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DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

CHILE

PROJECT FOR PRODUCTIVE DEVELOPMENT FINANCING IN CHILE

(CH-L1098)

LOAN PROPOSAL

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1. Monitoring and Evaluation Plan
2. Environmental and Social Management Report (ESMR)

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1. Economic analysis of the project
2. Technical study on financial inclusion in Chile
3. Law 20,727 - January 2014
4. Law 19,983 - December 2004
5. Central Bank of Chile Working Paper - Supply and Demand Identification in the Credit Market

ABBREVIATIONS

ACHEF	Asociación Chilena de Factoring [Chilean factoring association]
ANFAC	Asociación de Empresas de Factoring Chile A.G. [Chilean association of factoring companies]
BPC	Bolsa de Productos de Chile [Chilean Commodity Exchange]
CACs	Cooperativas de Ahorro y Crédito [savings and loan cooperatives]
CAIGG	Consejo de Auditoria Interna General de Gobierno [General Government Internal Audit Council]
CGR	Contraloría General de la República [Comptroller General's Office]
CORFO	Corporación de Fomento de la Producción [Production Development Corporation]
CRF	Corporate Results Framework
DAES	División de Asociatividad y Economía Social [Cooperatives and Social Economy Division]
GAF	Gerencia de Administración y Finanzas [Administration and Finance Office]
GCI	Gerencia de Control Interno [Internal Control Office]
GDP	Gross domestic product
GIF	Gerencia de Inversión y Financiamiento [Investment and Finance Office]
IIC	Inter-American Investment Corporation
MIF	Multilateral Investment Fund
NBFIs	Nonbank financial intermediaries
MSMEs	Micro, small, and medium-sized enterprises
OECD	Organisation for Economic Co-operation and Development
PCR	Project Completion Report
PORs	Project Operating Regulations
SAP	Systems Applications Products
SBIF	Superintendencia de Bancos e Instituciones Financieras [Superintendency of Banks and Financial Institutions]
SMEs	Small and medium-sized enterprises
SVS	Superintendencia de Valores y Seguros [Superintendency of Securities and Insurance]
UFs	Unidades de Fomento [Chilean unit of currency often used in the Chilean housing and construction sectors. The exchange rate between the UF and the Chilean Peso is set by the Central Bank of Chile and indexed to inflation.]
WAL	Weighted average life

PROJECT SUMMARY

CHILE

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Financial Terms and Conditions

Borrower: Republic of Chile
Executing agency: Corporación de Fomento de la Producción (CORFO)

Source	Amount (US$)	%
IDB (Ordinary Capital):	120,000,000	99.75
Local counterpart:	300,000	0.25
Total	120,300,000	100.00

Flexible Financing Facility[(a)]	
Amortization period:	13 years (bullet payment)
Maximum original WAL:	13 years[(b)]
Disbursement period:	4 years
Grace period:	13 years (bullet payment)
Inspection and supervision fee:	[(c)]
Interest rate:	LIBOR-based
Credit fee:	[(c)]
Approval currency:	U.S. dollars (from the Ordinary Capital)

Project at a glance

Objective and description: The objective is to expand/improve the supply of production financing instruments in the Chilean financial sector for micro, small, and medium-sized enterprises (MSMEs). To that end, CORFO will be funded to channel resources through nonbank financial intermediaries (factoring companies, savings and loan cooperatives, and nonbank leasing companies). The project seeks to enhance the Chilean financial sector (by extending tenors and cutting interest rates) and is also expected to boost the productivity of MSMEs.

Special contractual conditions precedent to the first loan disbursement: The following special contractual conditions precedent to the first disbursement of the loan will apply: (i) the project executing team will have been set up within CORFO and the staff necessary for its operation has been appointed; and (ii) the project's Operating Regulations will have been approved and entered into force, in accordance with the terms and conditions previously approved by the Bank (see paragraph 3.8).

Exceptions to Bank policies: None

Challenges:[(d)]	**SI** ☑	**PI** ☑	**EI** ☐
Cross-Cutting Themes:[(e)]	**GD** ☐	**CC** ☐	**IC** ☐

(a) Under the Flexible Financing Facility (document FN-655-1), the borrower has the option of requesting changes to the amortization schedule, as well as currency and interest rate conversions. When reviewing such requests, the Bank will take operational and risk management considerations into account.

(b) The original weighted average life and grace period may be shorter, depending on the effective signature date of the loan contract.

(c) The credit fee and inspection and supervision fee will be established periodically by the Board of Executive Directors as part of its review of the Bank's lending charges, in accordance with the applicable policies.

(d) SI (social inclusion and equality); PI (productivity and innovation); and EI (economic integration).

(e) GD (gender equality and diversity); CC (climate change and environmental sustainability); and IC (institutional capacity and rule of law).

I. PROJECT DESCRIPTION AND RESULTS MONITORING

A. Background, problems addressed, and rationale

1.1 **Chilean economy.** Chile has a small and open economy and is a member of the Organisation for Economic Co-operation and Development (OECD). The country's recent growth has been affected by the global slowdown in growth and falling raw material prices—both critical for its exports, which account for approximately one third of its gross domestic product (GDP). In 2014, GDP growth decelerated (1.9%) due to the stagnation of investment in the mining sector and the slowdown in household consumption. This weak growth continues. The national accounts for the third quarter of 2015 showed further weakening of domestic demand and activity, and the expectations of businesses and consumers deteriorated once more.[1] External risks and weak international growth seem to be hampering recovery.[2]

1.2 **Diagnostic assessment.** Traditionally, the diagnostic assessment of Chile's economy has focused on its productive structure, characterized by its concentration in the primary sector and by productive processes with relatively little knowledge and technology content. In the transition toward a more diverse economy based on innovation to boost productivity and competitiveness, the country—and the wider region—faces significant challenges, failures, and market imperfections, including, significantly, the difficulties in channeling financing to enterprises, especially micro, small, and medium-sized enterprises (MSMEs).

1.3 **MSMEs in Chile.** MSMEs[3] are key actors in the economy in terms of employment (49.3%), yet do not compete abroad,[4] and many of them are informal.[5] MSMEs are present in almost all sectors of economic activity, but are

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1 Central Bank of Chile. Quarterly National Accounts (http://www.bcentral.cl).

2 The central bank's September report on monetary policy adjusted growth levels for 2015 and 2016 to between 2% and 2.5% and 2.5% and 3.5%, respectively. Over recent months, inflation has also been higher than expected, reaching 4.6% annual inflation in July based on its consumer price index measurement. The strong depreciation of the Chilean peso (16% nominal depreciation over the year) has been the main cause of this phenomenon and is expected to continue to affect inflation over the coming months.

3 Law 20,416 of 2010 established that microenterprises are enterprises with annual revenue from sales, services, and other business activities that did not exceed 2,400 Unidades de Fomento (UFs) in the last calendar year (US$86,791); small enterprises are those with annual revenue from sales, services, and other business activities that was over 2,400 UFs but under 25,000 UFs (US$904,079) in the last calendar year; and medium-sized enterprises are those with annual revenue from sales, services, and other business activities that was over 25,000 UFs but under 100,000 UFs (US$3,616,319) in the last calendar year. At the close of 2015, one UF was equal to Ch$25,629.09 (US$36).

4 The third longitudinal survey of companies (2015) polled 302,840 companies from the main economic sectors, excluding those with annual sales of 800 UFs or less. The survey design includes four sizes—micro, small, medium, and large—defined based on sales. Large companies account for 3.2% of the study sample, and produce 84.7% of total sales, and 27.7% of them export. Small and medium-sized enterprises (SMEs) account for 52.1% of companies, produce 14.0% of total sales, and 5.6% of them export. Microenterprises account for 44.7% of companies, produce 1.4% of total sales, and only 1.6% of them export.

