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CHILE

**MICROLEASING RESTRUCTURING PROGRAM FOR INVERSIONES
PARA EL DESARROLLO S.A. (INDES)**

(TC-99-04-01-9-CH)

DONORS MEMORANDUM

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ABBREVIATIONS

BANDESARROLLO	Banco del Desarrollo (Development Bank)
EC	Executive Committee
CESI	Committee on Environment and Social Impact
CORFO	Corporación de Fomento de la Producción (Industrial Development Corporation)
ECLAC	Economic Commission for Latin America and the Caribbean
EDCS	Ecumenical Development Cooperative Society
FOSIS	Fondo de Solidaridad Social
GB	Grameen Bank
IFC	International Finance Corporation
INDAP	Institute for Agricultural Development
INDES	Inversiones para el Desarrollo S.A.
INE	Instituto Nacional de Estadística (National Statistics Institute)
INVICA	Fundación Instituto de Viviendas Populares (Housing Administration)
MIDEPLAN	Ministerio de Planificación (Ministry of Planning)
MSE	micro and small enterprises
SE	Small Enterprise
SBIF	Superintendencia de Bancos e Instituciones Financieras (Office of the Bank Examiner)
SENCE	Servicio Nacional de Capacitación y Empleo (National Training and Employment Service)
SERCOTEC	Technical Cooperation Service
SIDI	Société d'Investissement et Développement International
UF	Development Units

MICROLEASING RESTRUCTURING PROGRAM FOR INVERSIONES PARA EL DESARROLLO S.A. (INDES)

(TC-99-04-01-9-CH)

EXECUTIVE SUMMARY

Requester: Inversiones para el Desarrollo S.A. (INDES)

**Executing
agency:** INDES

Financing:	MIF Window III-A	US\$570,000
	INDES:	US\$400,000
	Total:	US\$970,000

Terms:	Execution period:	36 months
	Disbursement period:	42 months

Objectives: The project's objective is to support the development of a model for microleasing (leasing for microentrepreneurs) that is technically, financially and methodologically sustainable, in order to guarantee timely access for micro and small enterprises in Chile to medium-term resources that will enable them to purchase new or used capital goods, thereby increasing their productivity.

Description: The restructuring of INDES will cover its administrative, technical, financial and markets units, and will include an upgrade of management information systems and dissemination of micro-leasing techniques as a sector development tool in other countries of the region.

These components are intended to help INDES define an appropriate organizational structure for change and growth, to consolidate and improve micro-leasing technology, and to boost its financial consolidation and optimizing asset quality so as to serve as a model for services for the micro and small enterprise sector based on the financial leasing mechanism.

It should be noted that INDES is the only institution in Latin America serving the microenterprise sector utilizing this innovative mechanism. Its advantages stem from its in-depth knowledge of its clientele and its traditional leasing management experience. The

challenge it faces is in making specific modifications to achieve a greater impact on the sector's productivity.

Special contractual conditions:

As a condition precedent to the first disbursement, the following documentation must be submitted to the Bank's satisfaction: (i) a strategic plan reviewed and approved by the Board of Directors (paragraph 2.5); (ii) terms of reference and bidding procedures for consulting services in program methodology, organization and financing (paragraph 4.1); (iii) a plan for gradual divestiture of Banco del Desarrollo shares, implementation of which will be a condition for the third and subsequent disbursements (paragraph 2.8), and (iv) minutes of the Shareholders' Meeting indicating that: (a) the shareholders agree to accept the designation of an additional director who will represent the MIF on the Board of Directors for the term of the project and who will be appointed by mutual consent of the parties (paragraph 2.8); (b) the IDB will be informed of the shareholders' dividend policy and their intention to reinvest the maximum dividend permitted by current law in the company (paragraph 2.21); and (c) the shareholders are committed to the project (paragraph 2.22).

Conditions for project execution:

The first disbursement from the revolving fund will be up to 10% of the total amount of the technical-cooperation funding. This disbursement will be made once the conditions precedent have been fulfilled.

An additional 20% may be disbursed once the executing agency submits to the Bank: (i) justification of expenses for the first disbursement, with the opinion of an outside auditor; (ii) a cost-benefit study of commercial relations between INDES and Banderrollo; and (iii) a progress report prepared by the executing agency.

An additional 20% may be disbursed once the following documentation has been submitted to the Bank's satisfaction: (i) justification of expenses for the second disbursement, with the opinion of an outside auditor; (ii) proof that the recommendations based on the cost-benefit study have been put into effect, establishing a relationship between INDES and its shareholders based on the arm's length principle; (iii) proof that the Board of Directors has established and implemented a performance-based incentive plan for its executives, particularly the manager, whose contract has been revised and approved by the Shareholders' Meeting with the Director for the MIF voting in favor; (iv) proof that the divestiture plan is being executed and that a portion of the shares has been sold; and (v) a progress report prepared by the executing agency.

An additional 20% may be disbursed once the following

documentation has been submitted to the Bank's satisfaction: (i) the mid-term evaluation report mentioned in paragraph 4.15; and (ii) justification of expenses for the third disbursement, which must be accompanied by the opinion of an outside auditor.

