, and in accordance with its mission to support micro and small enterprises.

v Executive Committee

This consists of 3 Directors and the General Manager, and has responsibility for planning, policy design, commercial strategy, management control and the follow-up of institutional development. The Executive Committee, in part, assumes a role normally reserved for the General Management, being directly involved in the management of INDES, mainly from the point of view of raising external resources.

The executives who belong both to the Board of Directors and the Committee are people who are recognised in the sector which provides support for SMMEs, and all have a commitment in realising both the social and profitability objectives of INDES.

The Executive Committee also plays the role of the Credit Committee which meets once a week, requiring the presence of minimum two members and the General Manager plus the commercial or sales executives to constitute the necessary quorum for the approval of loans and leasing operations which are beyond the attributions of the General Management, as the tables below explains.

Table N - Management levels for the approval of Leasing operations:

Level	When there is no collateral - in UF	With certified endorsement(s) - in UF
• General Manager	Up to 100	Up to 150
• Credit Committee	> 100	> 150
Conditions: Individual contribution must be of (minimum):	25 %	20 %

Source: INDES

Table O - Management levels for the approval of other Credit operations:

Level	Guarantees		Real		Commercial
	Without guarantee – (in UF)	With certified endorsement(s) – (in UF)	With pledges (in UF)	With mortgage (in UF)	Factoring- (in UF)
• General Manager	---	Up to 50	Up to 150	Up to 400	Up to 100
• Credit Committee	All	> 50	> 150	> 400	> 100

Source: INDES

v *General Management*

This is the management level responsible for overseeing institutional development, the approval of a certain number of operations, the co-ordination of tasks among the personnel, the production and revision of information (financial and operational) and the preparation of all the reports which are required by the Executive Committee and/or the Board of Directors.

In October 2000, a new General Manager was incorporated at INDES, under the decision to change the management to a level in accordance with the institution's new stage of development. The new General Manager is accountable to the Executive Committee and is responsible to establish clear procedure and norms for all personnel, and also to upgrade the procedure manuals for all financing operations granted by INDES.

Included in this new role is the task to work out new commercial policies, a new strategy and a formal human resources policy.

All operational tasks previously performed by the General Manager have now been assigned to the Commercial or Operational area. A great step to lessen centralisation has been made. All these changes aim at preparing INDES to confidently face coming challenges either related to the Chilean field of microfinance with an increase in competition or related to its own institutional development.

v *Commercial division*

The commercial division is responsible for financial operations, and is the division on which all the sales points, the cashier manager and the process for the normalisation of late credit payments, are dependent³⁵.

Agencies or Sales points:

Until October 2000, INDES had sales points in cities near Santiago, such as Valparaiso, Los Andes, San Felipe y Rancagua. It also maintained some branches in Santiago's district: La Florida, Quinta Normal, and Republica. All of them established in Micro-enterprise Centres of Banco del Desarrollo.

Due to new regulations INDES has to leave all these locations. Hence, INDES is now studying a new plan to develop the location of branches or sales points. This plan is linked with the New Business Strategy. Nevertheless INDES has maintained the financial services in Valparaiso, Los Andes, San Felipe and Rancagua from the Head Office; the same as Republica, La Florida and Quinta Normal branches.

v *Operations department*

The Operations department has its own Chief who is responsible for the supervision of administrative measures, accounts and systems, as detailed below:

³⁵ The process of payment retrieval, which includes normalisation, legal procedure, and write-offs, is detailed in Appendix 4 of this report (See page 77).

a - Administration, Treasury and Accountancy

The Chief of the Operations department, together with the account personnel, elaborates the monthly financial statements, which are subsequently revised by the General Management.

Regarding the payment of taxes, INDES is liable for annual income tax payments of 15 % on its benefits (it is paid in advance in monthly instalments, as a percentage of the total sales amount). INDES also pays taxes in the form of fiscal stamps and stamps for the credits, so that it acts as a tax collector for the credits and the fiscal payments, which it makes once a month.³⁶

b - Information System

At present INDES counts with the following three information systems:

v System for Administration of Leasing and Credits (SFI)

The system has been created and developed by INDES. It has been in use since 1996 and its purpose is to administer all leasing and loan operations. Its main features are the recording of operations, payments, invoicing and the mailing of diverse reports, principally relating to repayment, management and accountancy³⁷.

The maintenance and performance enhancements of this system fall under the responsibility of a small computer area consisting of one computer analyst and a computer operator.

v System of Accountancy (Flexline Flecon)

A computer package programme bought on the market and used since 1992 (although it has been upgraded to a Windows configuration). It is used for the administration of the institution's accounts data, in accordance with the current norms relative to accounts and tax payments, and it produces balance reports and other reports.

v System of Analysis and Evaluation of Micro and Small Enterprises (EVAL)

As with the SFI, this system was created and developed by INDES in 1996 and also requires up-grading. The EVAL comprises the evaluations and assessments of the micro and small enterprises and their projects of investment, and produces reference sheets for the Credit Committee. It is a system that enables on-the-spot evaluations, and the systematisation and grading of clients and their projects. However, the EVAL is not exploited to its full capacity given that the grading facility is not being used and the system is only installed on one laptop computer. Consequently the other executives have to feed it manually.

To summarise, although the three systems have played an important role within INDES, in its management considerations and its operational performance, it is necessary at present to consider upgrading them with a view to creating an integrated network (with a Windows configuration) with access to email. Moreover, it is necessary to analyse the information that is required and produced by the system to avoid duplication, and make more effective use of it in a way that facilitates decision-making processes.³⁸ Equally, the use of laptops

³⁶ INDES pays for the difference in the VAT payments for the purchases made (of the commodities which it acquires for the leasing operations for example) and the VAT which it charges on its services (each leasing quota becomes a service). INDES cannot discount the VAT from the bank expenses for which it is liable.

³⁷ The reports satisfy the requirements which correspond to the administration of individual operations (outgoing, development tables, payments, tracking of the movements of each operation, debt balance per client, other); as detailed or summarised reports (of accountancy, charges, management, accounts sheets (monthly VAT - Monthly Indemnification Insurance – fiscal stamps), overall default and the default-rate per operation, balance per portfolio and per branch, debtors per portfolio and branch, and others).

³⁸ For example, the list of debtors, which can be obtained daily, is not used optimally, since it is only used once a month. In addition, the information concerning the principal sources of clients is not being used to define market strategies. Likewise, there are several types of reports which are partially or not used at all. Consequently, although at present, some models and subsystems are being developed, in order to complete

in all the evaluations that are carried out in the field should be considered, which would cut out the procedure of transcribing collected data. Investments in systems and equipment may be costly but they are necessary for growth and good operational and administrative management, and they should be considered a high priority, if possible with help from technical assistance funds.

Finally, it is worth mentioning that, in December 2000, INDES signed an agreement with IADB-FOMIN to strengthen its management and organisational structure. This agreement will provide resources especially to develop new information and accountancy systems as well as to buy new computer equipments for office and field works, which will allow INDES to solve all the above-mentioned failure and limitations of today systems.

v Evaluation & Control

INDES is subject to an external evaluation by Deloitte & Touche which carries out an annual audit of the balance sheets and cash flows in accordance with the generally accepted norms and principles of auditing and accountancy, and double-checks this information with INDES' clients and personnel. Besides, an external legal adviser is also responsible for legal procedure concerning loan and leasing operations.

Internal controls are in line but as yet simple, above all because INDES is a small entity. An assessment is being carried out of all internal control procedures and changes are being implemented.

With a more sustained portfolio growth, INDES will need to strengthen internal controls at various levels, and this matter is considered in the IADB's agreement.

C. HUMAN RESOURCES

The Chief of Operations is in charge of personnel and manages the account procedures for the payment of salaries and contributions. INDES does not have a policy for the management of human resources and the processes are not formalised.