5 The cross-checking of data from Chile's 2011 national socioeconomic profile survey and fiscal data provides a census of 1.5 million enterprises, 46% of which are informal. Among the formal companies, 96% are micro and small enterprises. *La situación de la micro y pequeña empresa en Chile*. Technical Cooperation Service, Ministry of Economy, Development, and Tourism.

most prevalent in sectors with the weakest productivity—the tertiary sector (commerce, restaurants, and hotels) and construction.[6]

1.4 MSME growth, productivity, and competitiveness depend on a wide range of factors, such as the business climate, formalization incentives, human capital, and the quality of infrastructure services, and the problem of access to financing. There is extensive literature on the empirical evidence of this problem and the rationale behind the correlation between access to financing and productivity.[7] From the financing standpoint, business scaling and growth are hindered by the problem of access to financing for working capital and investments. Although the level of total financing in the economy relative to GDP (109%) and the level of bank lending to the private sector relative to GDP (79%) are the highest in the region and are notable when compared to the average for Latin America and the Caribbean (52% and 47%, respectively) as well as to competitors like Mexico (31% and 23%),[8] the Chilean banking system does not offer credit to MSMEs on suitable terms or at acceptable rates. The 2015 Financing Small and Medium Enterprises and Entrepreneurs report,[9] the OECD Scoreboard, and the Global Competitiveness Report ranking[10] all found that Chile ranks very highly in terms of availability of financial services, access to credit, and system solvency, but it dropped 12 places in the ranking between 2014 and 2015 in terms of lending terms and conditions.[11] The credit squeeze facing MSMEs in Chile is the product of market flaws and imperfections (information asymmetries, transaction costs, and economies of scale, scope, and density) associated with the finance business. In this context, the supply of financial and credit services is concentrated and oligopolistic, providing credit at suboptimal levels and emptying the market at above-optimal prices. A recent study published in 2013[12] shows that there is market concentration in bank commercial and consumer credit markets in Chile. Although the effect of such concentration would be at a price level that is below joint profit maximization or a monopoly, MSMEs resort to using their savings or to vendor or usurious financing, because bank lending is only available at tenors, rates, and collateral conditions that do not match their business cycle and limit their opportunities for production expansion.

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6 *Demografía de Empresas en Chile*, 2014. G. Suazo and J. Pérez. Central Bank of Chile. This study also found that the tertiary sector shows lower survival rates on average (ratio of the number of companies born in year t-1 that remain at the end of year t and the number of companies existing in t-1) as compared to goods producers (study period: 2007 to 2012).

7 For a review of the literature and an explanation of the rationale for productive development financing programs, see: "Support to SMEs and Financial Access/Supervision Sector Framework Document" (Inter-American Development Bank, document GN-2768).

8 World Bank Development Indicators 2014.

9 OECD iLibrary. Financing SMEs and Entrepreneurs 2015. An OECD Scoreboard.

10 World Economic Forum. The Global Competitiveness Report 2014–2015.

11 Global Competitiveness Rankings Report 2014-2015. World Economic Forum.

12 IDB (2013). *Competencia en el mercado bancario del crédito en Chile.* Bernardita Piedrabuena K.

1.5 **MSME financing: Microentrepreneurship survey.**[13] According to Chile's third microentrepreneurship survey, published in 2013, 70.3% of (formal or informal) Chilean MSMEs have never applied for a formal loan and finance themselves with their savings or the profits generated by their economic units. The reasons for not obtaining a formal loan are the negative perception of the terms of the transaction, lack of solvency, or lack of confidence. In addition, 77.6% of Chile's 1,753,505 MSMEs hold no debt at a bank or other financial institution, which in part points to a conservative attitude regarding financial management, but is mainly an indication of the lack of financial products to meet their needs. Among those companies that do hold debt, the most common type is consumer loans (40.8%), bank credit lines (21.7%), and commercial loans (21.3%). This shows that not only are interactions between MSMEs and the financial system insufficient, they are inadequate because MSMEs are not being offered enough credit for production purposes and consumer loans are not suitable for strengthening productive activities.

1.6 **Concentration of the limited supply of microcredit.**[14] A July 2014 study commissioned by the Multilateral Investment Fund (MIF)[15] estimated that microcredit only accounted for 2% of the financial system's US$221.3 billion portfolio: banks, savings and loan cooperatives (CACs) regulated by the Superintendency of Banks and Financial Institutions (SBIF), compensation funds regulated by the Superintendency of Social Security (SUSESO), and cooperatives supervised by the Cooperatives and Social Economy Division (DAES) of the Ministry of Economy, Development, and Tourism, and unregulated microfinance institutions. Within the microcredit portfolio, the banks had an 85.1% share; the SBIF-regulated CACs had 6.6%; and the unregulated microfinance institutions, 6.6%. The DAES-regulated CACs and compensation funds had smaller shares of 0.5% and 1.2%, respectively. Importantly, among the group of banks, the Banco Estado Microempresa has a dominant position, accounting for 32% of the microcredit portfolio. It is an accepted fact that a greater diversity of lenders serving microenterprises with products tailored to them can boost the competitiveness of the financial system and microenterprises. Lastly, it should be noted that, in the best of cases, the tenor of loans to MSMEs is 24 months, as is the case with leasing, according to data provided by the Corporación de Fomento de la Producción (CORFO).

1.7 **Government policies.** For all these reasons, the government has been adopting cross-cutting policies to boost the productivity and competitiveness of enterprises, with a strong focus on MSME financing.[16] A number of the measures

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[13] All the data in this paragraph was extracted from the Tercera Encuesta de Microemprendimiento 2013 (EME3). Microenterprises account for 90.7% of the businesses, while 5.5% are small, 0.7% are medium-sized, and only 0.3% are large (according to the stratification by turnover). Turnover was not reported by 2.8% of the companies surveyed.

[14] There is no formal or regulatory definition of microcredit in Chile. According to estimates of the Microfinance Development Network in Chile, the average size of a microloan in 2014 was US$2,096, although this figure is drawn from widely dispersed data.

[15] Palán, Carlos: *Estudio Técnico Sobre la Inclusión Financiera en Chile.* MIF, 2014.

[16] The 2014 Productivity, Innovation, and Growth Agenda focuses on strategic investments; sector plans; infrastructure; SME lending and support, entrepreneurship, and innovation; and regulatory, market, and institutional reforms.

to finance and support MSMEs in the 2014 Productivity, Innovation, and Growth Agenda[17] are focused on strengthening current financing and technical assistance programs. For example, CORFO's hedge programs benefit more than 120,000 companies, 115,000 of which are micro and small enterprises. However, the level and spread of rates applied to all the MSME segments, as well as the negligible difference between the rates for secured loans and the banking system's regular rates, suggest that the system's problems related to competitiveness and the concentration of loans/market share hamper the efficiency of hedge programs.[18]

1.8 **The project.** This project seeks to increase the supply of financing for MSMEs in the Chilean financial market, by channeling funding through CORFO to nonbank financial intermediaries (NBFIs), CACs, and other lending institutions, factoring businesses, and nonbank leasing companies.[19] This intervention seeks to improve access to financing and facilitate investment and growth. First, CORFO is the ideal partner for the project, given that it is one of the main Chilean government agencies whose mission is to boost competitiveness and increase production diversification in the country and has almost 80 years' accumulated experience and knowledge. CORFO carries out its mission by promoting investment, innovation, and entrepreneurship through a series of programs—primarily focused on MSMEs—that include various financing modalities, hedging, technical assistance, and venture capital for innovation, among other instruments. Such programs square with the Chilean government's 2014 Productivity, Innovation, and Growth Agenda (see paragraph 1.7). Second, the intervention is based on the accumulated evidence of the capacity of NBFIs to cover the financing demand that has been left unmet by traditional banks—thereby rectifying market flaws through their knowledge of MSMEs, with which they traditionally work—, their capacity to reach the final beneficiaries as borrowers, and the provision of financial solutions like the ones under this project suited to the borrowers' business activities. The differing requirements on the demand side in terms of tenor are expected to be met by using factoring to finance working capital and leasing and credit for long-term productive investment. In this regard, the importance of the development of financial

17 See: http://www.agendaproductividad.cl/.

18 CORFO *Financiamiento de Empresas*, January 2015. Presentation by the Investment and Finance Department.

19 Factoring and leasing are alternative financing techniques for lending to MSMEs. Both rely on an underlying asset as a source of repayment. Leasing is mainly used to finance equipment or real estate, while factoring is backed by accounts receivable, purchase orders, and other promissory notes. In the case of leasing, the lender owns the equipment and leases it to the lessee (borrower). Leasing can also offer tax benefits to the lessor and lessee. Factoring consists of the purchase of accounts receivable by a finance company, known as the factor. Factoring, strictly speaking, is not a loan; it is a more agile financing mechanism that is not based on information on the borrower, but on a third payer. This makes factoring a more attractive financing instrument for SMEs. For more detailed information on the economic role of these types of instruments, see Small and medium-size enterprises: Access to finance as a growth constraint. *Thorsten Beck *, Asli Demirguc-Kun 2006* and footnote 18.

systems as one of the determining factors of productivity and competitiveness has been widely documented.[20]

1.9 **Factoring.** The share of factoring in Chile's GDP is close to 10%, similar to developed countries like France (8%), Italy (9%), and the United Kingdom (13%).[21] The factoring industry[22] is comprised of companies linked to banking institutions and of nonbank institutions. The group that belongs to the Asociación Chilena de Empresas de Factoring (ACHEF) is comprised of 13 institutions, only two of which are nonbank institutions. The group has 17,876 clients and a stock of Ch$2,567.571 billion (US$4.239 billion) in instruments purchased (net).[23] The second group is comprised of 18 nonbank businesses that are members of the Asociación de Empresas de Factoring Chile A.G (ANFAC) (6,000 clients and a stock of Ch$296.462 billion in factoring (US$489 million) as of December 2014). In addition, the Bolsa de Productos de Chile (BPC) is a public market established under Law 19,228, regulated by the Superintendency of Securities and Insurance (SVS). So far in 2015, the BPC has a stock of Ch$65 billion (US$107 million), with 50.3% of invoices negotiated by MSMEs. The average tenor of an invoice discounting operation is approximately 71 days.[24] As for companies that have sold invoices on the BPC, MSMEs accounted for 14.6% of the total traded in 2014. In addition, MSMEs accounted for 12.7% of the total amount and 52.7% of the number of companies in 2014. Lastly, there are some 100 additional factoring companies that are neither affiliated nor regulated, and there is limited information available about them. As there is no qualitative financial data on nonbank factoring companies, typically smaller in size than those associated with banking institutions, they are unable to issue commercial papers. This drives up the cost of their sources of financing, hence the high cost of loans to MSMEs, making them less competitive than bank factoring companies.

