TC PROFILE (ABSTRACT)

I. Basic project data

- Country/Region: Bolivia
- Program Name/Number: Deepening the Bolivian Leasing Market BO-M1001
- Team Leader/Members: Valentina Sequi (MIF/INV), team leader; Miguel Aldaz (MIF/INV), Rita Bettiol (IIC), Fernando Catalano (COF/CBO).
- Date of Request: March 2004
- Beneficiary: Bolivian Small and Medium Enterprises (SMEs)
- Executing Agency: Fortaleza Fondo Financiero Privado (FFP)
- Financing Plan:

(i) *Equity:*

MIF (IIIB)	US$ 400,000
Fortaleza FFP	US$ 400,000
Private Third Party	US$ 200,000
Total	US$1,000,000

(ii) Line of Credit:

MIF (IIIB)	US$1,000,000

(iii) Technical Assistance (Supervision):

MIF (IIIA)	US$ 85,000

- Technical and Basic Responsibility: MIF Investment Unit
- Tentative Dates:

POC	March 2004
Donors	June 2004

II. Background

Benefits of Leasing

2.1 Financial Leasing is a contractual arrangement between two parties, which allows one party (*lessee*) to use an asset owned by the other (*lessor*) in exchange for specified periodic payments. The *lessee* uses the equipment and pays a rental to the *lessor* who owns the equipment. Security for the transaction is provided by the asset itself and enables borrowers without well-developed balance sheets or credit histories to access otherwise inaccessible equipment financing.

2.2 Compared to traditional equipment loans, leasing is advantageous for small and medium-sized enterprises because: (i) lessees do not require collateral or long credit histories since the lessor maintains ownership of the equipment; (ii) transaction costs are lowered because outside security does not need to be established; (iii) leasing makes it possible to finance a higher percentage of the cost of investing in equipment, typically with less down payment; (iv) leasing is flexible and can be tailored to the lessee’s cash flow cycles; and (v) leasing often has tax benefits because lessees can offset their full lease payments against income before tax compared to just interest on bank loans.

2.3 The advantages for the leasing company include: (i) ownership of the asset, which provides it with a more secure guarantee since assets can be repossessed more easily than collateral; (ii) relatively simple documentation that makes it possible to efficiently

conduct a large volume of leasing operations; and (iii) guarantees that the funds are used appropriately since the lessor buys the equipment for the lessee.

2.4 Leasing can have a substantial impact on the development of the SME segment by supporting entrepreneurial activities, catalyzing investments and enabling sustainable growth of businesses. In addition, leasing benefits opening economies because it helps domestic firms access foreign technology when they have neither the financial resources nor the expertise to import capital goods.

2.5 An IFC Best Practices study concluded that leasing companies greatly help the development of local capital markets.[1] On the asset side, leasing introduces SMEs that previously relied on informal financing, supplier credit and internal cash generation, to formal financial markets. On the liability side, a leasing company's efforts to mobilize debt and equity help deepen and broaden domestic capital markets. Typically, leasing companies mobilize debt by: (i) borrowing from banks and finance houses, (ii) issuing bonds or other marketable securities; and (iii) securitizing their lease receivables. Leasing not only fosters competition in the financial services sector, but more importantly, introduces businesses and lenders alike to cash flow based analysis.

2.6 According to the IFC Bets Practices paper, the approach most frequently used by multilateral organizations to catalyze the leasing industry has been to set up new independent leasing companies in collaboration with foreign leasing specialists and a skilled local partner.

Leasing Market in Bolivia

2.7 The leasing market in Bolivia has always been weak and with a limited number of industry players. Several small firms that appeared in the early 1990's dropped out due to problems in raising capital, high operating costs and lack of a well-diversified portfolio. More recently, the modification of the Ley de Bancos y Entidades Financieras, through law 2297 passed in December 2001, prohibited regulated financial institutions from providing leasing services except through stand-alone subsidiaries.

2.8 The only two financial institutions to have established independent leasing subsidiaries are BHN Multibanco and Banco Bisa. BHN's leasing operation was closed in 1998 when Citibank acquired Multibanco. Bisa Leasing has remained as the only regulated leasing arm of a financial institution operating in Bolivia. Some small, unregulated microfinance NGOs also provide leasing types services to micro-enterprises[2].