Nowadays a Human Resources Management Policy is being developed by the new administration in order to establish a clear definition and responsibility for each post by assigning the tasks that should be performed by each employee.

this process, it is considered necessary, in the short term, to move towards more modern programmes (in a Windows environment) which are also more efficient.

v Selection & Profile

The selection process is conducted on the basis of personal contacts or referees as well as from the data bank of Banco del Desarrollo's Personnel Selection Office. The potential candidate is interviewed by the General Manager, and a member of the Executive Committee, if they approve the candidate must then sit a psychometric test. If both are positive, its application is submitted to the approval of the Executive Committee. However, this procedure is not always strictly followed.

The probation period of the contract last 3 months. All personnel are on normal (permanent) contract. INDES pays for 12 salaries annually. In general, the contribution to the Pension Fund Administration system (AFP) amounts to 20% of the salary per employee (13% to Retirement Pension Schemes and 7% to the health insurance).

The standard profile of the field personnel is a commercial expert, accountant or business administrator, although having one of these titles is not an essential requirement, and more important are the candidate's aptitudes and customer relations.

v Incentive scheme

In the past, the only economic incentive that the personnel had, was that of a bonus which was contingent on the performance of the employee as well as INDES' performance and financial indicators. However, this incentive was not regulated and depended on the reference of the immediate superior.

At present, a new Human Resources Management Policy is being outlined, which will set up an incentive scheme to include factors such as the value of the portfolio, the number of clients, the default rate and write-off for each sales executive. This scheme will also allow to set up tasks for the Operations department related to the number of leasing and loan operations to be processed, invoicing and report on default portfolio, management and accountancy. Subsequently, a final evaluation will help to clearly define the criteria for promotions, economic and other incentives.

Also a salary review is being carried out in order to fix salary levels in accordance with the responsibility and the targets performance by employees.

v Review of efficiency

It is complicated to calculate the efficiency of each sales executive given that a few executives work certain days in the head office and the other days in other sales points. Moreover, in the branches, the executives carry out all the specifications of their job, whereas at the level of the head office, the tasks tend to be split as well as the procedures from evaluations, disbursements, follow-up and payment collection.

The new administration – new General Manager – is in the process to establish clear procedures to improve efficiency. In this respect it is important to have in mind that given its target market and its related organisation, measuring INDES' efficiency should be somehow different from a normal MFI. INDES has two senior and two junior sales executives. The investment portfolio is currently being checked with the view to reassigning among the 4 sales executive so as to improve the efficiency in its management.

The new Human Resource Policy will consider issues such as capacity-building and motivation of personnel and the development and maintenance of an institutional culture and image.

To summarise, INDES' personnel play an important role in the development and performance of the institution. The staff is characterised by their enthusiasm and vocation; turnover is low: most of the personnel have been at INDES for an average 5 years. They have a substantial knowledge of the sector, its characteristics and needs, and of the leased machinery and goods: description, rate of depreciation, market value, be they new or reconditioned. They also have the capacity to undertake evaluations of clients in respect to end use of the loan, the type of machinery to be leased, and are qualified to serve the clients regarding any one of the services offered by INDES.

INDES, for its part, is making an effort to capitalise on the comparative advantage of its personnel, hence the reason why the senior commercial executives take responsibility for carrying out the evaluation of the clients, especially those considered as SMEs, while others process the credits and leasing. This definitely entails certain advantages, but also raises challenges: how to transfer this experience and knowledge to juniors' levels.

D. CLIENTS

The minimum eligibility criteria for clients are not fixed with INDES. In general, levels of technical and economic ability of the business; the viability of the project; a minimum entrepreneurial experience of one year and a demonstrable capacity to pay; and commercial reports, are taken into account.

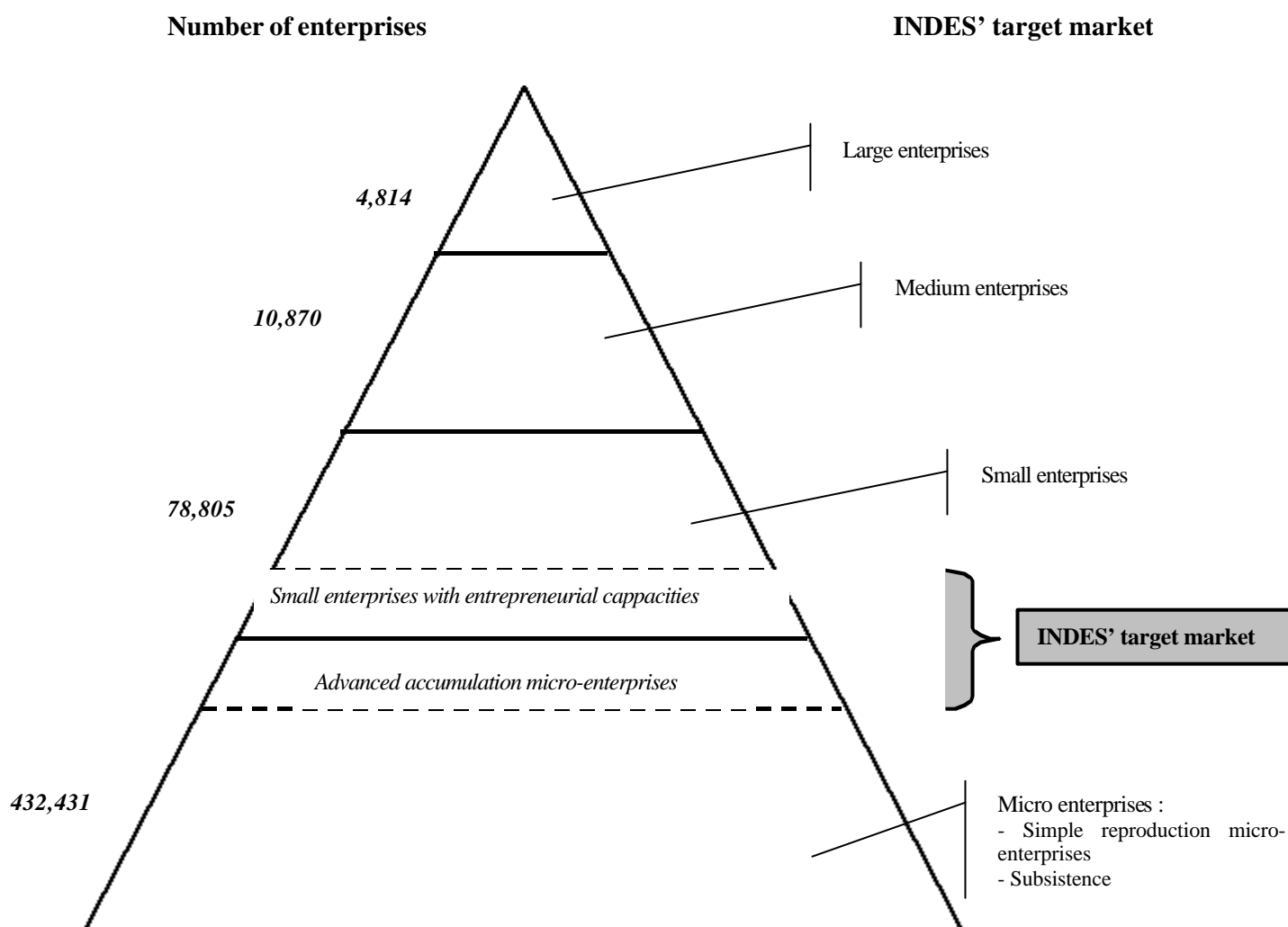
The criteria are flexible and unlike the banks, for example, INDES offers credits to people over the age of 70 and also to those who can provide evidence of having paid off late debts despite the fact that they remain in the DICOM records for not having paid the withdrawal fee.

v Characteristics of the client base

INDES has defined its target market as the third level (or upper strata) of micro-enterprises and the sector of small enterprises who have entrepreneurial capacity and experience in their field, but who have difficulties in accessing the formal financial system to carry out investments in the medium and long terms.