1.10 **Savings and loan cooperatives (CACs).** CACs are nonprofit institutions that emerged at the end of the nineteenth century with the aim of mitigating the lack of access to financial services for the medium- and low-income population. The members are from a segment of the population that largely lacks access to the banking system and is lower income.[25] In Chile, there are 42 CACs, 35 of which are supervised by the Ministry of the Economy's DAES, while the others are regulated by the SBIF. At present, the CAC sector has the following characteristics: (i) very high concentration—just three cooperatives account for 86% of the sector's total assets; (ii) low market share of CACs in the Chilean market, only 1.2%, as compared to countries like Peru (2.3%), Bolivia (6%), and

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[20] See Support to SMEs and Financial Access/Supervision Sector Framework Document (document GN-2768-3), (2014); Beck et al (2000), "Finance and the sources of growth", Journal of Financial Economics 58(12), 261-300, among others.

[21] Baudrand, C. (2014). *Herramientas para las PyME: Financiamiento basado en activos.*

[22] The cornerstone of the regulatory framework for factoring in Chile is Law 19,983 of 2004, which regulates the transfer and gives the copy of the invoice enforceable merit. Subsequently, Law 20,727 of 2014 required all firms to issue a digital invoice, providing for a gradual transition for MSMEs.

[23] ACHEF.

[24] OECD, Op. cit.

[25] Narrative report on the social economy/cooperatives sector. DAES, Government of Chile, 2015.

Ecuador (18,7%);[26] and (iii) a loss of competitiveness of CACs stemming from the commercial lending boom, and—with the exception of the largest CAC (Coopeuch)—a failure to grow steadily over time. Despite their heterogeneity, CACs are a very important formal source of financial services for the low-income population and for a significant group of micro and small enterprises. The cooperative nature of CACs and their proximity to microenterprises make them suitable candidates for overcoming market flaws and boosting MSME access to credit.

1.11 **The leasing industry.** The leasing industry is concentrated mainly in the real estate sector (almost 50%) and in the financing of movable assets such as machinery and transport vehicles, the latter being the most important to MSMEs. As with factoring, there is bank and nonbank leasing. The main association is the Asociación Chilena de Leasing (ACHEL), which is led by 12 banks and a nonbank institution. In 2013, the leasing industry recorded US$11.888 billion in operations through 80,355 contracts. In this industry, the number of leasing operations carried out by nonbank financial institutions is in decline owing to a lack of long-term financing. As a result, these institutions opt to develop the factoring business because of the lower amounts and the shorter tenors of each operation. The average amount of a leasing operation ranges from US$120,000 to US$300,000, which requires amortization and grace periods that are consistent with MSME business flows. At present, leasing companies in this business do not provide financing with a tenor of more than five years, which limits their capacity to provide suitable financing to MSMEs and puts pressure on clients to repay in a time frame that is not consistent with their cash flows.

1.12 **Project scale.** Under the project, the average amount provided in an individual financing operation would be US$1,400 for credit and US$4,300 for a factoring transaction, which together would account for 80% of the loans under the current operation. The average leasing amount would be US$30,000. These figures are based on information on demand provided by CORFO. The project's final beneficiaries are the MSMEs, which have limited, inadequate, or no access to credit. According to CORFO's estimates, for purposes of this operation, the population is comprised of 40,000 enterprises. Based on an estimate of unmet demand for credit based on the level of bank financing provided to this type of company at the international level (between 45% and 55% of demand is unmet, according to data from the International Finance Corporation Small and Medium Enterprises (SME) Banking Knowledge Guide) and according to the experience acquired by CORFO through its previous programs, MSME demand for credit is at least four times greater than the amount allocated in the project. The amount of this operation—US$120 million—seems small in comparison to the financing stock of the NBFIs. It is clear that this operation does not provide sufficient resources to bridge this deficit all at once. Rather, it seeks to foster an innovative and diverse supply of credit, with better tenors, for MSMEs, based on all lending technologies, and to give CORFO the specific tools for structuring a set of lines

[26] Market share measured as total assets cooperative sector/total assets financial market. Arzbach & Durán. (2014). *Regulación y Supervisión de Cooperativas de Ahorro y Crédito en Latinoamérica*.

of credit to NBFIs so as to bring about significant changes, given sufficient time, in the supply of financing to MSMEs,[27] under better terms and conditions.

1.13 **Project additionality.** With technical cooperation resources for Using Broadband to Enhance Financial Inclusion (ATN/OC-14484-RG; RG-T2442), the Bank will provide additionality to the project through technical assistance that will address at least three areas: (i) the eligibility system and financing programs: a diagnostic assessment of the current eligibility system for NBFIs will be conducted and will be updated in line with best practices. CORFO will also be supported in designing and implementing product lines to channel project resources, improving tenors and rates. The system will cover the three financing modalities and could include web content components; (ii) institutional capacity: CORFO will be supported in strengthening its institutional capacity for developing financial programs to support the MSME market through NBFIs and its risk management; and (iii) information system: the Bank will support CORFO in setting up and running the information system needed for the operation's eligibility and monitoring and evaluation mechanisms, identifying the NBFIs that will participate and those that will not.

1.14 **Coordination with the private sector.** This loan was prepared in coordination with the MIF and the Inter-American Investment Corporation (IIC). The latter's inputs and comments—particularly its experiences with loans using factoring and leasing—were taken into account in the preparation of the operation.[28] For its part, the MIF declared project CH-M1068 eligible (pending final approval), the objective of which is to help improve access to financing and other financial services for smaller companies in Chile by strengthening the capacities of NBFIs, including CACs, microfinance institutions, and production cooperatives. The project has a US$150,000 contribution from the MIF and a national counterpart of US$1,350,000 to achieve the aforementioned objective. This effort complements this project by strengthening the first-tier banks that will be delivering resources to project beneficiaries and will be receiving resources from CORFO. Going forward, as a result of efforts to expand the supply of financing to previously underserved sectors through traditional instruments like credit and nontraditional ones like leasing or factoring, this loan will result in potential new clients for the MIF and the IIC.

1.15 **Empirical evidence.** There is little literature examining the effect of measures like those in this project on the financial market itself. The impact assessment studies also fail to directly consider leasing and factoring instruments. There are a small number of comprehensive evaluations of the impacts of access to credit on MSMEs. In particular, there is literature on the effects on companies of financing through instruments such as guarantee funds. In the case of Chile, the

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27 A description of the various technologies for channeling financing to MSMEs is available at Berger, A.N., Udell, G.F., 2006. A more complete conceptual framework for SME finance. Journal of Banking and Finance. The authors also address the importance of an efficient institutional and regulatory framework so that each technology can be used by the companies (formal/informal, transparent/opaque, medium-sized/small, etc.) to which it is most suited.

28 Loans CH3751A-03, CH3919A-01, and CH3735A-03, which involve this type of financing, are worthy of note. They include factoring, financial leasing, and operational leasing operations in support of the MSME sector in Chile.

impact of the Fondo de Garantía para Pequeños Empresarios [Small Enterprise Guarantee Fund] (FOGAPE), administered by the Banco del Estado de Chile, has been analyzed (Benavente, Galatovic, and Sanhueza, 2006, Larrain and Quiroz, 2006) using an experimental design. According to the findings, the probability of companies accessing credit rose 14% and their sales and profits also increased (32% and 24%, respectively). The World Bank (2010) conducted impact assessments of the financing programs aimed at MSMEs in several countries, including Chile. The results of this study were positive in terms of technology adoption and labor productivity, but mixed in terms of MSME participation in financing programs.[29] In the case of the United States (Meyer and Nagarajan, 1996, and Honohan, 2008), the impact of guarantees was analyzed, identifying impacts on the growth in income per capita of participating households (Craig, Jackson, and Thomson, 2007) and on the labor market (Craig, Jackson and Tomson, 2008). Aroca (2010) shows positive yet not robust results in terms of the average revenue of microenterprises that gained access to microcredit programs, among other benefits. The project evaluation will make it possible to expand the evidence of the impact of such instruments. (See paragraph 3.10 on evaluation of the Monitoring and Evaluation Plan).