2.9 Between 1998 and 2002, Bisa Leasing's portfolio shrunk by 41% from US$18.8 million to US$11 million but this is in line with the trend in the whole of Latin America and general economic downturn in the Region. As a comparison, the volume of leasing activities in the whole of Latin American dropped by 62% between 1997 and 2001[3].

2.10 Bisa Leasing specifically targets the corporative market, namely medium and large companies in the industrial sector. In addition there exist small, unregulated microfinance NGOs that also provide leasing types services to micro-enterprises[4]. To date, however,

[1] "Leasing in Emerging Markets"; IFC Lessons of Experience Series; 1996; p.5
[2] "El Desarrollo de la Pyme en Bolivia y Las Perspectivas Para Mejorar su Acceso a la Financiacion", Grupo Caisa, p.13
[3] London Financial Group Global Leasing Report (1999, 2003) and CEPAL
[4] "El Desarrollo de la Pyme en Bolivia y Las Perspectivas Para Mejorar su Acceso a la Financiacion", Grupo Caisa, p.13

the individual professional and SME segment has been overlooked by leasing companies and therefore represents a significant market given the number of firms the segment represents[5] and the severe lack of alternative financing sources.

2.11 The proposed Leasing Company aims to serve the SME segment, as well as individual professionals, and is targeting an average lease size of US$25,000. In comparison, Bisa has an average lease size of US$95,000.

III. Program objective and description

3.1 The general objective of the project is to contribute to a sustainable increase in the productive capacity of SMEs and individual professionals in Bolivia.

3.2 The specific objective of the project is to provide SMEs and individual professionals with access to leasing services, an ideal mechanism for financing their entrepreneurial and business expansion projects. In addition, through demonstration effects, it is hoped that it will eventually lead to the development of a robust leasing market in Bolivia. Finally, the know-how acquired by MIF in setting up this leasing company in an underdeveloped market will help similar projects in related services such as factoring, insurance and mortgage in other LAC countries.

3.3 The project will reach the desired outcomes by financing the launch and initial operation of a SME-focused Leasing Company through an equity investment as well as with debt financing in the form of a senior loan.

3.4 The specific objective of the project is to enable the launch and initial operation of an SME-focused leasing company in Bolivia by providing equity capital as well as debt financing through a senior loan. This project will serve as an example to the financial services industry that it is possible to create viable leasing companies that target the SME sector, and through demonstration effects, it is hoped that it will lead to the development of a robust leasing market in Bolivia.

3.5 The preparation of the Leasing Company business plan was made possible by an SDS/MIF *Innovation Initiative* which financed the analysis and preparation of five highly innovative projects in the Financial Services and Business Development Services fields. The business plan addresses the company's service offering, risk evaluation policies, marketing and distribution strategy, regulatory environment, and financial projections and was prepared by Lico Leasing and Ikei Consulting of Spain together with the Fortaleza group.

3.6 The Leasing Company is expected to provide 41 leases for a value of US$990,000 in the first year of operation, an additional US$1.2 million in year two and US$1.4 million in year 3. By year 4, the Company is expected to reach 16% of the potential market with 68 leases for a total portfolio value of US$3.5 million.

3.7 Specifically, the Leasing Company will target the following sectors: (i) Machinery and Equipment (Primary focus); (ii) IT and Office Equipment; (iii) Medical Equipment, as well as several minor others. These sectors were identified as attractive segments because of their size, growth prospects, consolidated industry structure, and an existing secondary resale market. Overall, the markets that the proposed Company would target have been estimated at a value of US$230 million in annual equipment acquisitions.

[5] Approximately 35% of the country's GDP

3.8 Although the Leasing Company will be operated as an independent subsidiary of Fortaleza FFP as the Law requires, it will be able to leverage synergies in the areas of back office and marketing from its alliance with Fortaleza FFP. The Leasing Company will physically be housed in Fortaleza FFP facilities in the major cities and will cross-sell the leasing products, thereby significantly reducing fixed costs.