An additional 20% may be disbursed once the following documentation has been submitted to the Bank's satisfaction: (i) justification of expenses for the fourth disbursement, with the opinion of an outside auditor; (ii) proof that the divestiture plan has continued, with at least 70% of the shares having been sold off to date; and (iii) a progress report prepared by the executing agency.

The remaining 10% may be disbursed once the Bank receives, to its satisfaction: (i) justification of expenses for the fifth disbursement, with the opinion of an outside auditor; and (ii) a progress report prepared by the executing agency.

**Monitoring and
Evaluation:**

For each of the three years following the first disbursement, INDES will submit audited financial statements to the Bank. It will also submit semiannual statistical reports on the trends in the performance indicators described in the Logical Framework Matrix.

A consultant selected by the Bank and hired by INDES with resources from the technical-cooperation will prepare a mid-term evaluation once 50% of the technical-cooperation funding has been disbursed or 18 months into the project, whichever occurs first. The evaluation will review all aspects of project execution and indicate any necessary corrective measures to ensure project execution. It may recommend that disbursements be suspended if structural defects in project execution are detected. Disbursements may be resumed once the executing agency has shown that it has taken the measures necessary to correct the situation (paragraph 4.15).

A progress report prepared by INDES must be submitted for each disbursement. The report will detail the institutional, administrative, financial and technical changes being carried out, and compliance with the performance indicators. Deviations of more than 20% in the attainment of these targets will lead to the suspension of disbursements, which may be resumed once compliance with the indicators can be demonstrated.

**Exceptions to
Bank policy:**

None

I. FRAME OF REFERENCE

A. The micro and small enterprise (MSE) Sector in Chile

- 1.1 The Corporación de Fomento de la Producción (CORFO) ranks companies according to sales volume and employees. Microenterprises are considered productive units with sales of up to 2,400 Development Units (UF)¹ annually and employ up to 4 workers. Those with maximum sales of 25,000 UF and employ between 5 and 49 persons are small enterprises. Based on these parameters, and the 1998 economic surveys, there were 526,920 enterprises, of which 432,431 were microenterprises and 78,805 were small enterprises, in other words, 97% of the companies were MSE.
- 1.2 The Instituto Nacional de Estadística [National Statistics Institute] (INE) and the Ministerio de Planificación (Ministry of Planning) (MIDEPLAN) estimate that one-third of the employed population have informal jobs, indicating that there are 5.4 million workers in Chile, of whom two million, i.e., 37%, work in microenterprises.
- 1.3 The Chilean MSE have certain features that are different from MSE in the rest of Latin America, differences which are due to economic conditions, cultural factors and the widespread custom of utilizing subcontracting systems and chains. Certain elements that distinguish the sector are export capacity, average income and credit access. In fact, 11% of the Chilean exporters are microentrepreneurs (ME) and 39.2% are MSE. With respect to average income, the Economic Commission for Latin America and the Caribbean (ECLAC) has determined that the urban population employed in low productivity sectors² has an average income in Chile equivalent to 5.9 basic baskets, equivalent to the amount used to identify the poverty line. Considering the entire region, this figure is only slightly exceeded by the population having the same profile in the urban area of Buenos Aires. Lastly, according to figures reported by CORFO, 70% of the formal credit operations between 1994 and 1997 were directed at these sectors, although they only received 10% of the funds.
- 1.4 From the above, it is obvious that even though the most advanced MSE sector relies on formal credit access, this is not enough. This is because formal banking concentrates on the business sector, which has less risk and handles large volumes of resources, allowing for greater financial sector productivity.
- 1.5 For its part, the least advanced MSE sector, not having sufficient collateral, has no access to formal credit, this need being partially satisfied by a group of non-

¹ The UF has a value of approximately US\$30.

² These are defined by the ECLAC as employees and owners of microenterprises, unskilled independent workers and domestic workers.

governmental organizations (NGOs), dealing exclusively with their working capital needs. Therefore, the medium- and long-term financing needs, particularly with respect to the financing of capital goods that will increase their productivity, are not addressed by the formal banking sector nor by the NGOs.

- 1.6 An appropriate mechanism for capital goods financing is leasing, which is gaining greater acceptance, particularly in the small enterprise sector, which generally has no access to commercial bank credit. Such growing acceptance is due to the advantages of the system for both the lessor and the lessee. The lessor has the following advantages: (i) ownership of the asset constitutes in itself a security; (ii) the financial institution can be certain that the funds will be used appropriately since the transaction is configured as a non-monetary transaction; and (iii) less documentation is required. The advantages to the lessee are: (i) financial background and reporting requirements are less stringent, since the analysis is based on cash flow generated by the assets; (ii) there is no requirement for larger guaranties other than the asset itself, which is the subject of the contract; (iii) less immediate liquidity is required to the extent that the leasing finances up to 100% of the investment; (iv) there are fewer transaction costs since the transactions are quickly processed; (v) lease contracts can be flexible and adapted to the seasonality of production and sales cycles; and (vi) in the case of Chile, 4% of the contract amount represents a tax credit, and the entire payment is considered a deductible expense.
- 1.7 The Chilean leasing market also clearly addresses the needs of the modern business sector, as shown by the fact that in December 1999, 17 leasing companies had an average of US\$73,000 in loans. The average needs of micro and small enterprises range between US\$10,000 and US\$15,000.
- 1.8 The foregoing shows that medium- and long-term financing of the MSE, particularly those relating to capital goods financing for productivity growth, is neither addressed by the formal banking sector nor by informal lending institutions. But there is an entity that has participated in this market since 1992, financing new and used capital goods for the MSE sector through the leasing mechanism: Inversiones para el Desarrollo (INDES) S.A., the executing agency of this project.