1.16 **Bank experience and lessons in the sector.** It is important to note that the Bank has acquired vast experience in the region's production financing based on multiple and diverse operations that it has developed with several public financial institutions. Examples include the lessons learned from the program "Financing of Investment Projects, Productive Restructuring, and Export Development (Bancóldex II)" (2193/OC-CO), which made it possible to continue to meet the investment financing needs of the real sector of the economy, demonstrating the countercyclical role played by this type of operation by giving calming signals to the market. As for financing, lessons were learned through Rural Financing in Mexico (2656/OC-ME) in terms of the Bank's importance and value added in relation to medium- and long-term financing. In addition, lessons learned are being compiled from individual operations under the expanded Conditional Credit Line for Investment Projects (CCLIP) to provide financing to Agencia Financiera de Desarrollo (1968/BL-PR), which focused on expanding the supply of financing available to MSMEs. This program specifically assesses the effect on final beneficiaries of expanding the tenors and reducing the rates of subloans, and the outcomes of the assessment will be taken into account in this project. Recent production financing operations in the region included those in El Salvador (3271/OC-ES) and Paraguay (3616/OC-PR). The main lesson from executing operations with the rural sector, in particular operation 2656/OC-ME, was that there is a need to create long-term financing opportunities for rural producers. All the aforementioned experiences have been used in formulating this proposal and its annexes. Similarly, the experiences of the above-mentioned programs with best practices in monitoring and management of social and environmental matters will be applied to this loan.

1.17 **Innovation.** The project is innovative because it adds to traditional credit the boost that development banking, headed by CORFO, can give to two types of

[29] The International Bank for Reconstruction and Development: Impact Evaluation of SME Programs in Latin America and the Caribbean, 2010.

alternative financing (leasing and factoring), using MSME-focused NBFIs. In this regard, incentives will be generated to encourage Chilean MSMEs to make a transition towards digitizing, using innovative mechanisms such as electronic invoicing, thereby supporting the Chilean government's innovation policies (see paragraph 1.9). From the public perspective, this operation is the first of its kind with CORFO in Chile.

1.18 **Strategic Alignment.** The project is consistent with the Update to the Institutional Strategy 2010–2020 (document GN-2788-5) and is directly aligned with the development challenge of (i) social inclusion and equality since it fulfills the Bank's strategic objective of including all segments of the population in financial markets by offering credit to MSMEs that may not have access to financing (see paragraph 3.5 of document GN-2788-5). It is also directly aligned with the development challenge of (ii) productivity and innovation since it contributes to improving the financial sector's depth and development factor, by expanding the supply of financing through innovative instruments such as factoring and leasing (see paragraph 2.9 of document GN-2788-5). In addition, the operation will contribute to the Corporate Results Framework (CRF) 2016-2019 (document GN-2727-4) through country development results indicators by helping to deliver on the number of MSMEs financed (see Table 2 of the CRF). In this regard, the specific indicator of the project's Results Framework is the number of MSMEs financed with project resources through beneficiary NBFIs. As mentioned in the project objective, the aforementioned improvement in financing could have an impact on the productivity of MSMEs (see paragraph 1.8), which is aligned with the provisions of the Support to MSMEs and Financial Access/Supervision Sector Framework Document (GN-2768-3). The factors that explain this relationship are based on expansion of the supply and better tenor and rate conditions, among others. The project is also aligned with the Institutions for Growth and Social Welfare Sector Strategy (document GN-2587-2), specifically with the component on enhancing the productivity and growth of MSMEs, by addressing such companies' limited access to financial services. Along the same lines, the operation is consistent with the objectives of the Country Strategy with Chile (2014-2018) (document GN-2785), specifically in terms of competitiveness and innovation. The strategy calls for the Bank to support the government's competitiveness and innovation objectives by offering technical and financial assistance for support programs as well as by providing financing. The operation is also in line with the priorities identified under the Government of Chile's 2014 Productivity, Innovation, and Growth Agenda.

B. Objectives, components, and costs

1.19 **Objective.** This operation seeks to expand and/or improve the supply of production financing instruments for MSMEs in the Chilean financial sector. To do so, financing will be provided to CORFO, which will in turn channel resources through NBFIs (factoring companies, CACs, and nonbank leasing companies). The project focuses on enhancing the Chilean financial sector (increasing tenors and cutting interest rates); but it is also expected to boost the productivity of MSMEs.

1.20 **Components.** The project is structured around three components that will tentatively be distributed as follows: (i) Component I - Factoring (US$50 million).

In principle, this component will provide financing through CORFO to eligible factoring companies that are neither associated with nor owned by a bank, which will use the resources to discount MSMEs' invoices and other commercial papers, mainly to provide working capital resources. (ii) Component II – MSME credit[30] (US$50 million). This component will provide financing to eligible CACs, which will use the resources to provide medium- and long-term subloans to MSMEs. Given the associated term length, the companies will use these resources for investment financing, promoting the possibility of restructuring production. Under this component, resources could be used to finance operations for microfinance institutions and productive or service cooperatives, other than CACs, involved in the financial intermediation business; and (iii) Component III - Leasing (US$20 million). This component will finance eligible leasing institutions that are neither associated with nor owned by a bank, which will use the resources to finance MSME assets or medium- and long-term investments. The amount established for each component is a highly flexible guideline. At CORFO's discretion and based on demand, the size of a component may change during execution, since their aims are complementary. Each of the components under this loan may complement CORFO's efforts in other existing or future programs that focus on promoting innovation, MSME certification and training, or any other initiative or intervention that results in higher business productivity. Importantly, this project is the starting point for CORFO to provide its own resources, which could exceed the amount of resources actually granted by the project.

1.21 **Eligible nonbank financial institutions (NBFIs).** Eligible NBFIs are institutions that meet risk management and other criteria established by CORFO in its credit regulations and its product manuals, which must be duly approved by the Executive Credit Committee. Along with the reporting and audit conditions stipulated by CORFO for NBFIs, these criteria are a key part of the project's Operating Regulations (PORs), which will be based on the results of the aforementioned technical assistance projects (see paragraph 1.13). The product that CORFO refers to as "Microcredit" and any other new program created for the transfer of project resources must comply with the above conditions and those stipulated in the Fiduciary Agreements and Requirements (Annex III). In all cases, the resources will be mobilized through first-tier financial intermediation institutions that have been established and evaluated by CORFO. In addition, the current and future product manuals must establish minimum eligibility conditions for subloans and financing that are aligned with the loan objective in terms of type of borrower, terms offered, and application conditions, among others.

C. Key results indicators

1.22 **Results.** The project objective is established in terms of the financial system and also its results. Several results are expected from the financing being granted to

[30] The CACs are overseen by the SBIF or the DAES of the Ministry of the Economy, Development, and Tourism, depending on their size. With the exception of the companies that issue bonds or commercial papers and that are registered and subject to the supervision of the SVS, there are nonbank intermediaries that are not supervised by government agencies. It has not been determined in advance whether bank guarantee certificates or other types of guarantees will be required for the proceeds lent to NBFIs.

NBFIs through CORFO: (i) one expected result is an increase in the volume of total NBFI lending to MSMEs; (ii) the diversification of supply is expected to lead to lower loan interest rates compared to market rates, e.g. the factoring discount; and (iii) improvements in the average loan tenor for MSMEs, mainly in leasing. The project is expected to finance up to 50 NBFIs.

1.23 **Economic analysis.** The economic analysis of the project is based on a study to estimate Chile's credit supply and demand. It consists of a comparative static analysis, which uses the elasticities of credit supply and demand to calculate the net welfare for the market stemming from the Bank's intervention in terms of the credit flow offered and the interest rates on US$14.841 billion in credit. The exercise is periodically carried out for four years of disbursement. In addition, the benefits from an increase in financing tenors were calculated. The net benefits were discounted at a rate of 12%, minus the project's administrative costs, to achieve a net present value of US$5.77 million. Lastly, sensitivity analyses were applied taking into account different scenarios in demand elasticity, delay in reaping profits, cost of past-due portfolio, cost of implementation, and replacement of the preexisting demand for credit. The analysis produced robust results for these scenarios (see Economic Analysis of the Project).