The following diagram shows the number of potential clients that INDES has:

Diagram C – Target market of INDES



INDES' initial vision of serving these sectors with a view to making them "bankable" (preparing them for credit provided by banks) is no longer pertinent. Today, INDES is aware that a client who is being served and who has a good track record of payments, is a good investment and, consequently, it does not make sense to transfer him to another financial institution. INDES intends to follow the client through his/her process of development and offer him/her the services, which he/she requires, from the range of services it has on offer.

The selection of the micro entrepreneurs is carried out in accordance with the parameters laid down by FOSIS, which correspond with the characteristics of micro-enterprises of accumulation, regarding levels of sales, fixed assets, and the number of employees. INDES' definition of the sector of the small enterprise is broader and more flexible. While the emphasis is on serving those enterprises which do not have access to traditional financing, the institution also serves, to a lesser degree, the larger small enterprises which have the necessary guarantees and appear to be operations of a low risk.

INDES' main leasing clients operating in the sector share many characteristics of the micro-enterprises of accumulation, and various features of the bottom level of small enterprises: print shops (16%), mechanical and precision workshops (23%), grocery manufacturers (16%), car mechanics workshops (11%), furniture (6%), dress shops (5%), and others.

Approximately 90% of INDES' clients work in the formal sectors of the economy; they pay VAT, manage their balance sheets, and pay their obligations. The majority of the clients is aged between 35 and 49 years (51%); have medium level education (49%) or a technical training (25%); 70% are married and have 1 to 2 children. Likewise, the majority of the clients interviewed (60%) have between 11 and 15 years relevant working experience and their enterprise is between 6 and 10 years old, which would seem to suggest that they acquire experience and preparation in the area of their business as employees in other enterprises, before going independent and becoming self-employed.

In addition, regarding the leasing clients, the majority (70%) belongs to the manufacturing sector and the majority of these (65%) financed the purchase of the assets or new equipment (especially winches, vehicles and printing machines), and the rest purchased used or reconditioned goods.

Many of INDES' clients are not being served by the traditional banking sector for a variety of reasons. According to the interviews with the clients and INDES' personnel, the main problem which prevents clients from having access to the traditional banking sector is not so much a matter of collateral, and that the level of registered and declared sales are not real. The majority of the clients in micro and small enterprises, despite being formal, do not declare their actual level of earnings in order to pay fewer taxes. However, this prevents them from having access to larger amounts of loans from the regulated institutions. INDES has the advantage that by being more flexible and through an evaluation in the field using internal procedures, a good knowledge of the sector, and the experience of the analysts, it can make an evaluation of actual sales levels, and identify more accurately their genuine capacity to pay, and thus match the amount of the loan or leasing with this capacity.

By assessing the client and his/her project as opposed to just his/her financial status, INDES is able to reach sectors that have collateral but do not have access to formal financial institutions. However, this flexibility may entail a certain number of risks.

v *Clients incentives*

There are various motivations that push clients to approach INDES. However, the majority of the clients does not have a specific preference for a particular product, and even less so in the case of leasing insofar as they are unaware of the existence of this type of operation.

In the next section we consider some of the motivations that the clients indicated during the interviews:

- v At INDES the attention clients receive has a more personal touch, and the approach of the staff is more welcoming and not as impersonal as in the banks. Moreover, INDES' personnel carries out follow-up through visits in the field and, according to the clients, the institution shows an interest in their businesses, and their work. Thus, 96 % of the clients who were interviewed expressed great satisfaction with the service and attention they get from INDES.

- v The majority of the clients who do not comply with the requirements and of the traditional banking sector see in INDES an alternative way of obtaining credit for the development of their businesses.
- v INDES is the only institution aimed at this segment of the population providing credit for the acquisition of capital goods (60 % of the leasing clients), or used or reconditioned goods (30 %) and where the interest rate is low (for the FOSIS leasing).
- v At INDES, clients receive a range of products, including the factoring, which they cannot receive in regulated institutions.
- v Many clients consider INDES a serious institutions which is backed up by Banco del Desarrollo, which gives it the image of permanence and credibility, especially regarding lease-back operations.
- v Another motivation for the client is that, unlike the formal banking sector, INDES does not levy any charges prior to the disbursement of credit, rather it assimilates these into the quota payments.

INDES's does not hold information on the rate of "turnover" of its clients, which could serve, to a certain extent, to measure their fidelity. However, it is clear that the leasing clients once they have reached their option to buy and become the proprietors of the good, do not immediately renew their financing, unlike the short-term operations for working capital.

v *Impact*

INDES has not carried out impact evaluations of the leasing and other credits in the enterprises. However, the results of the interviews conducted for this report reveal that with an average of 4.3 employees per operation, the total number of people affected reaches approximately 2,700. Moreover, 90% of the interviewees consider that the credit and leasing operations enabled them to increase the level of their production and sales, with the corresponding increase in incomes.³⁹

When asked how INDES might improve its service, approximately 60% of the clients interviewed responded that it should offer training, evaluating support and technical assistance. This is an issue that should be analysed within INDES given that the current trend among MFIs is specialisation and achieving economies of scale. Training programmes are expensive, and in Chile there are numerous NGOs who are concerned exclusively with the provision of this type of service, using funds, which can be bid for, from the state for precisely these ends.

³⁹ Clarification Note: The impact studies have serious flaws, especially as it is difficult to isolate the credit or leasing factors and other determining factors which contribute to improving the revenue of the enterprise and the quality of life. Therefore, this section only summarises the results obtained in the interviews.

v Market

In the absence of studies and reports on the demand for financial services in the sector for micro and small enterprises, the scale and quantification of this demand remains unknown. It can be affirmed, however, that the market for micro-enterprises of accumulation and small enterprises that require capital goods is relatively small, thus the market for leasing services is smaller and is considerably enlarged if the demand for credit is incorporated.

As there are few institutions offering leasing services to this segment, INDES has reached an advantage position in the market. However, there is always the possibility that other institutions may seek to “enter” this market and INDES must be prepared to face up to this eventual competition.

v Marketing

Having not yet fully serviced its target market, INDES has not had to design and implement policies and marketing strategies. Being a small institution, INDES still does not have a recognisable image in the sector of micro and small enterprises and is generally associated with Banco del Desarrollo.⁴⁰

In general, INDES’ strategy in respect to the search for new clients has focused on prioritising direct relations with institutions that can pass on those clients that they cannot serve directly themselves.

Unfortunately, there are no recent data concerning the transferral of clients to INDES. However, from conversations with the staff of INDES and studies which are now outdated, INDES’ main source of clients are the suppliers of capital goods who see in INDES an alternative for serving those clients that they themselves cannot finance, or that are not accepted by the traditional leasing companies due to lack of formal financial information for their evaluation, or because their businesses are too small. Moreover, certain suppliers already know about the personalised attention clients receive at INDES.

Another important source of clients for INDES is Banco del Desarrollo, as much through the transfer of clients from its commercial branches, as from the Micro-enterprise Centres and Banco del Desarrollo Leasing. This transferral of clients is a result of the synergy with Banco’s companies.

Other sources of clients, although to a lesser degree, are INDES’ clients themselves – who become promoters of the institution and its services, and usually recommend it to their colleagues. Clients are also attracted through the promotional campaigns and the direct contacts made by INDES’ executives who publicise the institution’s services and advantages. Finally, there is a stream of clients from state entities such as FOSIS, CORFO and SERCOTEC among others, and private entities such as the Fundación para el Desarrollo, the Fundación Contigo, NGOs and others.