B. Bank strategy in the country and in the sector

- 1.9 The Bank's strategy in Chile is aimed, among other things, toward innovative projects that enable private sector expansion, particularly those geared toward increasing the productivity of micro and small enterprises. For its part, the Bank's strategy with respect to the microenterprise is aimed at, among other things, supporting solid and sustainable institutions that offer financial and non-financial services to address the demands of the microenterprise, and to facilitate access by the ME to financial and commercial services.

II. EXECUTING AGENCY

A. Background summary

- 2.1 Inversiones para el Desarrollo S.A. (INDES), a private profit enterprise was organized on June 17, 1987 by an initiative of the Fundación para el Desarrollo, a shareholder of the Banco del Desarrollo [Development Bank] (Bandesarrollo), the Fundación Instituto de Viviendas Populares [Housing Administration] (INVICA), the Fundación de Asistencia Social Cámara Chilena de Construcción [Chilean Contractors Association Welfare foundation] and the Unión Social de Empresarios Cristianos [Christian Entrepreneurs Union]. In order to implement capital increases, they invited other institutions to participate, such as Société d'Investissement et Développement International (SIDI) of France, the Ecumenical Development Cooperative Society (EDCS) of The Netherlands and other entities. At present, there are 13 shareholders.
- 2.2 Its strategic goal is to strengthen the productivity of the micro and small enterprise by means of medium-term equipment and capital goods financing through leasing. INDES is the only institution in Latin America with a leasing program geared to the small and microenterprise.
- 2.3 INDES has great strengths, such as the commitment of the Board of Directors, a firm knowledge of its customers and a management that is committed to the sector. It operates within a regulatory framework favorable to the leasing system. Despite the fact that it can potentially weaken, INDES has no competition. Finally, it has managed its administrative costs well and its shareholders have had the policy of reinvesting profits.
- 2.4 INDES has formulated a strategic plan which contemplates the growth of its activities and the possible formation of a Latin American model. To carry out this plan, INDES has requested technical cooperation from the MIF as well as the possibility of structuring a capital investment or long-term subordinated debt that would serve as the basis for growth by helping to restructure terms. However, the analysis conducted concludes that in order for INDES to attract new investors and ensure its long-term sustainability, it must first make improvements to its administrative structure and the loan-granting process. The quality of its assets must be improved and be totally suited to the market. For these reasons, the project team decided to address the request solely insofar as it relates to technical assistance, focusing on the restructuring of INDES to achieve a leasing model for the procurement of capital goods geared to the MSE.
- 2.5 The project team has asked INDES to review and approve the strategic plan. This review should include alternatives for growth financing other than the arrangement originally put forth by the MIF.

B. Governance and Management

- 2.6 The shareholders' meeting, the five-member Board of Directors, the Executive Committee (EC) and the general manager's office are the governing bodies of INDES. The Executive Committee, consisting of three directors and the manager, has an active role in the management of INDES. Notwithstanding an organizational chart with a defined structure, in practice the general manager carries out all decision-making. Organizational structures which are discretionary and centered around one person are common in family-owned companies or companies which decide to enter new markets. This may have been an advantage in the early years when INDES needed to break new ground in the leasing market for small and microentrepreneurs. However, with maturity, such institutions are now exhibiting such disadvantages as, for example, difficulty in adapting to industry standards.
- 2.7 Two directorships of the five on the Board of Directors of INDES represent 33.6% of the capital of Bandesarrollo. Moreover, INDES holds 1.2% of the shares of Bandesarrollo, equivalent to US\$1.4 million.
- 2.8 The MIF contribution, representing consultations rather than investments, totals an amount which approximates the contribution of the majority shareholder. Therefore, and considering that it involves a restructuring project, it is contemplated that a director representing the MIF would be designated for the duration of the project, as well as requirements pertaining to divestiture of the shares held by INDES in Bandesarrollo, to guarantee liquidity and to direct the INDES assets to the fulfillment of its corporate mission.

C. Target market

- 2.9 INDES serves the formal growth segment of the small and microenterprise (empresas de acumulación), in other words, it pays municipal business tax and is subject to value-added tax. It obtains its clients by passive marketing strategies. On one hand, it has developed relationships with various providers of capital goods, who refer customers to INDES. On the other hand, INDES relies in large measure on customers referred by Bandesarrollo, if they do not qualify as customers of the formal financial system.