II. FINANCING STRUCTURE AND MAIN RISKS

A. Financing instrument

2.1 The operation amount is US$120.3 million, consisting of US$120 million to be delivered under the global credit program modality, and CORFO's local counterpart of US$300,000 for administrative expenses. This amount corresponds to less than 10% of the unmet demand described above (see paragraph 1.12). This operation will be financed with resources from the Bank's Ordinary Capital (OC), under the Flexible Financing Facility. The loan proceeds of up to US$120 million will be used to finance the components described above. The disbursement period of the loan will be four years, consistent with the size and type of demand and the types of financing offered.

B. Environmental and social risks

2.2 This is a financial intermediation operation mainly governed by guideline B.13 of the Environment and Safeguards Compliance Policy (OP-703) and, therefore, does not require classification. The specific environmental and social requirements that NBFIs should take into account are included in the PORs and are also described in the Environmental and Social Management Report (ESMR).

2.3 CORFO has developed environmental and social requirements for its operations, which will be continued and updated for this operation to enhance their coverage and monitoring. In view of the size and destination of the end loans, it is unnecessary to implement a special system. CORFO will monitor the final destination of the loans and will ensure compliance with the Bank's safeguards policy. In this regard, CORFO will submit periodic reports to the Bank on environmental and social matters related to the use of project resources.

C. Fiduciary risks

2.4 CORFO's experience in operations of this kind shows a positive track record in the administration of funds and, therefore, offers the sufficient fiduciary reliability required. An analysis of execution and transfer mechanisms was carried out to update knowledge of CORFO's processes, confirming its capacity to implement this type of project. CORFO is supervised by the Office of the Comptroller General of the Republic (CGR), and many of its acts must be submitted to the CGR for review, to verify their legality. The PORs will include operational guidelines to mitigate and safeguard the project's operational risk. The opportunity to strengthen institutional capacity for project monitoring and evaluation by the institution is described in paragraph 1.13 herein. No procurement risks are expected, since there are no plans to use the loan proceeds for the procurement of works, goods, and services or for the hiring of consulting firms or individual consultants.

D. Other project risks

2.5 **Macroeconomic risk and fiscal sustainability.** This risk is considered medium. The project's expected demand for credit for the MSME segment could be reduced as a consequence of some kind of external macroeconomic deterioration affecting the country (such as a drop in raw material prices or a rate hike in the United States). To some extent, the loan serves as a countercyclical instrument for mitigating such a risk, in addition to the constant supervision of the NBFIs carried out by CORFO, in accordance with its corporate governance and the requirements stipulated in the PORs.

2.6 **Development risk.** This risk is considered medium. It concerns the possibility of reduced demand for proceeds from the operation owing to nonmacroeconomic exogenous events. CORFO estimated the demand for loan proceeds in advance and, despite possible reductions in economic activity, it is expected to be maintained. CORFO may periodically conduct surveys of participating and nonparticipating NBFIs to monitor demand (see Monitoring and Evaluation Plan). These surveys will make it possible to adjust the supply of products on offer while refocusing them to address changes in demand. These changes will be reflected in the product manuals and in the PORs as necessary.

2.7 **Sustainability.** The operation seeks to increase supply and also improve the structure of tenors and rates. This would have a long-term impact on eligible NBFIs that grant these types of loans. Importantly, sustainability is justified by: (i) the project's positive return; and (ii) the demonstration effect it will generate among the participating and nonparticipating NBFIs.

III. IMPLEMENTATION AND MANAGEMENT PLAN

A. Summary of execution arrangements

3.1 **Borrower and executing agency.** The borrower will be the Republic of Chile, represented by the Minister of Finance. CORFO will act as executing agency for the administration, execution, control, and monitoring of the operation's resources.

3.2 **Implementation.** CORFO will be responsible for the execution and supervision of the effective use of subloan proceeds and the provision, as planned and on schedule, of the necessary human and technological resources. CORFO will receive the project resources from the Bank, in its capacity as a second-tier bank, and will make the resources for the loans available to the NBFIs and institutions deemed eligible in accordance with the provisions of the PORs. As this is a financial operation, no design is needed post-approval.

3.3 **The Corporación de Fomento de la Producción (CORFO).** CORFO was established in 1939 as a government agency with legal status, autonomous management, and its own assets. Its mandate is to promote national productive development. Its activities to boost production are currently grouped into three areas of support: (i) optimization of resource use (boost productivity, quality, and productive partnerships); (ii) technological innovation and business entrepreneurship (individual and through partnerships); and (iii) productive investment. These activities are mainly financed through credit and hedging instruments (with CORFO acting as a second-tier bank) and subsidies. CORFO has the capacity to meet the needs of the project's mix of NBFIs at the same time. It intends to set up an executing team within its Investment and Finance Office (GIF) to implement the project at the national level. CORFO can also generate value added by implementing this project, given the work it does with other projects and programs that promote the development of NBFIs and microenterprises, thereby improving efficiency in achieving overall results with a greater impact. CORFO will use its organizational structure and will determine the responsibilities and functions needed to implement the project. CORFO's experience in handling hedging and refinancing programs, along with its experience working with the Bank on previous operations, confirm that it has the operational and fiduciary capacity necessary to implement the project successfully. In addition, CORFO will hire a project officer to strengthen project execution. The project will be executed and monitored by the GIF, which is responsible for the administration of MSME financing programs. As a government agency, CORFO is inspected by the CGR, the agency responsible for overseeing the legality of government acts. Accordingly, the CGR may perform biannual audits of the project, to be agreed upon with the CGR under the framework of the project audits. In the case of this project, the audit will be performed by the CGR by agreement between the latter and the Bank and with CORFO's agreement. CORFO approves its budgets in the Public Sector Annual Budget Laws. The Budget Division is responsible for overseeing the efficient allocation and use of public resources in the context of fiscal policy and it therefore oversees CORFO-executed projects.

3.4 The Treasury of the Republic will deliver the resources to CORFO, which will be included in a special chart of accounts to be administered by CORFO's Administration and Finance Office. The GIF will coordinate lending to eligible NBFIs. CORFO will deliver the resources under competitive conditions to eligible NBFIs for distribution to eligible companies. The funds may be denominated in Chilean pesos or U.S. dollars. The risks of the final beneficiaries will be assumed by the NBFIs, and the risks of the NBFIs by CORFO.

3.5 **Retroactive financing.** The Bank may retroactively finance up to US$24 million (20% of the proposed loan amount) against the loan proceeds as eligible expenditures incurred by the borrower through the executing agency prior to the loan approval date, so as to finance subloans contained in the product lines to be financed under the project, provided requirements substantially similar to those stipulated in the loan contract have been met. Such expenditures will have been incurred after 2 October 2015 (project profile approval date), but will in no case include expenditures incurred more than 18 months prior to the loan approval date.

3.6 **Project Operating Regulations (PORs).** Loan execution requires PORs in keeping with the policies and rules of CORFO and the Bank, as well as with the country's financial practices and laws. The PORs include general characteristics of the credit programs that will use project resources, NBFI eligibility conditions, the characteristics of the subloans and subborrowers that will be financed, among others. In this regard, the PORs will include conditions for an NBFI to be able to apply for project resources. Such conditions, while extensive, are not limited to evaluation and management of counterpart risk, control of guarantees, periodic supervision of the NBFIs, and risk concentration. The PORs will also be specific about the mechanisms that will be used to ensure that the transfer of resources to the end beneficiaries, in terms of tenors and rates, is done in a manner consistent with the project's proposed objective. Similarly, the PORs will contain provisions on the monitoring and management of social and environmental matters related to the use of the loan proceeds. Lastly, the PORs will include the conditions under which the NBFIs will deliver information to CORFO on the use of the project resources and will address, at a minimum, the matters detailed above and those consistent with the stipulations of the Monitoring and Evaluation Plan.

3.7 No procurement of works, goods, services, consulting firms, or individual consultants using proceeds from the loan is anticipated.

3.8 **The following are the special contractual conditions precedent to the first disbursement of the loan: (i) the project executing team will have been set up within CORFO and the staff necessary for its operation has been appointed; and (ii) the project's Operating Regulations will have been approved and entered into force, in accordance with the terms and conditions previously approved by the Bank.**

B. Summary of arrangements for monitoring results

3.9 **Reports.** CORFO will be responsible for project monitoring and evaluation, with support from IDB consulting services during the first year. The PORs provide for semiannual reports, which are to include at least the progress of results indicators and compliance of the loans to be financed with the eligibility criteria. The project's financial statements will be the responsibility of CORFO and will be audited by auditors deemed eligible by the Bank, such as the CGR. The monitoring will include tallying the allocation of subloans and financing by gender for subsequent analysis.