As part of the process of institutional reinforcement and the institution’s objectives relative to growth, the design of a marketing strategy through larger search actions and directed at INDES’ target group should be envisaged.⁴¹ Indeed, there is a need to analyse which are

⁴⁰ 100% of the clients who were interviewed said that they did not know what the image of INDES was in this sector. 15% of clients suggested that INDES should carry out promotional campaigns since they had only found out about the existence of the company “by chance”.

⁴¹ According to a study which was just carried out in the República agency in the total number of people who were being served (760) between September 1996 and December 1997 (50 per month), only 25% qualify and go through the process of being evaluated, and of these only 15%

the most appropriate sources for the transferral of clients who are best suited to the services which INDES offers and consolidate these relations by means of agreements structured in such a way that all parties stand to gain.

E. FINANCIAL STRUCTURE

The structure of assets and liabilities at INDES, as of 30 October 2000, is summarised in the table below.⁴²

Table P - Assets and Liabilities Structure

Assets	%	Liabilities	%
• FOSIS Leasing and SMEs	40	• Capital, reserves and retained earnings	40
• Credits	18	• FOSIS Resources	20
• Leases to the Banco del Desarrollo	13	• Local bank Credits (Banco Des.)	34
• Investments and shareholdings in companies: - Banco del Desarrollo - Bandedesarrollo Leasing - Venture Capital	26	• Other Liabilities: - Current - Suppliers - Provisions	6
• Other Assets	3		
Total (%)	100		100
Total US\$ Million	6.40		6.40

Source: INDES

As can be observed in table above, INDES counts on various sources of funding which serve to finance its portfolio of investments and assets in general.

Next, a description is given of some of the lines of credit which the institution currently counts on, followed by a description of financing possibilities in the future.

carry out leasing operations. This study reveals that of the total number of people being served, 4% take out a leasing and 11% obtain a credit. Consequently, it is necessary to evaluate the type of marketing campaign that will be aimed at the group, which, for the most part, meets the prerequisites for accessing INDES' services.

⁴² Financial Reports as of 30/10/2000

v FOSIS resources

The FOSIS line of financing is essential in the institution's capital structure. It is on a long-term basis and has a financial cost equivalent to inflation rate. It allows INDES to finance operations that are granted to micro-enterprises.

If INDES did not receive financing from FOSIS, it probably would not carry out leasing for micro-enterprises given that the operational risk and supervision costs are high, or else it would definitely have to increase the interest rate (currently fixed by FOSIS which is equivalent to UF+12 annually), to continue generating at least the same rate of profitability on the capital.⁴³

v Credit lines from Banco del Desarrollo

As mentioned above, INDES has two credit lines with Banco del Desarrollo with the following characteristics:

- Line for capital operations worth 860 million pesos (1.5 million US\$) at a rate equivalent to approximately UF+8,5 %
- Line for rental (of vehicles and vans) worth 150 million pesos (600 mil US\$) at rate equal to UF+8%

As of 30/10/2000, INDES had used approximately 96% of these lines. The line for capital operations was very useful for financing new operations especially credit operations, although the limitation of this line is that it needs to be renewed every year.

Likewise, INDES has access to a short term credit line with Banco Edwards which is worth 150 million Pesos with an annual interest rate of UF+9%. This line has not been used yet, since existing funds were sufficient to finance growth and because it is the most expensive source of funds.

v Other sources of funding in the future

Given the nature of the leasing product and the other products which are provided to the sector, it makes sense to count on a stable and long-term source of financing which makes it possible to offer terms and conditions which correspond with the returns on the projects being financed. Consequently, INDES needs to tap into local or external sources of funding which meet the appropriate conditions for supporting and investing in the growth of the sector that it serves.

At present, although INDES' investment portfolio and assets in general are financed by different sources, including the long-term FOSIS line, to maintain the bridge between the term of the bank's funding (12 months) and the term of the ventures (leasing operations with average terms of 29 months) continues to be a problem, and above all to be able to finance the eventual growth in the number of operations and the corresponding growth in the portfolio.

INDES has been negotiating long-term funds with different agencies, to enable adequate fund management:

⁴³ It is important to note that part of the FOSIS subsidy (UF+0) is transferred to the user since he/she is charged a low interest annual rate of UF+12. Consequently, if INDES obtained the FOSIS lines at a higher cost, the interest rate for leasing to micro entrepreneurs would also increase.

a - IADB

The IADB has granted a non – reimbursable technical assistance fund worth US\$ 600,000 to INDES through the Multilateral Investments Fund (MIF). The proposal of the project is to contribute to INDES' institutional reinforcement.

The specific objectives pursued by the IADB are to extend INDES' coverage, to at least two other cities apart from Santiago, to consolidate the methodology of the leasing service, and assess whether it is a replicable model in the Latin American context.

b - CORFO

INDES has negotiated a long-term credit directly from the CORFO. In December 2000, CORFO granted INDES a long-term credit line worth US\$ 1.0 million, at an interest rate of UF+5% annually; in order to finance loans and leasing operations for small enterprises.

Financing from this Corporation can be considered as an exception, given that as a state entity for refinancing the financial sector, CORFO provides credit lines only to institutions that are regulated by the SBIF.

F. FINANCIAL SITUATION AND PORTFOLIO

The purpose of this study was not to make a financial evaluation of INDES. However, in this section, a few observations are made regarding aspects of the institution's financial situation and portfolio which are considered being determinant in the performance of the organisation.

v Financial reports

As of December 31, 2000, revenues from leasing, credits and operational leasing (vehicle an van rental), including penalty interest, amount to 72% of total revenues. 53.7% of INDES' assets are allocated to the leasing and credit portfolios and 11.6% to operational leasing. Investment in Banco del Desarrollo account for 16.5% of the assets and 16.6% of the revenue.

As of 31/12/2000, the operational revenues of leasing and credits and operational leasing amounted to US\$ 1,1 million and the operational expenditures amounted US\$ 0,7 million. Equity investment in Banco del Desarrollo generated a non-operational revenue totalling US\$ 0.26 million.

On average, the ratio of administrative costs to the portfolio (including leasing) is 24 %, and 74% of the administrative costs are tied-up in salaries and fees for the personnel and assessors, which suggests that INDES will have to face up to the challenge of maintaining low costs, while increasing the volume of operations, with the same number of personnel and the implementation of a more modern information system.

Another important factor in INDES' performance is the policy of the shareholders not to share out dividends but reinvest them in the company. This capitalisation of profits has made it possible to increase the capital stock to reach US\$ 2.2 million.

v *Loan portfolio*

a - Analysis of the portfolio in default:

The default rate at INDES is expressed as the ratio of unpaid instalments to the total balance of the leasing and credit portfolio, and corresponds to 13.45% (as of 31/12/2000). This rate measures the value of defaulting payments on the principal. If we consider the total outstanding debt, the rate reaches approximately 17.7% (portfolio at risk).

However, the exposure of INDES is reduced due to the underlying collateral of leasing and loan operations. Indeed, the majority of the operations count with mortgage, pledge and the asset in leasing.

b - Growth of Portfolio

INDES' credit and leasing portfolio grew between 1992 and 1998 at an annual rate of 17%. However, the actual growth rate of the portfolio is reflected in the size of credit operations (with a 116% average rate of growth over the period). The leasing portfolio remained stable. This difference in growth rate can be explained, in part, because the rotation of credits is greater than for leasing given that the latter have longer terms for the acquisition of a commodity which has a use for several years and, as such, they are not automatically renewed once the operation is terminated. Furthermore, obtaining a leasing is much longer and requires going through more procedures.

More recently, INDES' credit and leasing portfolio grew between 1999 and 2000 at an annual rate of 19.6%, made of a 20% average growth rate for leasing operations and only 17.7%, for credit operations.