D. Capital structure and asset composition

- 2.10 54.5% of the assets are placed in leasing and loan portfolios, 31.6% of the assets are concentrated in investments in the Bandesarrollo group. 42% of the assets are financed with INDES' own capital, 26% with FOSIS funds, 26% with bank loans from Bandesarrollo and 6% with demand deposits. The FOSIS resources are readjustable without interest. Such funds are contractually tied to the application of limits on the interest rate and terms. The Bandesarrollo credit lines are under commercial terms.

- 2.11 One of the major resources for leasing companies are the funds managed by CORFO, aimed at facilitating small enterprise productivity. However, INDES cannot participate in the general bids scheduled by CORFO since it does not satisfy the condition of being an entity under the supervision of the SBIF.

E. Products, portfolio and portfolio at risk

- 2.12 INDES began its microleasing program in 1992 serving customers that could not be served by leasing affiliates. Since then it has approved close to three thousand transactions. The portfolio composition in August 1999 was as follows:

Product	Number of Loans		Amount in US\$	
Microenterprise leasing (ME)	178	23.4%	515,500	17.3%
Small enterprise leasing (SE)	59	7.8%	688,886	23.1%
Bandesarrollo operational leasing	65	8.5%	800,000	26.9%
UF loans	46	6.0%	250,064	8.4%
Peso loans	228	30.0%	417,100	14.0%
Discount documents	173	22.7%	205,762	6.9%
Working capital	12	1.6%	101,255	3.4%
Total	761	100.0%	2,978,567	100.0%

- 2.13 With the addition of microentrepreneur participation in the active portfolio of other products, together with ME leasing, the INDES portfolio for the sector scarcely exceeds 30%, which could be higher. The market of growth microenterprises (microempresas de acumulación) and small enterprises with no facilities for obtaining funds from the formal banking sector represents a potential that INDES has not yet exploited, as shown by the fact that approximately 20% of the microenterprises, i.e., almost 80,000, are growth microenterprises.
- 2.14 The credit technology used by INDES is based on the traditional standards of credit analysis. Despite the involvement of a significant component of personal service and visits to clients, which are appreciated by the ME, the type of analysis and the time expended involve high transaction costs, which the ME generally avoid.
- 2.15 A large portion of the INDES portfolio is tainted with delinquencies. The following table shows delinquencies of 90 days or more in the INDES portfolio at August 31, 1999.

Product	Number of Loans		Amount in US\$	
Microenterprise leasing (ME)	50	28.1%	161,252	31.3%
Small enterprise leasing (SE)	24	19.4%	292,919	19.7%
UF loans	15	32.6%	116,070	46.4%
Peso loans	81	35.5%	101,215	24.3%
Discount documents	0	0%		0%
Working capital	0	0%		0%
Total	170	22.3%	671,455	22.5%

- 2.16 The reasons for the INDES delinquencies could be summarized in the conviction that what matters is the amount written off as effectively uncollectable (in 10 years of operation, INDES has effectively lost the equivalent of 1.2% of the current portfolio), the lack of a loan manager, a deficient management information system, dependence on the FOSIS resources, and the lack of a disciplined loan methodology.
- 2.17 Notwithstanding, INDES has sufficient reserves to cover any possible portfolio losses.³ Reserves to date total US\$280,167 and the team's calculations, based on the SBIF rules, indicate that if the portfolio were supervised, it would require reserves equivalent to US\$195,037.
- 2.18 INDES has a portfolio supervision and monitoring system which it developed on a rather inflexible platform, which means that it now needs to migrate to more current languages and operate on more modern equipment. A portfolio supervision system is needed that reports delinquencies by customer and branch on a daily basis, mounted on an interactive database to permit comparisons and estimates by sector, activity, etc.
- 2.19 INDES' earning power in relation to its average net worth has hovered around a nominal 18%, hardly a break-even point in terms of its average weighted capital cost. These results affect the rise in the return rate due to default penalties and subsidies granted by Bandesarrollo for office rentals, two-thirds of the manager's salary, cost of commercial references, and the failure to invest in credit technology or market development. By revising the financial statements to include all of the costs that INDES would have to assume if it did not receive the Bandesarrollo subsidies, it would have an average rate of return of 8%.
- 2.20 The low liquidity of INDES is due to the high delinquency rate, the use of part of its own resources for the financing of the operational leasing with Bandesarrollo,

³ The Executive Committee designed its own system for calculation of reserves, which is more exacting than that of the SBIF, despite the fact that INDES computes default on installment payments and not on the outstanding principal.

and maintaining part of its assets in non-liquid investments that represent non-operative profits.