3.10 **Evaluation.** CORFO will be responsible for gathering relevant information required for the project evaluation. The ex post evaluation is described in the Monitoring and Evaluation Plan and consists of using ex post cost-benefit analysis. Should there be sufficient information, the use of a quasi-experimental methodology is proposed for the impact assessment (regression discontinuity or difference in differences).

Development Effectiveness Matrix			
Summary			
I. Strategic Alignment			
1. IDB Strategic Development Objectives	**Aligned**		
Development Challenges & Cross-cutting Themes	**-Social Inclusion and Equality -Productivity and Innovation**		
Regional Context Indicators			
Country Development Results Indicators	**-Micro / small / medium enterprises financed (#)***		
2. Country Strategy Development Objectives	**Aligned**		
Country Strategy Results Matrix	**GN-2785**	**Improved SME management and productivity.**	
Country Program Results Matrix	**GN-2849**	**The intervention is included in the 2016 Operational Program.**	
Relevance of this project to country development challenges (If not aligned to country strategy or country program)			
II. Development Outcomes - Evaluability	**Evaluable**	**Weight**	**Maximum Score**
	8.2		**10**
3. Evidence-based Assessment & Solution	**8.9**	**33.33%**	**10**
3.1 Program Diagnosis	**2.4**		
3.2 Proposed Interventions or Solutions	**4.0**		
3.3 Results Matrix Quality	**2.5**		
4. Ex ante Economic Analysis	**8.5**	**33.33%**	**10**
4.1 The program has an ERR/NPV, a Cost-Effectiveness Analysis or a General Economic Analysis	**4.0**		
4.2 Identified and Quantified Benefits	**1.5**		
4.3 Identified and Quantified Costs	**1.5**		
4.4 Reasonable Assumptions	**0.0**		
4.5 Sensitivity Analysis	**1.5**		
5. Monitoring and Evaluation	**7.2**	**33.33%**	**10**
5.1 Monitoring Mechanisms	**1.8**		
5.2 Evaluation Plan	**5.4**		
III. Risks & Mitigation Monitoring Matrix			
Overall risks rate = magnitude of risks*likelihood	**Medium**		
Identified risks have been rated for magnitude and likelihood			
Mitigation measures have been identified for major risks	**Yes**		
Mitigation measures have indicators for tracking their implementation	**Yes**		
Environmental & social risk classification	**B.13**		
IV. IDB´s Role - Additionality			
The project relies on the use of country systems			
Fiduciary (VPC/FMP Criteria)			
Non-Fiduciary			
The IDB's involvement promotes additional improvements of the intended beneficiaries and/or public sector entity in the following dimensions:			
Gender Equality			
Labor			
Environment			
Additional (to project preparation) technical assistance was provided to the public sector entity prior to approval to increase the likelihood of success of the project			
The ex-post impact evaluation of the project will produce evidence to close knowledge gaps in the sector that were identified in the project document and/or in the evaluation plan			

Note: (*) Indicates contribution to the corresponding CRF's Country Development Results Indicator.

The operation Financing for Productive Development in Chile, for an amount of USD 120 MM, has the objective of improving the supply of productive financing instruments for micro, small, and medium enterprises (MSME). Given its focus on the quantity and quality of the supply of such instruments, this operation distinguishes itself for pursuing development results at the level of specific financial markets (for example, some expected results are higher loan terms and lower interest rates of financial instruments intended to serve small businesses). Another distinguishing feature of the operation is that the intermediation will be conducted through non-bank financial institutions (NBFI) such as leasing companies, factoring companies, and credit and savings cooperatives. The diagnosis suggests that, although Chile has a high availability of financial services, credit conditions (tenors, rates, amounts) are not adequate for MSMEs due to market failures such as high transaction costs, asymmetries of information, amongt others. Funding NBFI, which are closer to their final clients, would help to address these market failures.

Although the focus of the operation and its results is in the financial market, it is expected that MSMEs will benefit indirectly from better credit conditions; hence, the operation is aligned with the objective of improving enterprise management and productivity in the Bank´s Country Strategy with Chiles. The project´s objective, vertical logic, activities and components center on the improvement of financial development outcomes of the Chilean NBFI sector.

The cost-benefit analysis consists of a comparative statics exercise, relying on the elasticities of supply and demand of credit. Project benefits arise from the increase in the volume of credit, and the reduction in the interest rates of new loans. Additionally, benefits arising from the increase in loan terms were estimated based on the gains accruing to final beneficiaries. The sensibility analysis shows that the net present value (NPV) of the operation remains positive for a large number of scenarios (such as higher intermediation costs, crowding out, and delays in the materialization of benefits, amongst other).

The evaluation plan centers on an ex-post cost-benefit analysis relying on the same methodology used ex-ante. Baseline and follow-up surveys will be administered in order to collect the necessary data for monitoring indicators and carrying-out the evaluation. The survey will be administered to all treated NBFI (50 approximately) and to a control group. However, the survey instrument could have been improved in order to collect information on all outcome indicators. Further, the proposed survey instrument does not collect sufficient data to ensure that the treatment and control groups have similar ex-ante characteristics. Data at the MSME level will not be collected due to the financial focus of the operation.

RESULTS MATRIX

Project objective	The objective is to expand and/or improve the supply of production financing instruments in the Chilean financial sector for micro, small, and medium-sized enterprises (MSMEs). To that end, Corporación de Fomento de la Producción (CORFO) will be funded to channel resources through nonbank financial intermediaries (NBFIs) (factoring companies, savings and loan cooperatives (CACs), and nonbank leasing companies). The project seeks to enhance the Chilean financial sector (by extending tenors and cutting interest rates) but is also expected to boost the productivity of MSMEs.

Indicators	Unit	Baseline 2015	2016	2017	2018	2019	2020	Target 2020	Description
Impact									
NBFI market share of total private sector financing	% of GDP	5%						**5.5%**	This indicator measures total NBFI lending (factoring, leasing, loans) as a percentage of total lending to the private sector via the same products. Baseline **Source:** World Bank: World Development Indicators, CORFO, and the Superintendency of Banks and Financial Institutions.

Indicators		Unit	Baseline 2015	2016	2017	2018	2019	2020	Target 2020	Description
Outcomes										
Average growth of new commercial loans by participating NBFIs using project funds.		%	0%	0.75%	0.75%	0.75%	0.75%	3%	3%	Growth over the previous year's commercial lending levels of all participating NBFIs using project funds. The 3% target for 2020 represents the accumulated growth over the four previous years. For the attribution analysis, a comparison will be made with a control group of nonparticipating NBFIs. **Source:** CORFO.
Spread	Between the average of the discount rates of NBFI factoring operations with MSMEs and the average of discount rates of factoring operations using project resources.	Basis points	0						100	This indicator reflects the spread (arithmetic difference) between the average of discount rates of NBFI factoring operations with MSMEs and the average of discount rates of factoring operations granted using project resources in a month. For the Project Completion Report (PCR) attribution analysis, the spread will be specified in relation to a control group commensurate with the sample. **Source**: CORFO.
	Between the average discount rate of NBFI leasing operations to MSMEs and the average discount rate of leasing operations using project resources.	Basis points	0						100	This indicator shows the spread (arithmetic difference) between the average discount rate of NBFI leasing operations with MSMEs and the average discount rate of leasing operations using project resources in a month. For the PCR attribution analysis, the spread will be specified in relation to a control group commensurate with the sample. **Source:** CORFO.

Indicators		Unit	Baseline 2015	2016	2017	2018	2019	2020	Target 2020	Description
	Between the average interest rate of CAC commercial lending and the average interest rate of loans using project resources	Basis points	0						200	This indicator shows the spread (arithmetic difference) between the average interest rate on CAC commercial loans overall and the average interest rate on loans using project resources. For the PCR attribution analysis, the spread will be specified in relation to a control group commensurate with the sample. **Source:** CORFO.
Number of MSMEs financed with project resources through beneficiary NBFIs.		Number	0	500	500	500	500	0	2,000	Number of companies that received project resources. The following average amounts are assumed: leasing: US$28,900; factoring: US$4,300; and CACs: US$1,400. For the PCR attribution analysis, the number of MSMEs financed by project participants will be compared to a valid control group. The estimated total number of MSMEs currently receiving NBFI credit is 800,000. This number will serve as the baseline for the attribution analysis. **Source**: CORFO.
Increase in the financing term awarded to MSMEs by beneficiary NBFIs (leasing)		Year	2	3	3	4	4		5	Average lease term granted to MSMEs by leasing NBFIs. For the PCR attribution analysis, the term increase will be specified in relation to a control group commensurate with the sample. **Source:** CORFO.