4th Part

CONCLUSION

Discussing the idea of replication and getting to know about INDES' coming challenges

A. ADVANTAGES OF INDES' LEASING

Leasing represents an effective method of financing for reaching those enterprises whose financial necessities cannot be met by a traditional "minimalist" microfinance approach.

v From the microentrepreneur's standpoint

For micro-enterprises of accumulation and small businesses which have difficulties in deciding between different financing options, especially when they require large amounts for the buying of new machines or other capital goods, leasing is a viable option which has added advantages besides accessibility:

- v Leasing allows clients to increase their total ready availability of capital derived from external sources, freeing-up their own sources of capital for productive assets. This, then, signifies that the additional income generated for the use of the leased goods should be sufficient to meet the monthly payments to the lessor.
- v Through the leasing mechanism, the client decides what and where to buy the asset he needs for his business activity. In addition, the good being leased can be new or used and is insured for the duration of the leasing operation.
- v The lessee has the possibility to get discounts for the full payment in cash.
- v For the lessee, leasing is an attractive operation that generally avoids the necessity of additional collateral.
- v The lessee also has tax incentives by discounting VAT pay and net amount payments on his/her lease from earnings and thus paying less income tax; and only pay the tax for the value of an additional instalment or the option to buy, which allows ownership of the capital goods and consequently capitalisation of net capital stock value.
- v Leasing also provides the micro-entrepreneur with an access to certain technological advantage as it gives him/her the ability to up-grade capital goods by spreading costs over a period of time and the opportunity to afford more recent technology.

v From INDES' standpoint

- v Leasing operations are more secure because they are guaranteed by the very object of the leasing, becoming a response, at the same time, to the lack of collateral in this sector.
- v For the "lessor", this mechanism is a secure one since the institution can, if the client defaults, recuperate the asset of which it is the proprietor and re-rent it or sell it in the market.

- v The proprietor of the goods does not depend on the assets, capital stock, or credit history of the client, rather on his/her ability to generate sufficient cash flow to meet his/her monthly payments for the lease.
- v The lessor buys the piece of equipment directly from the supplier once the lessee has made his/her choice and, thereby rules out the possibility that the client uses the loan for other ends or purposes. In other words, the lessor knows exactly the type of investment the client has undertaken, which is not always the case with credits.
- v As the legal proprietor of the goods, the lessor is in a position of increased security. He has increased rights and a greater facility to repossess the good in cases where the contract is broken. It is easier to execute a leased asset (which is part of the leasing operation) than an asset which is merely pledged or has some other form of guarantee, since the leased asset is under the name of the financial institution.
- v The tax advantage for the lessor is that the expenses of the acquisition of the goods and the depreciation value count as expenditure that can be deducted from tax obligations.
- v The risk is less than in the case of traditional loans given that, in general, the lessee does whatever is necessary so as not to lose his asset, as he needs this asset to produce and generate income.

The conceptual model and the norms of leasing in Chile are biased in favour of the lessor. This becomes apparent when the client does not pay his monthly instalments and breaks the contract. The lessor can reclaim the leased asset (of which he continues to be the proprietor) and demand that the remaining quotas be paid in full under the terms of the contract. However, the problem of this model is that although it favours the lessor, it does not provide him with the instruments to transfer assets onto third parties, particularly when it concerns machinery where the fall in value is marked because of depreciation.⁴⁴

B. DETERMINANTS OF THE INDES EXPERIENCE

The conviction exists that INDES' experience, offering various products and, notably, leasing has been positive and should be capitalised with a view to replicating it elsewhere and, in this way, give more effective support to the upper strata of micro-enterprises and small businesses, by extending access to medium-term financing for capital goods.

Nevertheless, the replicability of the INDES experience depends on a set of characteristics, which are exclusive to its external and internal situation.

⁴⁴ Depreciation plays an important role in leasing given that when the client has finally finished paying for the good, the latter has depreciated in value.

v External determinants

Among the external factors which could be cited are the fact that in Chile macroeconomic conditions have provided the necessary stability (in particular referring to revenues, interest rates, exchange rates and other monetary aggregates). The country counts on a well defined prudential, fiscal and legal regulatory framework, and very clear rules, which INDES has used to expand and ensure its durability in time, allowing it to provide leasing services and other financial products to a specific segment of the economy.

Moreover, the support of the Chilean Government through the FOSIS programme was, at the beginning, important in INDES' financial structure, by providing it with long-term resources with a financial cost equal to inflation rate (in 2000, annual inflation was 4.7%), to finance leasing operations to micro-enterprises and other operations targeted at small entrepreneurs.

INDES has also had the significant advantage of having a captive niche market with a good economic potential and the ability to act as an intermediary financial institution, signifying that it serves those clients who are not served by other financial institutions, either because they are too big (for the MFIs) or too small (for the traditional leasing companies and banks). Likewise, the segment of micro-enterprises of accumulation and small enterprises in Chile is highly developed and is, for the most part, formal. Hence, the limitations they face regarding sources of financing from formal institutions are more likely to be linked to their lack of financial know-how and adequate bookkeeping.

v Internal determinants

With respect to the internal factors, the supportive relationship of the Banco del Desarrollo has been very important in INDES' performance. The relation between both institutions is not formalised by means of an agreement or contract, and the different entities act independently of each other. However, these informal arrangements between the Bank and INDES work and implicitly generate a certain synergy, which is beneficial to both institutions.

On the one hand, the Banco del Desarrollo supports INDES in various ways. The Bank provides two credit lines on behalf of INDES for capital operations and for operational leasing. INDES benefits from the image of security and confidence that the Bank generates in the eyes of INDES' clients, especially for those who leave their property in mortgage for leaseback operations. On the other hand, the Bank also benefits from the relationship with INDES since the latter is an institution with a good image, which tends to complement the services offered by the Bank through its Micro-enterprise and Leasing subsidiaries.

Since October 2000, the internal structure of INDES has been going through significant changes that will consolidate the institution and enables it to be ready to face the new stage of its development. The most significant change were the hiring of a new General Manager and the new role of the Executive Committee.

Together with the comparative advantage of its leasing operations, INDES owes its performance, to a large extent, to the diversity of its package of products with leasing, credits and its capital structure with the FOSIS line and its investment funds in the Banco del Desarrollo and its Leasing Subsidiary.

INDES is in the process of systematising policies and procedures and internalising its learning process and the institution must confront various challenges in attaining institutional reinforcement.

C. ELEMENTS FOR REPLICATION

Leasing, with its specific advantages and some adjustments and improvements may be replicated and interesting for other microfinance institutions which are looking to diversify their products, and reach new market niches, where there is a demand for long-term investments for the acquisition or renewal of a production asset, vehicle or property.

Despite being a well know financing methodology, the innovation of this product resides in its adaptability and flexibility for the segment of micro and small enterprises which does not have access to traditional leasing and/or other forms of financing and which has specific demands.

In considering dissemination and replicability, it is essential to evaluate the mentioned external and internal determinants of INDES and of Chile and attempt to replicate and streamline the innovations and characteristics of INDES' leasing product, as follows:

- v Emphasis on the analysis of the viability of the project and the financial operation is not based on the financial reports declared by the client, given that these seldom reflect a true state of sales and revenue. INDES uses evaluations which are designed internally and which allow the institution to gain a better understanding of the characteristics of the enterprise, its activities and capacity to pay, and thus provide the amount of the leasing accordingly.
- v Personalised and friendly service to the client by carrying out preliminary evaluation in the field, followed by visits and calls, which show the institution's interest in the client and his/her project.
- v Advice to the client during the acquisition of the machine and in the formulation of the leasing operation, which can be quite complicated.
- v Incorporation of costs relating to the evaluation of the work place, payment of the solicitor and other commissions and fees into the leasing instalments, thereby spreading the total cost over the medium term, rather than as one comprehensive payment, at the beginning of the process.
- v Possibility of acquiring new or old (or re-conditioned) goods or machinery, which enables the lessee to keep cost down – a mechanism better suited to this segment of enterprises.
- v Flexibility in collateral requirements, with the possibility for certain leasing operations to be financed up to 100% of the value of the goods, without requiring a down-payment, if the evaluation deems this to be practicable.
- v Committed staff, capable of establishing good client relations. The staff has a broad knowledge of the sector, of its strengths and weaknesses, and of the type of machinery and equipment that is required and its availability in the market (suppliers).