- 2.21 Finally, a factor that undoubtedly has had an impact on INDES' performance has been the policy of the shareholders not to distribute dividends. This capitalization of profits has enabled its capital to grow to US\$2.2 million. To ensure that this sound policy remains in place, a condition precedent to the first disbursement is the submission of minutes of the shareholders' meeting in which they resolve to keep the Bank informed of its dividend policy and its intention to reinvest in the company the maximum possible dividend, by permitted by current laws.
- 2.22 One of the problems INDES has in attracting new investors is not due to the nature of its field of activity (leasing and credit to small and microentrepreneurs), but to the following factors: (a) lack of an internal regulatory framework; (b) lack of a credit technology that would give it the flexibility to adapt its products to its customers without having to resort to the development of new products to bridge the customer's financial gap; (c) absence of an effective and modern portfolio supervision system; (d) a complex asset/liability recording system relationship with Banderarrollo; and (e) an overly centralized structure of corporate/administrative governance. One of the conditions precedent to the first disbursement will therefore be the submission of shareholders' minutes, stating, among other things, project support.
- 2.23 In order to help INDES establish an arm's-length relationship with Banderarrollo, INDES will have to undertake a cost-benefit study of such a relationship, based on the valuation in rates and conditions that would exist between unrelated parties. Based on the results of this analysis, INDES should adapt its real cost structure to the lending rate necessary to achieve the minimum profit margin objectives. INDES is expected to have a clear negotiating component and that, based on this study, relations between the two institutions can be renegotiated.
- 2.24 This factor is essential for the development of a model, since no model can be based on partial dependency on another entity. The disbursement of the second tranche will therefore only be made once it has been verified that INDES has put into practice the recommendations of this study.
- 2.25 In view of the clearly positive results in productivity generated by the leasing mechanism in this type of enterprise and in a country such as Chile, it would be appropriate to support INDES in a restructuring project to surmount the problems mentioned and develop a financing model for the leasing industry. This project is designed to assist INDES in that regard.

III. THE PROJECT

A. Objective

- 3.1 The project's objective is to support the development of a model for microleasing (leasing for microentrepreneurs) that is technically, financially and methodologically sustainable, in order to guarantee timely access for micro and small enterprises in Chile to medium-term resources that will enable them to purchase new or used capital goods, thereby increasing their productivity.

B. Components

- 3.2 The project has three components: (i) administrative, technical, financial and market restructuring; (ii) upgrade of management information systems; and (iii) miscellaneous. The project includes activities aimed at the distribution of the microleasing mechanism in other countries.

1. Administrative, technical, financial and market restructuring

- 3.3 Administrative restructuring is intended to help define an adequate structure for a mature institution, define strategic and executive roles tailored to the strategic plan for growth, reformulate policies and manuals of procedure and define job profiles and duties. The Board of Directors will have the support of a new director who will represent the MIF, with the right to vote and speak at meetings for the duration of the project. The submission of minutes of the shareholders' meeting will be a condition precedent to the first disbursement, in which they declare their commitment to accept the designation of an additional member of the Board of Directors, with the consent of the parties, who will represent the MIF for the duration of the project.
- 3.4 Technical restructuring involves improving credit analysis based on cash flow generated by the asset to be financed, defining policies with respect to loans, reserves and write-offs, redefining formats for analysis and documents to be presented to the loan committee, increasing the productivity of trade executives, defining target-incentive bonus models for manager compensation (profitability, credit standing, default) and trade executive compensation (default-related stock and flow variables and placements), techniques and processes for effective collection. It includes funding for INDES executive internships at companies with similar objectives of serving the microenterprise with medium-term financing products. Such an internship could be with the Grameen Bank leasing program, the pioneer in development of the microleasing model.
- 3.5 Financial restructuring would involve the need to make a real risk evaluation of INDES, rating its portfolio and taking the measures necessary to bring its risk down to a level acceptable to national and international markets. Such restructuring

should be conducive to the rationale, accounting and effective payment of costs currently subsidized by Bandesarrollo. This will require a cost-benefit study as mentioned in paragraph 2.23. For budget purposes, the incremental amount resulting from the calculation of administrative costs due to restructuring has been taken into account.

- 3.6 Market strengthening applies to the study to provide specific information on market opportunities, the establishment of branches and the design of variations necessary to make leasing a flexible and profitable product in itself, as well as to implement a marketing strategy that would help expand the customer base and rely on capital goods providers, trade associations, etc.

2. Upgrade of management information systems

- 3.7 This refers to the procurement of equipment, configuration of the accounting, information and oversight procedures to the future needs of INDES, and an auditing system which would provide the information necessary to upgrade equipment and programs. This audit should be undertaken by a firm other than Bandesarrollo.

3. Miscellaneous

- 3.8 This component covers short-term consultations on environmental matters, for the Board of Directors, the Executive Committee, the Manager's Office and Trade executives. The intent is to increase awareness of these matters so that they can implement the rules of eligibility of customers for INDES products and have valid and conscientious arguments within the scope of the decision-making bodies to approve or deny loan applications.
- 3.9 Also included are costs relating to dissemination of the lessons learned, an impact evaluation to verify the supposition concerning the effect of access to capital goods on small and microenterprise productivity, intermediate and final evaluations of the project and contingencies, estimated to be 4% of the total project value. For dissemination of the project outcome, two short-term workshops will be held, together with a publication of the outcomes. These workshops should illustrate the restructuring procedure, the model configuration, describe the elements of replication and the lessons learned in the process.