Indicators		Unit	Baseline 2015	2016	2017	2018	2019	2020	Target 2020	Description
Increase in the tenor of loans granted to MSMEs by beneficiary NBFIs (CACs).		Year	2	2	2	3	3		3	Average tenor of loans granted to MSMEs by CACs. For the PCR attribution analysis, the increase in tenor will be specified in relation to a control group commensurate with the sample. **Source:** CORFO.
Outputs										
Amount granted to NBFIs by CORFO using project resources.	Nonbank factoring	US$ million	0	12.5	12.5	12.5	12.5	0	50	Project resources granted to NBFIs under the project. Baseline: amount that is currently being provided through the project. **Source:** CORFO.
	Nonbank leasing		0	5	5	5	5	0	20	
	CACs		0	12.5	12.5	12.5	12.5	0	50	

FIDUCIARY AGREEMENTS AND REQUIREMENTS

Country: Chile

Project number: CH-L1098

Name: Project for Productive Development Financing in Chile

Executing agency: Corporación de Fomento de la Producción (CORFO)

Prepared by: Francisco Lois, Financial Specialist (FMP/CCH); and Raúl Lozano, Lead Procurement Specialist (FMP/CPR)

I. EXECUTIVE SUMMARY

1.1 The evaluation of the proposed project's fiduciary management was carried out based on the Proposal for Operation Development, which established that the objective of this project is to expand/improve the supply of production financing instruments in the Chilean financial sector for micro, small, and medium-sized enterprises (MSMEs). To do so, financing will be provided to CORFO, which will in turn channel resources through nonbank financial intermediaries (NBFIs) (factoring companies, savings and loan cooperatives (CACs), and nonbank leasing companies). The project focuses on enhancing the Chilean financial sector (extending tenors and cutting interest rates) and is also expected to boost the productivity of MSMEs.

1.2 CORFO was established in 1939 as a government agency with legal status, autonomous management, and its own assets. Its mandate is to promote national productive development. Its activities to boost production are currently grouped into three areas of support: (i) optimization of resource use (boost productivity, quality, and productive partnerships); (ii) technological innovation and business entrepreneurship (individual and through partnerships); and (iii) productive investment.

1.3 **Components.** The project is structured around three components that will tentatively be distributed as follows: (i) Component I – Factoring (US$50 million). In principle, this component will provide financing through CORFO to eligible factoring companies that are neither associated with nor owned by a bank, which will use the resources to discount MSMEs' invoices and other commercial papers, mainly to provide working capital resources. (ii) Component II – MSME credit[1] (for US$50 million). This component will provide financing to eligible

[1] The CACs are overseen by the Superintendency of Banks and Financial Institutions (SBIF) or the Cooperatives and Social Economy Division (DAES) of the Ministry of the Economy, Development, and Tourism, depending on their size. With the exception of the companies that issue bonds or commercial papers and that are registered and subject to the supervision of the Superintendency of Securities and Insurance (SVS), there are nonbank intermediaries that are not supervised by government agencies. It has not been determined in advance whether bank guarantee certificates or other types of guarantees will be required for the proceeds lent to NBFIs.

CACs, which will use the resources to provide medium- and long-term subloans to MSMEs. Given the associated term length, the companies will use these resources for investment financing, also promoting the possibility of restructuring production. Under this component, resources could be used to finance operations for microfinance institutions and production or service cooperatives, other than CACs, involved in the financial intermediation business; and (iii) Component III – Leasing (US$20 million). This component will finance eligible leasing institutions that are neither associated with nor owned by a bank, which will use the resources to finance MSME assets or medium- and long-term investments. The amount established for each component is a highly flexible guideline. At CORFO's discretion and based on demand, the size of a component may change during execution, since their aims are complementary. Importantly, this project is the starting point for CORFO to provide its own resources, which could exceed the amount of resources actually granted by the project.

1.4 The project is complemented by project CH-M1068 of the Multilateral Investment Fund, the objective of which is to contribute to improving conditions for access to financing and other financial services for smaller Chilean companies by strengthening the capacities of NBFIs such as savings and loan cooperatives, microfinance institutions, and production cooperatives.

1.5 The project does not include financing from other multilateral institutions.

II. FIDUCIARY CONTEXT OF THE EXECUTING AGENCY

2.1 The executing agency operates within the public financial administration system and is governed by Decree-Law 1,263 of 1975. It also uses the Enterprise Resource Planning system or the Systems Applications Products (SAP) for its budget, accounting, and payments, which provides information to the government financial management information system. This system is administered by the Budget Division to aggregate and consolidate the central government's accounting. It also has a strong internal audit unit and is under the supervision of the Comptroller General's Office (CGR). The Bank has performed a diagnostic assessment of the development level of the following country systems: budget, treasury, accounting, government internal audit (General Government Internal Audit Council—CAIGG), and external audit (CGR); it concluded that they were highly developed.

2.2 As a government agency, CORFO is regularly inspected by Chile's CGR, and the programs it executes, in budgetary terms, are monitored by the Budget Division of the Ministry of Finance.

A. Evaluation of fiduciary risk and mitigation actions

2.3 CORFO's experience in operations of this kind shows a positive track record in the administration of funds and, therefore, offers the sufficient fiduciary reliability required. CORFO is experienced in the formulation of the provisions of the project's Operating Regulations (PORs) on credit and hedging (guarantees), as well as results monitoring and follow-up. Nevertheless, an analysis of execution and transfer mechanisms was carried out to update knowledge of CORFO's processes, which confirmed its capacity to implement this type of project.

2.4 As CORFO is inspected by CGR, many of its acts must be submitted to the CGR for review. In addition, it is regularly audited by the CGR. Under such audits, the CGR reviews and audits CORFO's different programs and instruments.

2.5 CORFO, as the operation's executing agency, has effective systems for the fiduciary management of the resources intended for intermediation loans. In addition to the aforementioned administrative accounting systems, it has a project management system, which allows it to develop and manage projects, as well as keep in contact with the project officers; a computer-based financial intermediation system; and an integrated development system.

2.6 Although the financial fiduciary risks are considered low, there are weaknesses in the formulation of the project's financial statements and in the programming of the project's financial resource needs stemming from the lack of experience of those in charge of preparing the Bank's reports and calculating resource needs based on an estimate of demand for the loans to be granted by the NBFIs.

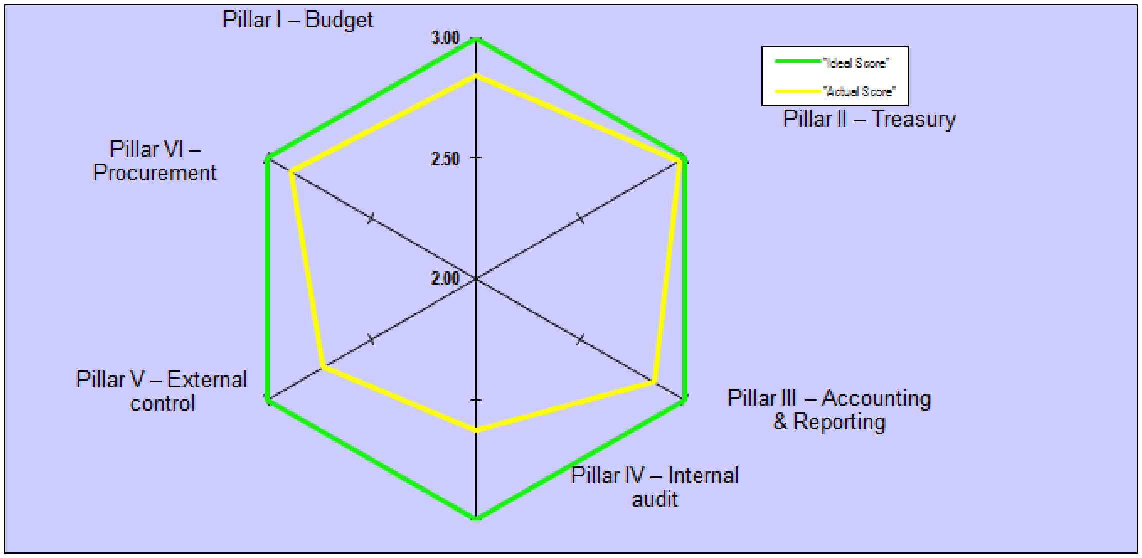
2.7 CORFO will use its organizational structure to determine the responsibilities and functions necessary for project execution. CORFO's experience in handling hedging and credit programs, along with its experience working with the Bank on previous operations, confirm that it has the operational and fiduciary capacity necessary for the successful implementation of this project.