Any replication of the leasing model, as practised by INDES, must be considered with care. Some changes will necessarily be implemented, not least in response to the legal and financial

environment. Some attention will also need to be given to ensure greater price transparency for the leasing client to clarify the effective cost of the operation, as well as an improvement of the procedures for default management and recovery. Likewise, there is a need for clearer information and definitions on economic and profitable activities in the segments of the market, which require leasing.

The emphasis should not merely be on how to extend the range of financial services, but rather, on how to better define the conditions of access to financial services with appropriate terms and conditions for micro and small enterprises.

D. CHALLENGES FOR THE COMING PERIOD

INDES has various challenges and opportunities which it must face up to, relating to its growth, and with a view to extending its coverage and its activities ; the definition of its institutional structure ; the securing of new sources of financing ; and access to technical assistance funds for its institutional reinforcement.

Like the majority of MFIs, INDES must consolidate new sources of long-term funding (whether this is through the IADB or the CORFO), which will enable it to finance its growth in a continuous manner and, in particular, to find the right balance with its medium term leasing operations. This is vital given that the FOSIS programme, which is the only source of long-term financing, will come to an end in 2003, and its renewal is not assured.

External financing agencies have certain reservations, however, about financing institutions whose mission and strategy is not aimed at development by giving economic impetus to the most deprived segments of the economy, and may also insist that the institution become regulated by the Central Bank.

Consequently, the most viable strategy for INDES at present is to maintain its institutional structure as a private stock company, not regulated, and independent from Banco del Desarrollo, although the relationship between the two institutions could be formalised by means of an agreement, or letter of understanding characterised by full financial transparency.

A new strategy of growth is being developed by INDES which will consider another products and services to be offered to the micro and small enterprises.

Appendices

<u><i>v Appendix 1</i></u>	List of persons interviewed
<u><i>v Appendix 2</i></u>	Procedure for loan application – Chart
<u><i>v Appendix 3</i></u>	Assessment of client’s application
<u><i>v Appendix 4</i></u>	Process of payment retrieval
<u><i>v Appendix 5</i></u>	Programmes supported by the Chilean government in favour of SMMEs development

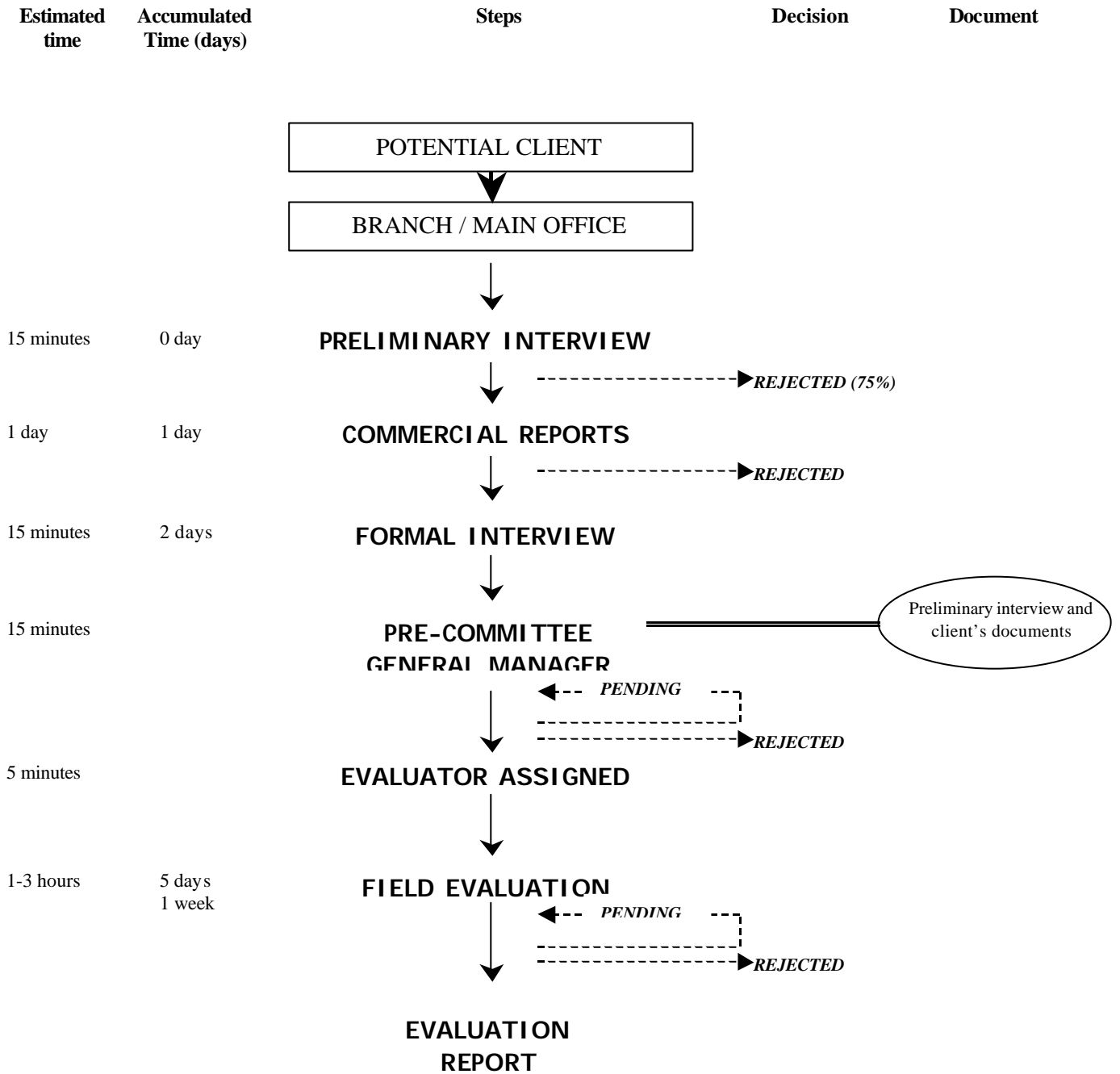
APPENDIX 1:

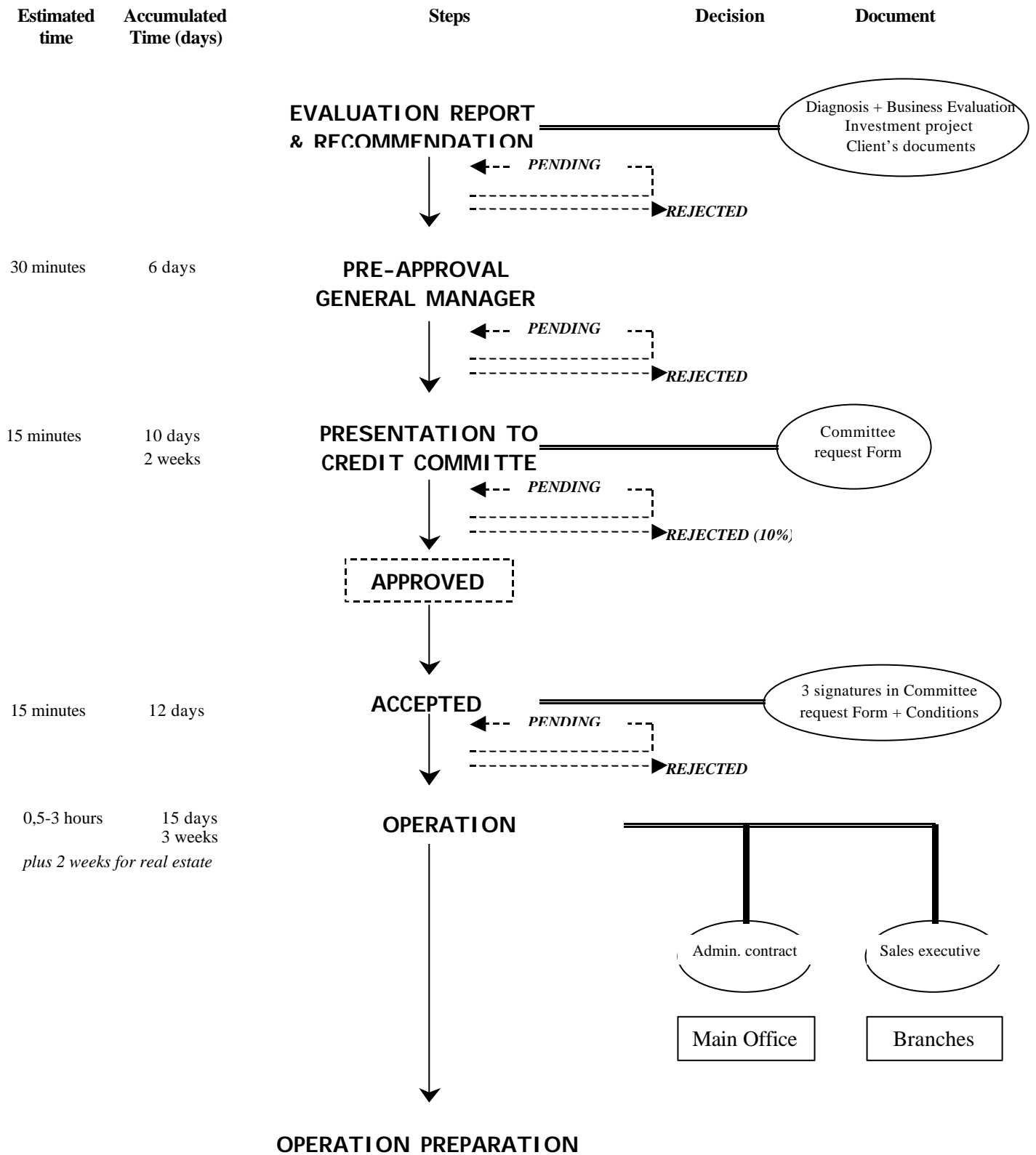
LIST OF PERSONS INTERVIEWED OUTSIDE INDES

Institutions:

- | | |
|--|--|
| ▪ FOSIS | Mr. Jaime González S. |
| ▪ Superintendencia de Bancos e Instituciones Financieras | Mrs. Mariela Barrenechea P. |
| ▪ Banco del Desarrollo | Mr. Humberto Molina |
| ▪ Bandedesarrollo Leasing | Mr. Jose Veloso C. |
| ▪ Bandedesarrollo Microempresa | Mr. Mauricio Rojas M.
Mr. Alvaro Retamales C. |
| ▪ Sur Profesionales | Mr. Luis Magallon M. |
| ▪ Fundación para el Desarrollo | Mr. Felipe Ríoseco |
| ▪ Ministerio de Hacienda | Mr. Rafael Bertini |
| ▪ Inter-American Development Bank | Mr. Rafael Millán |

APPENDIX 2: PROCEDURE FOR LOAN APPLICATION - CHART





APPENDIX 3: ASSESSMENT OF CLIENT'S APPLICATION

1 - Preliminary Interview

The first interview is conducted at INDES' office and serves to get to know the client and his business and to evaluate the financial viability of the project by collecting basic information regarding the client and the business (identification number, years of experience in the field, number of employees, accounting procedures, monthly income statements and others), as well as some details on his financial needs and collateral. During this interview, the potential client who is interested in purchasing a good or machinery also receives a detailed explanation on the leasing product, its requirements and an estimate of the monthly instalments and terms.

Pre-selected clients are then requested to prepare the following documents:

- 2 income tax declarations
- 2 commercial balance sheets
- 12 VAT declarations (for the last 12 months)
- Activity start-up statement (municipal registry or municipal work permit - RUT)
- For larger businesses, each proprietor or shareholder must present a personal income statement.
- Price of the good to be acquired through leasing.
- Name and address of the supplier selected by the client.

This documentation serves INDES to know if the client is on time on his payments and whether he is paying taxes punctually. The diverse papers constitute a referential base for the declared amount of sales.

2 - Commercial reports

To know the level of indebtedness and the commercial references of the client, INDES' sales executives access the DICOM by typing the RUT of the potential client. This registry includes the following information:

- Effective, defaulted, due and written-off loans
- Effective and unpaid loans as well as historical cheques referred to drawer.

For some of the few larger operations of its portfolio, INDES can have access to the historical credit information of leasing clients.

The clients that have problems with other financial institutions or are included in the registry cannot proceed to the following stage. This rule is overlooked for clients who can prove that they have effectively paid their debts and have not notified the DICOM to avoid the penalty fee charged to update the database.⁴⁵

3 - Formal Interview

During the formal interview, the sales executive verifies if the client is still interested in obtaining the leasing and if he has prepared the requested documents.

Furthermore, the sales executive gives advice to the potential client on the type of service most adequate to his needs, as well as the financial conditions and requirements of INDES.

4 - Pre - Committee (General Manager)

The General Manager reviews the reports from the preliminary interview, the commercial reports and is in charge of conducting an initial analysis of the client's cash flow, payment capacity and type of collateral.

If the client complies with all the requirements, a sales executive is assigned to proceed with the evaluation.

5 - Field Evaluation

Unlike banks and traditional financial entities that base their evaluations on an analysis of written documentation, INDES conducts an evaluation in the field for every potential client. In such evaluation, the sales

⁴⁵ There is a risk (like for any other society) that a client's debt to a non-regulated financial institution or a commercial store is not registered at DICOM and thus can be undetected.

executive fills out some forms that include a business diagnosis, a work plan as well as an evaluation of the entrepreneur and his project, all of which are used to elaborate an exhaustive analysis of the business and the client.

This analysis includes a close examination of the net and real income, market strategies, product quality, description of the suppliers and social information on the client's family.

Thanks to the information collected, the knowledge and experience of the sales executives, INDES bases its analysis on a more realistic sales flow not always reflected in the tax statements and thus it can better determine the real payment capacity and level of indebtedness of the client to further undertake a risk analysis according to project perspectives.

The sales executive invites the potential client to attend a final meeting at INDES' office where this evaluation ends.⁴⁶

6 - Report, Evaluation and Recommendation

The sales executive must also prepare another form denominated Investment Project Evaluation. This document permits to verify if the potential client fulfils the requirements established by the Leasing Fosis Programme for which a new qualification and registration form needs to be filled out. The sales executive must complete the forms and provide a recommendation.

7 - General Manager Pre-Approval

The General Manager receives the business diagnosis report, the investment project evaluation and the initial committee request form. He examines once again the project, clarifies some specifications and reviews the leasing conditions (interest rate, term, amount and collateral).

The table below explains the attributions of the General Manager and the Credit Committee in the approval of the leasing operations depending on the amounts and the collateral:

Management levels for the approval of leasing:

Level	Without collateral in UF	With certified endorsement(s) in UF
• General Manager	Up to 100	Up to 150
• Credit Committee	> 100	> 150
Conditions:		
• Individual contribution (% minimum)	25 %	20 %

8 - Credit Committee Presentation

The Credit Committee includes the President, the Vice-President and General Manager of INDES as well as the representative of the Fundación para el Desarrollo, all of whom have voting power. Although the sales or commercial executive can participate and present his client's case to the Committee, he does not have a voting right.