C. Cost and financing

- 3.10 The cost of the project is US\$970,000, of which US\$570,000 has been requested from the MIF and the amount of US\$400,000 will be contributed as a counterpart. The budget is itemized in the table below:

COMPONENT	MIF	INDES	TOTAL
1. Administrative, technical, financial and market restructuring			
a. International consultation	280,000	120,000	400,000
b. Member of the Board of Directors	80,000	8,000	88,000
c. Institutional sharing	20,000		20,000
d. Portfolio rating		20,000	20,000
Subtotal	380,000	148,000	528,000
2. Information Systems			
a. Hardware and Software	100,000	20,000	120,000
Subtotal	100,000	20,000	120,000
3. Miscellaneous			
a. Environmental consultant	16,000		16,000
b. Restructuring costs		176,000	176,000
c. Impact study	10,000	10,000	20,000
d. Dissemination of lessons learned	34,000	6,000	40,000
e. Evaluations	30,000		30,000
f. Contingencies		40,000	40,000
Subtotal	90,000	232,000	322,000
TOTAL	570,000	400,000	970,000
% Participation	58.8%	41.2%	100.0%

- 3.11 The counterpart funds will be contributed by INDES in cash and in kind. It should be noted, however, that most of the funds will be in cash, and consist of the payment of incremental costs resulting from the restructuring and the elimination of the subsidies granted by Bandesarrollo.

D. State of the project

- 3.12 The project is in its initial phase, INDES being in the process of revising the strategic plan and defining the terms of reference for the hiring of the consultant or consultants. It is also going forward with discussions with the other shareholders of Bandesarrollo to determine the plan for gradual divestiture.

IV. PROGRAM IMPLEMENTATION

A. Project execution and management

- 4.1 The proposed project will be executed directly by INDES. To do so, it must bid for the contracting of one or more consulting firms specializing in the design of methodology and financing of programs aimed at the small enterprise and microenterprise. The presentation of the terms of reference for the competitive bid for this consultation will be a condition precedent to the first disbursement.

- 4.2 INDES will present to the Bank the names of possible candidates for the director that will represent the MIF. The selection will be by mutual consent, and once selected, INDES should hire that person directly. It will also directly hire the environmental consultant and the rating agency, other than Bandedarrollo, which must be acceptable to the Bank. Experience in risk evaluation of informal entities is desirable. INDES is also responsible for contracting for the systems audit and the procurement of equipment and management information systems that are better suited to the demands of growth and credit technology.

B. Beneficiaries

- 4.3 This project will directly benefit 800 small and microentrepreneurs located primarily in the metropolitan area and in the cities of Rancagua, Viña del Mar, Los Andes and Concepción. It should be pointed out, however, that the current clients (761) will also benefit, as well as all the other clients that INDES may attract once the project is completed. At the current annual growth rate of 25%, beneficiaries will total over 3,600 in less than 10 years.

C. Environmental impact

- 4.4 The project activities will not directly affect the environment; however, in accordance with suggestions from the CESI, the hiring of an environmental consultant to advise customers carrying out activities with high environmental impact has been budgeted, so that they can implement appropriate mitigation measures and advise management on the proper evaluation of loan applications.

D. Procurement of goods and services

- 4.5 INDES will be responsible for procuring the equipment and hiring the consultants, in accordance with the relevant rules, procedures and policies of the Bank on this matter and applicable to the private sector.

E. Implementation period and disbursement schedule

- 4.6 The project will be executed over a period of 36 months. Disbursements will be made over a term of 42 months.
- 4.7 With the first disbursement, the revolving fund will have up to 10% of the total the technical cooperation. This disbursement will be made once the conditions precedent have been satisfied.
- 4.8 An additional 20% may be disbursed when the following has been submitted to the Bank: (i) justification of expenses for the first disbursement, with the opinion of an outside auditor; (ii) a cost-benefit study establishing the arm's-length relationship between INDES and its shareholders; and (iii) a progress report prepared by the executing agency.

- 4.9 An additional 20% may be disbursed once the following documentation has been submitted to the Bank: (i) justification of expenses for the second disbursement, with the opinion of an outside auditor; (ii) proof that the recommendations based on the cost-benefit study have been put into effect, establishing an arm's-length relationship between INDES and its shareholders; (iii) proof that the Board of Directors has established and implemented a performance-based incentive plan for its executives, particularly the manager, whose contract has been revised and approved by the Shareholders' Meeting with the Director for the MIF voting in favor; (iv) proof that the divestiture plan is being executed and that a portion of the shares has been sold; and (v) a progress report prepared by the executing agency.
- 4.10 An additional 20% may be disbursed when the following has been submitted to the Bank's satisfaction: (i) the intermediate evaluation report mentioned in paragraph 4.15; and (ii) justification of expenses for the third disbursement, which must be accompanied by the opinion of an outside auditor.
- 4.11 An additional 20% may be disbursed once the following has been submitted to the Bank's satisfaction: (i) justification of expenses for the fourth disbursement, with the opinion of an outside auditor; (ii) proof that the divestiture plan has continued, having sold to date at least 70% of the shares; and (iii) a progress report prepared by the executing agency.
- 4.12 Finally, the remaining 10% may be disbursed once the Bank receives, to its satisfaction: (i) justification of expenses for the fifth disbursement, with the opinion of an outside auditor; and (ii) progress report prepared by the executing agency.