2.8 CORFO will supervise compliance with the PORs.

2.9 The PORs will also include operational guidelines to mitigate and safeguard the project's operational risks and will require the Bank's no objection. No procurement risks are expected, since there are no plans to use the loan proceeds for the procurement of works, goods, services, consulting firms, or individual consultants.

2.10 CORFO's development level and use of country systems

Pillars	**Score**		**Development Level**	**Risk Level**
	Ideal	**Actual**		
Pillar I – Budget	3.00	2.84	High	**Low**
Pillar II – Treasury	3.00	2.97	High	**Low**
Pillar III – Accounting & Reporting	3.00	2.85	High	**Low**
Pillar IV – Internal audit	3.00	2.63	High	**Low**
Pillar V – External control	3.00	2.73	High	**Low**
Pillar VI – Procurement	3.00	2.89	High	**Low**
SGFP and Procurement Development Level	**3.00**	**2.82**	**High**	**Low**



B. Procurement management

2.11 This operation does not call for procurement by the executing agency.

III. Considerations for the Special Provisions of the Contracts

3.1 The following special contractual conditions precedent to the first disbursement of the loan will apply: (i) the borrower and CORFO will have signed an interagency agreement on, among other things, CORFO's obligations as the project's executing agency and how the loan proceeds will be transferred; and (ii) the PORs will have been approved and entered into force, in accordance with the terms and conditions previously approved by the Bank.

a. The PORs (i) will be consistent with the rules and policies of CORFO and the Bank, as well as with the country's financial practices and laws; (ii) will include the project's main characteristics in terms of the use of the resources and eligibility of subloans and beneficiaries; (iii) will stipulate that failure to comply with the provisions therein will impede access to financing; (iv) their approval by CORFO and entry into force to the Bank's satisfaction will be a condition precedent to the disbursement of resources; and (v) any modification would require the Bank's no objection.

b. To determine the equivalent in U.S. dollars (US$) of an expenditure incurred in local currency using loan proceeds, the same exchange rate used for the conversion into local currency of the funds disbursed in U.S. dollars will be used. For reimbursement requests for expenditures under the loan and recognition of local counterpart expenses and to justify the local contribution, the exchange rate of the first business day of the month in which the reimbursement request is submitted will be used.

c. The project's financial statements will be annual statements at the end of the fiscal year. These statements will be submitted to the Bank after being audited by independent auditors acceptable to the Bank, including the CGR, and, in accordance with the terms of reference agreed upon with the Bank, they will be presented within 120 days of the end of the financial period and the final disbursement.

d. All subloans granted under the loan will include terms and conditions that ensure that the sublending entities comply with the Bank's policies on prohibited practices, environmental and social policies, and policies related to procurement and consultants.

e. The Bank may request an insurance audit, as and when deemed necessary. This will not substitute for delivery of the project's audited financial statements.

IV. AGREEMENTS AND REQUIREMENTS FOR PROCUREMENT EXECUTION

4.1 The executing agency will conduct no procurement for this operation.

V. AGREEMENTS AND REQUIREMENTS FOR FINANCIAL EXECUTION

A. Financial Management

1. Programming and budget

5.1 As an autonomous agency, CORFO has resources from the government for its operations.

5.2 CORFO is an autonomous public agency organized under public law, with legal status, established under Law 6,334.[2] Its main mission is to increase the country's competitiveness and productive diversification by boosting investment, innovation, and entrepreneurship and strengthening human capital and technological capacities in order to achieve sustainable and territorially balanced development.

5.3 The programming, administration, and execution of the budget are carried out by the Administration and Finance Office (GAF); in addition, its planning system is aligned with the annual plans of each of its programs. Project implementation could create certain difficulties, especially as the respective PORs must be submitted to the CGR for review.

2. Accounting and information systems

5.4 To control project resources, a special chart of accounts will be opened within CORFO's regular accounting in the SAP; and for the disbursements to intermediaries, the same procedures and mechanisms will be used as for the similar programs currently managed by the Investment and Finance Office (GIF).

5.5 The accrual accounting method is used; however, the accounting process for projects partially financed by the IDB is based on cash balance; the national practices; the International Accounting Standards; and the International Financial

2 It was established under the name Corporación de Reconstrucción y Auxilio.

Reporting Standards. The financial reports will be prepared and submitted to the auditors based on these regulations.

3. Disbursements and cash flow

5.6 **Disbursements and cash flow.** The General Treasury of the Republic maintains and controls the General Treasury Account, which supplies funds according to the Program of Cash Accounts maintained by institutions, while receiving revenue. These entities are autonomous in terms of managing these current accounts. At CORFO, payments are made through the SAP's treasury module. The system has several controls in the approval and authorization of funds phases. The following disbursement methods could be used: advances of funds, reimbursement of expenditures, and, when necessary, direct payment to the supplier.

4. Internal control and internal audit

5.7 **Internal control and internal audit.** The internal control system is based on CORFO's organizational plan; strategic plans and operating and control procedures, approved by the CAIGG; administrative rules on ethics and probity; Law 20,285 on transparency and access to public information; legal standards, regulations, and administrative rules; evaluation and verification mechanisms; and internal audits. CORFO's Internal Control Office (GCI) advises the Executive Vice President on internal control; reports to the ministerial auditor and the CAIGG; has suitable employees; and has work procedures, plans, and programs. The GCI will follow up on the observations made by the project's external auditors and will facilitate responses to those observations.

5. External control and reporting

5.8 **External control and reporting.** Independent auditors acceptable to the Bank will be used, including the CGR. The executing agency expressed interest in the CGR conducting the project's audits. Within 120 days of the close of every budget exercise of the executing agency and during the loan's disbursement period, the project's audited financial statements will be submitted in accordance with the terms of reference agreed upon with the Bank. The final report will be delivered within 120 days of the date established for the final disbursement of the loan.

6. Financial monitoring plan

5.9 Given that the current project's risks are considered low, the annual and final audited financial statements as well as financial information in the semiannual technical reports will be required. The external auditors will perform the ex post review of disbursements. The GCI will follow up on the observations of the external auditors. The Bank will have prior knowledge of the external auditors' audit plans and make the corresponding observations. It will also review the auditors' reports and work papers when necessary, and perform desk reviews and accounting visits at CORFO, based on the Risk Matrix of the Bank's portfolio in Chile. It will also conduct training sessions for the project's financial management specialists.

5.10 CORFO will be responsible for timely fulfillment of the clauses and agreements of the loan contract and the project-related activities.

7. Other agreements and financial management requirements

5.11 The project's accounting will be performed in the SAP, and will have its own chart of accounts.

5.12 The project's financial statements will be formulated by CORFO's GAF in collaboration with CORFO's GIF.

5.13 The disbursement requests should be numbered consecutively and approved by a designated CORFO employee, whose signature must be registered at the Bank.

5.14 The GCI will coordinate the responses to the external auditors' observations, follow up on those observations, and report to the Bank, as appropriate, when the project audits are performed.

5.15 A checking account will be set up for the project resources and it will be reconciled monthly.

5.16 The Bank will conduct financial training workshops not only for CORFO employees but also for the internal and external auditors.

5.17 The GIF will assign an employee to overseeing project execution, who will address the Bank's information needs, including the formulation of financial reports.

5.18 For the justification of advances of funds, the exchange rate of the currency conversion will be used, and for expenditure reimbursements and the local contribution, the exchange rate on the first business day of the month of the expenditure will be used.

5.19 The semiannual progress reports will include follow-up on the auditors' observations and a conciliation of the executing agency's accounting with that of the Bank.

5.20 The external auditors will perform ex post reviews of disbursements, and their findings will serve as inputs for the Bank's statement on eligibility of expenditures.

5.21 The project resources and local contribution may be used to pay taxes related to the project activities.

5.22 Semiannual execution and financial reports will be submitted within 60 days of 30 June and 31 December of each fiscal year.

B. Retroactive financing

5.23 The Bank may retroactively finance up to US$24 million (20% of the proposed loan amount) against the loan proceeds as eligible expenditures incurred by the borrower prior to the loan approval date, so as to finance CORFO's subloans to the NBFIs, provided requirements substantially similar to those stipulated in the loan contract have been met. Such expenditures will have been incurred after 2 October 2015 (project profile approval date), but will in no case include expenditures incurred more than 18 months prior to the loan approval date.

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-___/16

Chile. Loan ____/OC-CH to the Republic of Chile
Project for Productive Development Financing in Chile

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the Republic of Chile, as Borrower, for the purpose of granting it a financing to cooperate in the execution of a Project for Productive Development Financing in Chile. Such financing will be for an amount of up to US$120,000,000 from the Ordinary Capital resources of the Bank, and will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Project Summary of the Loan Proposal.

(Adopted on ___ __________ 2016)

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