3.9 Throughout the country, distribution channels will include own staff, and, most importantly, through equipment vendors themselves. In the latter case, the Leasing Company will be able to negotiate price discounts especially in those products that it most heavily finances. In MIF's experience, the group that most demands leasing services are the capital equipment manufacturers themselves since they cannot sell their products without also providing a mechanism for financing the purchases.

3.10 Once it has obtained the necessary track record through a few years of successful operation, the Leasing Company intends to seek debt financing to finance its growth through a number of different institutions. In addition, the Leasing Company will look into issuing bonds in the Bolivian capital market.

IV. Cost and financing

4.1 The project will finance the proposed Leasing Company through a US$400,000 equity investment from the MIF and an additional US$1,000,000 senior loan. In total, the leasing company will commence operations with US$1,000,000 in equity (of which US$400,000 will be contributed by Fortaleza FFP and additional $200,000 from private third parties) and US$1,000,000 in debt. As a comparison, Bisa Leasing carries a 3:1 debt to equity structure and began its operations in 1993 with US$700,000 in equity. The more conservative debt to equity structure of the proposed Company is justified in the initial phases of operation.

4.2 Fortaleza FFP will grant MIF a put option on its total equity investment that will allow MIF to sell its share in the Leasing Company back as of year 6 at a valuation that will be based on the larger of either a multiple of the company's book value, net income or value of invested capital.

4.3 MIF's loan will have a three-year life (renewable for another three) and is intended to provide the start-up funds that will enable the Leasing Company to begin operating and generating sufficient track record to eventually seek credit from second tier financial institutions or through bond issues. The loan will be priced at LIBOR + 4.5%. The team will negotiate guarantees, for example through a convertibility feature in the debt that will give MIF majority ownership in the event the company is underperforming.

V. Executing agency and execution structure

5.1 Grupo Financiero Fortaleza was born in 1995 and provides investment banking, microfinance, insurance and pension products. In accordance with Bolivian regulatory requirements, this group brings together different specialized financial institutions including CAISA Agencia de Bolsa, Fortaleza Sociedad Administradora de Fondos de Inversión, Fortaleza FFP, Compañía de Seguros y Reaseguros Cruceña and AFP Futuro de Bolivia.

5.2 The proposed leasing project is one of the pillars of Grupo Fortaleza's strategy of becoming the financial services organization in Bolivia that caters to SMEs, thereby differentiating itself from other industry players and providing maximum value to clients.

5.3 According to Bolivian banking regulations, regulated financial institutions are prohibited from making loans to affiliated entities. Hence Fortaleza FFP cannot provide any of the debt financing for this operation. However, overall, we feel that the funding sources are sufficient and don't expect the company to run into financing constraints.

VI. Major issues

6.1 The start-up nature of this operation implies significant risks. However, the direct involvement, ownership and technical knowledge by the local partner, together with the ample market opportunity, will help to mitigate these risks.

6.2 Although setting up an independent subsidiary, as the law requires, involves substantial costs, there are benefits to keeping the leasing activities separate from other traditional banking functions. It has been observed that leasing often grows faster and returns higher profits when carried out through an independent subsidiary because it yields more focused and professionalized leasing operations[6]. Studies have also found that for leasing operations that focus on SME clients, a subsidiary structure is preferable since banks often neglect their SME clients in favor of more profitable larger corporations. The stand-alone subsidiary structure will also be more transparent for outside investors.

6.3 Leasing operations suffer from macroeconomic slowdowns and are cyclical with the country's overall economic performance. As such, country political risk is also a factor that can jeopardize the success of the project.

VII. Action Plan

7.1 The following is a preliminary schedule for the project's approval process:

CESI	March 2004
Due Diligence	March-May 2004
Donors Committee	June 2004

VIII. Environmental and Social Strategy

8.1 The Leasing Company will comply with the IDB/MIF environmental and social guidelines for MIF transactions with financial intermediaries as well as with local environmental guidelines. Given the nature of the sectors in which the Leasing Company will operate we do not foresee significant environmental issues.

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[6] "Equipment Leasing and Lending: A Guide for Microfinance"; IDB/SDS Best Practices Series; Westley, Glenn D.; 2003; p.24