The Credit Committee meets twice a week, or more frequently if needed. It evaluates the debt capacity, the profitability, monthly sales, fixed and variable costs, and above all, the payment capacity of the client with respect to the his expenses and costs (including the monthly leasing instalments to INDES).

9 - Approval and Final Decision of the Leasing Conditions

The Credit Committee can reject, approve or modify the operation. The approval, together with the leasing conditions (amount, interest rate, term and collateral) are written down in the Committee request form, signed by all the members.

⁴⁶ This additional step seems unnecessary as it increases the transaction costs for the entrepreneur, and could be eliminated.

10 - Formalisation of the Operation

The client is informed regarding the approval and conditions of the operation and is requested to prepare the initial cash down payment and, if necessary, the additional collateral.

11 - Pre-operation, document preparation and “credit control”

At this stage, diverse documents are prepared, revised and signed:

- Administration form (details of the agreement)
- Instruction letter (through which the good is requested)
- Price of the good (from the supplier)
- Leasing agreement (to be signed by INDES and the client). This agreement is in UF and thus eliminates the risk related to inflation
- Purchasing order (given to the client to pick up the good from the supplier)
- Reception Charts
- Letters of exchange
- Leasing request letter
- Insurance order (so that the insurance company issues an insurance policy against theft and/or fire)
- Photocopy of the identity card or RUT
- Registry form as a beneficiary to the Leasing Fosis Programme
- When the good is used (second hand) and the seller cannot provide a receipt, a sales – purchase agreement is issued
- For leaseback, a legal property statement is elaborated to certify that the client is the owner of the good he wants to lease. In addition, the client signs a letter offering to sell the good to INDES with the possibility of buying it back.
- Development Chart (where all the credit conditions are detailed)
- Tickets (given to the client with the specification on the value and date of the instalment payments)
- Receipt from INDES for the initial cash down payment (that serves as collateral)

12 - Disbursal

When the supplier receives the purchasing order, he verifies with INDES its validity. The supplier then delivers the good to the client and sends the papers and receipt to INDES so that the latter makes the corresponding payment. Consequently, the client uses the leased good immediately after he receives it from the supplier and must pay the monthly instalments according to the contractual terms.

From the date of request for financing to the time of disbursement (or delivery of the purchasing order to the supplier), there is a delay of 15 working days for a leasing contract as an average.

13 – Follow-up and Control

The sales executive must do a follow-up for all the operations and verify that the monthly instalments are paid on time.

14 - Pay-off and Purchase Option

When the client finishes to pay his last instalment, in the next 30 days, he can exert his purchase option, pay the value of an additional instalment and become proprietor of the good.

15 - Renewal

For all renewals, the client must update the information and documents required in the preliminary interview, and is re-evaluated in the field.

The leasing clients once they have reached their option to buy and become the proprietors of the good, do not immediately renew their financing, unlike the short-term credits for working capital.

APPENDIX 4: PROCESS OF PAYMENT RETRIEVAL

At INDES, the recovery process is divided in the following two stages:

a. Normalisation

In the first stage, also denominated normalisation, the person in charge of recovering the loans revises the list with all the defaulted clients once a month. He then calls all the listed clients who have one or more instalments in default and proceeds with the attempt to recover the loan through phone calls. If the client does not pay anything the following month and has two instalments in default, the person in charge of normalisation (at the main office) or the sales executive (in each branch) begins to take charge of the procedure and exert some pressure by visiting the clients who are in arrears. INDES' strategy, nevertheless, is to get the client to pay even if it is a partial payment.

At INDES, all the clients who are late with their payments but who are otherwise paying, are subject to rescheduling and they do not become the object of notification to the DICOM, thereby avoiding negative ratings and future problems in obtaining loans. The rescheduling is done through previous evaluation of their payment capacity and the stability of their payments. In addition, each rescheduling is evaluated in the field and requires favourable reports as well as the approval from the Credit Committee. When a rescheduling is approved, the new operation cancels the prior one in bookkeeping.

The penalty interest rate charged on the defaulting client is 0.5% per month, which raises the monthly interest rate to 2.5% (instead of 2%).

In INDES, the system allows the disbursement of a new loan to the client who is in arrears to help him with the leasing. In this way, the client in addition to the leasing contract can have a credit contract with the institution that normally requires him to provide additional collateral in order to cover the credit operation.

b. Legal recovery

If the client has not paid anything in a 90-day period, he will be threatened with the legal recovery stage where a judge is requested to give an order for restitution of the good (new Chilean norms will allow INDES to seize the judge before legal recovery starts, but procedure has not been yet implemented). All clients that have passed to this stage are automatically reported to the DICOM.

The restitution process can be very slow not only because it takes time to obtain the judicial order but also because it is difficult to sell the recovered good (the machine can be too sophisticated, used, the re-adaptation cost can be very high or because there is no secondary market). Consequently, in such cases, INDES after a careful review of the viability of the business, tries to negotiate with the client through rescheduling or refinancing, to facilitate the payment of the defaulted operation.

Nevertheless, it is noteworthy to mention that it is easier to execute a leased asset (which is part of the leasing operation) than an asset which is merely pledged or has some other form of guarantee, since the leased asset remains in the name of the financial institution. Moreover, according to the norms of leasing in Chile, when the client does not pay his lease and breaks the contract, the lessor can seize the leased asset (of which he continues to be the proprietor) and demand that the remaining instalments be paid in full under the terms of the contract.

APPENDIX 5: PROGRAMMES SUPPORTED BY THE CHILEAN GOVERNMENT IN FAVOUR OF SMMES DEVELOPMENT

Programas publicos de fomento productivo estatal

Los instrumentos de financiamiento a través de los cuales opera el fomento productivo estatal y que, en teoría, buscan mejorar la asignación y optimizar el uso de recursos fiscales, son los siguientes:

- ***Subvención à la Asistencia Financiera (SUAF):***

Ejecutado por la CORFO y que consiste en que los pequeños empresarios con ventas inferiores a UF 25.000 al año y con características bancables (sin protestos vigentes ni deudas morosas ni previsionales) opten a una subvención destinada a la contratación de consultores especializados en la PYME que se encargan de preparar y presentar los antecedentes que solicitan las instituciones financieras para el otorgamiento de un crédito.

- ***Programa de Cupones de Bonificación de Primas Seguro de Crédito (CUBOS)***

Consiste en subsituir total o parcialmente la exigencia de garantías reales por un seguro de crédito que la instituciones financieras contratan con una compañía de seguros y que cubre por lo menos el 70% del riesgo de no pago de sus deudores. La prima de ese seguro, o sea su costo, es subsidiado por el Estado a través de la CORFO, mediante los CUBOS que tienen el valor de 1 UF y se licitan entre las instituciones financieras interesadas y reguladas.

- ***Créditos directos del Banco des Estado a la PYME***

El Banco del Estado a la PYME estableció una gerencia especializada en otorgar créditos de fomento y líneas de financiamiento en forma directa al sector de la PYME cuyas ventas anuales no superen a UF 160 mil.

- ***Intermediación financiera***

La CORFO actúa como institución de segundo piso y realiza periódicamente licitaciones o remates de fondos obtenidos mediante créditos de largo plazo del Banco Interamericano de Desarrollo (BID) abiertos a los intermediarios financieros regulados más solventes (con coeficiente de cobertura patrimonial no inferior al 100% y depósitos a plazo clasificados en la categoría A de riesgo).

El sistema financiero debe usar estos fondos para dar créditos a empresarios para financiar proyectos de inversión (activo fijo, excluida vivienda) de empresas nuevas o existentes que usen tecnología no perjudicial para el medio ambiente. Los empresarios deben financiar con otros recursos al menos el 15% del costo total del proyecto.

Estos créditos se dirigen a la adquisición de bienes de capital por montos hasta de US\$50 millones, a un plazo máximo de 12 años y con periodos de gracia de 3 años y con un tasa de aproximadamente UF + 7,5% anual.