F. Monitoring and evaluation

- 4.13 For each of the three years following the first disbursement of funds, INDES will submit to the Bank audited financial statements. It will also submit six-month statistical reports on the trend of the agreed performance indicators described in the Logical Framework Matrix.
- 4.14 Each disbursement will require the submission of a performance report prepared by INDES. This report will describe the implementation of the institutional, administrative, financial and technical changes being carried out, and fulfillment of the performance indicators. Deviations of more than 20% in the attainment of these targets will cause the suspension of disbursements, which may be resumed when compliance with such indicators is shown.
- 4.15 A consultant selected by the Bank and hired by INDES with the technical-cooperation funds will prepare a mid-term evaluation, once 50% of the technical-cooperation funding has been disbursed or 18 months into the project, whichever occurs first. The presentation of this report to the Bank's satisfaction is a condition for subsequent disbursements. This evaluation will look into the project's execution

in all aspects, comparing the changes made in the administrative, technical and financing areas. The report should indicate the necessary corrective measures that will ensure the project's execution and recommend the suspension of disbursements if there are structural defects in the project. Disbursements may be resumed once the executing agency has shown that it has taken the measures necessary to correct the situation.

- 4.16 With funds from the last disbursement, the Bank will select a consultant to be hired by INDES to make a final evaluation of the INDES project.

V. RATIONALE AND RISKS

A. Rationale

- 5.1 INDES has been able to break the paradigm that the ME is only a subsistence enterprise and therefore does not need to increase productivity. INDES is the only institution in the region that offers leasing to microenterprises, helping to expand productivity, providing access to new and used capital goods, thus clearly distinguishing itself from the formal financial sector and other microenterprise sector programs. INDES has accumulated valuable experience and has reached a turning point where it has the opportunity to change direction, orienting itself more toward leasing industry standards or toward creating its own model and standards. This would mean a substantial contribution to the microfinancing industry, which should also foster the development of new approaches and products.
- 5.2 The development of an alternative financing model for the microenterprise, specifically leasing, is necessary for the region, given its simplicity of analysis and the ease of obtaining the appropriate guarantees.

B. Risks

- 5.3 Given the close relationship that has existed between INDES and Badesarrollo, the negotiation process for a commercial relationship between the two institutions will undergo a major adjustment with all the risks such an adjustment entails. To reduce this risk, the third disbursement will be subject to the demonstration by INDES that the recommendations of the cost-benefit study have been carried into effect and that the commercial relations between the two institutions are based on terms that would be agreed between arm's-length entities.
- 5.4 Taking into account the organizational aspects of INDES, the risk exists that its management will try to perpetuate the manner in which it has habitually carried out various tasks. To prevent this, the disbursements of the contributed amount will be subject to the fulfillment of special conditions (paragraphs 4.6 et seq.) and requirements resulting from the consultations.

VI. SPECIAL CONTRACTUAL CONDITIONS

- 6.1 As a prerequisite to the first disbursement, the following must be submitted to the Bank's satisfaction: (i) a strategic plan reviewed and approved by the Board of Directors; (ii) terms of reference and competitive bid procedures for consultations in design methodology, organization and financing for the program; (iii) a gradual divestiture plan for the shares of Banco del Desarrollo, the execution of which will be a requirement for subsequent disbursements, and (iv) minutes of the Shareholders' Meeting indicating: (a) their commitment to accept the appointment by consent of the parties of an additional member of the Board of Directors, who will represent the MIF, during the project's execution, (b) their promise to inform the IDB of their dividend policy and their intention to reinvest in the company the maximum dividend in accordance with current law, and (c) their commitment to the project.

RESTRUCTURING OF THE MICROLEASING MECHANISM

Y OF OBJECTIVES	VERIFIABLE INDICATORS	VERIFICATION METHODS	ASSUMPTIONS
and adequate access by microentrepreneurs to increase	<p>June 2003:</p> <p>i) The microentrepreneur base to receive funds to acquire capital goods has been expanded and has two additional agencies.</p>	<ul style="list-style-type: none"> ▪ System for monitoring INDES portfolio operations ▪ INDES Portfolio statistics and customer database ▪ Financial statements of the microentrepreneurs ▪ Microentrepreneur surveys 	<ul style="list-style-type: none"> ▪ INDES is able to have access to financing sources and participate in the Chilean capital market. ▪ The Chilean economy remains
sustaining microleasing the experience gained from executed by	<p>i) INDES has an appropriate organizational structure, with clearly defined executive and strategic roles, and with skilled personnel to carry out the various duties.</p> <p>ii) INDES has adequate technology to analyze and assign loans and leasing geared to the small and microenterprise sector.</p> <p>iii) INDES has an effective loan monitoring system, portfolio supervision programs and appropriate procedures for administrative and out-of-court collections.</p> <p>iv) INDES has a complete diagnosis of its market and credit needs. It has developed the agricultural leasing product and has implemented an effective marketing strategy.</p> <p>v) INDES has a rating that will allow it to take the action necessary to fulfill the conditions under which the capital market would accept its participation.</p>	<ul style="list-style-type: none"> ▪ Reports of the Board of Directors ▪ Project execution, management and consultants' reports ▪ Reports of visits by Bank personnel ▪ Audited financial statements of INDES ▪ INDES statistics related to the number of operations, number of placements, portfolio delinquencies, tainted portfolio, analysis to conform the reserves to industry standards, etc. 	<ul style="list-style-type: none"> ▪ INDES Board and all shareholders and commit themselves to the results. ▪ INDES management promises proactively and properly execute project. ▪ It has the properly trained personnel to meet the project's challenges and new techniques. ▪ The Board of Directors will continue to seek long-term resources in the market, particularly through C ▪ The shareholders will continue to provide a substantial portion of the pro ▪ INDES will continue to be a private enterprise and will therefore have different financial instruments in the capital market.

<p>management is ned.</p> <p>as a credit technology te to serve the sector. as developed and ted a marketing or its products. as an institutional and olio rating and operates rket without subsidies.</p>	<ol style="list-style-type: none"> 1. Contracting of an international consulting firm specializing in the design and implementation of financial operations in non-regulated institutions. 2. Obtaining a risk rating for the institution 3. Hiring an environmental consultant 4. Hiring an outside advisor to the Board of Directors 		<ul style="list-style-type: none"> ▪ The appropriate international c are in place. ▪ The appropriate national consu place. ▪ INDES will be able to renegoti FOSIS the terms of the agreem the imposition of conditions in loans with its resources. ▪ INDES will assume the financ responsibility for all its admini expenditures and costs.
<p>and redefinition of the ional structure ation of policies management, credit, g, financing, portfolio on, and portfolio default on of procedural</p> <p>n of jobs profiles outside consultant to of Directors, with the ote and speak at</p> <p>ion on leasing-based hnnology for small and epreneurs personnel in the te handling and use of nology of loan application nd submission to the mittee</p>		<p>For all activities, the verification methods are:</p> <ul style="list-style-type: none"> ▪ INDES accounting records ▪ Auditor's reports ▪ Copies of contracts ▪ Reports of the Manager and Board of Directors 	<ul style="list-style-type: none"> ▪ The project is approved.

ment of administrative f-court collection es environmental t ent of hardware and with other institutions udy a marketing strategy ng an independent n on of subsidies			
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PERFORMANCE INDICATORS

Figures in thousands of US\$

Indicator	2000	2001	2002	2003	2004	2005	2006
Total Portfolio	3,429	3,840	4,301	4,187	5,395	6,042	6,768
% Portfolio/Assets	57.1%	58.5%	59.9%	61.2%	62.4%	63.7%	65.0%
% Portfolio/Vehicles	18.3%	17.2%	16.1%	15.1%	14.2%	13.3%	12.4%
% Portfolio/Leasing	50.7%	51.8%	52.9%	53.9%	54.9%	55.8%	56.6%
Leasing Revenue/Total Revenue	30.6%	31.4%	32.1%	32.7%	33.4%	34.3%	35.2%
Loan Revenue/Total Revenue	21.3%	21.8%	22.3%	22.7%	23.2%	23.9%	24.5%
Reserves/Portfolio	8.7%	8.7%	8.7%	8.7%	8.7%	8.7%	8.7%
Portfolio at risk	22.5%	18.0%	16.0%	14.0%	12.0%	10.0%	10.0%
Gts Mgmt/Portfolio L+C	20.0%	19.5%	19.0%	17.5%	15.5%	14.5%	13.5%
Microentrepreneur customers	174	214	263	350	433	518	644
Small enterprise customers	109	121	135	143	156	171	179

PROPOSED RESOLUTION

**CHILE. NONREIMBURSABLE TECHNICAL COOPERATION FOR
THE MICRO-LEASING RESTRUCTURING PROGRAM OF INVERSIONES PARA EL
DESARROLLO INDES S.A**

The Donors Committee of the Multilateral Investment Fund

RESOLVES:

1. That the President of the Inter-American Development Bank or such representative as he shall designate is authorized, in the name and on behalf of the Multilateral Investment Fund, to enter into such agreements as may be necessary, and to take such additional measures as may be pertinent for the execution of the project proposal contained in the Donors Memorandum MIF/AT-____ with respect to a nonreimbursable technical cooperation for the Micro-leasing Restructuring Program of Inversiones para el Desarrollo INDES S.A.

2. That up to the sum of US\$570,000 or its equivalent in other convertible currencies shall be authorized for the purpose of this resolution, chargeable to resources of the Small Enterprise Development Facility of the Multilateral Investment Fund.

3. That the above-mentioned sum is to be provided on a nonreimbursable basis.