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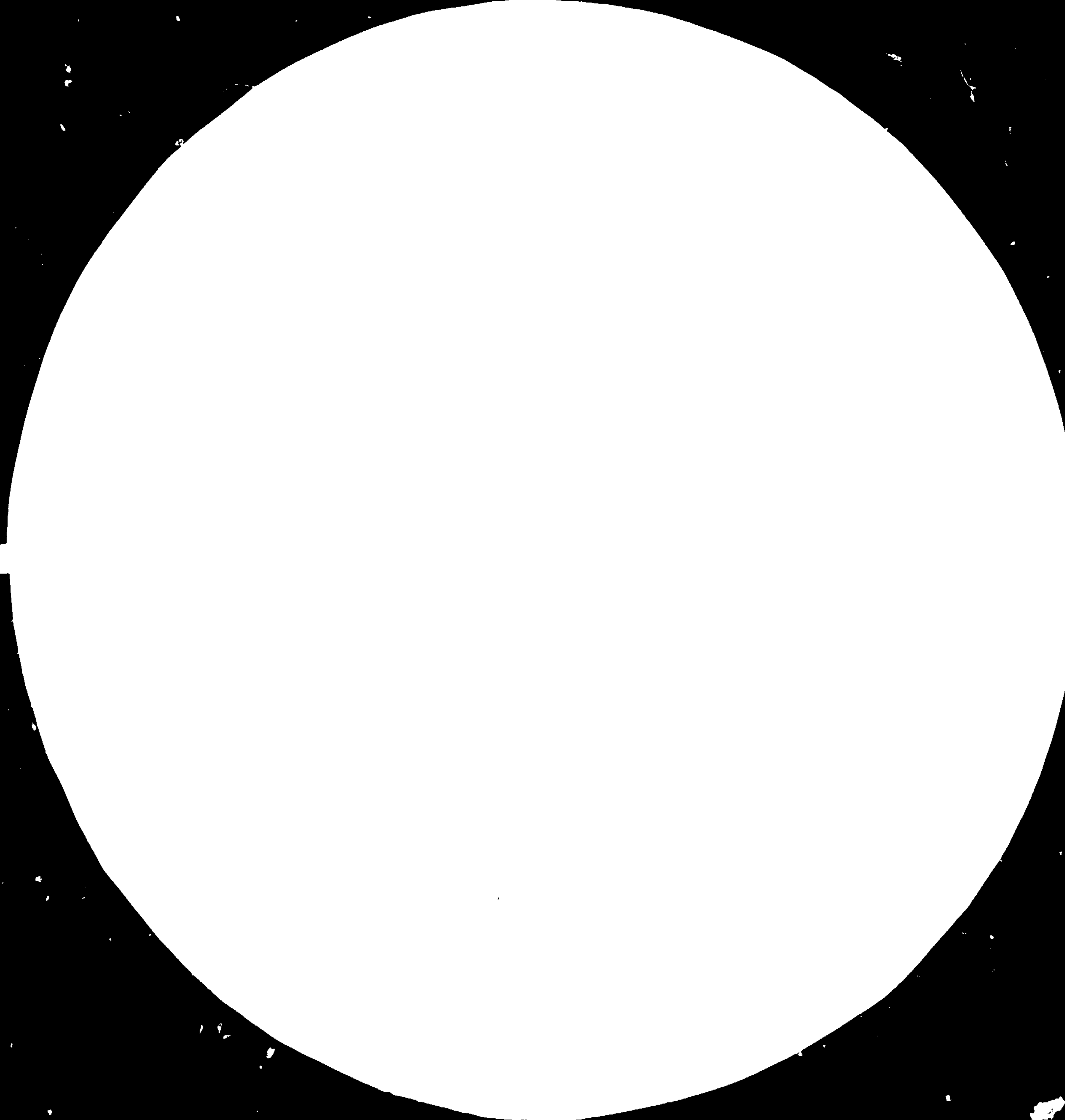

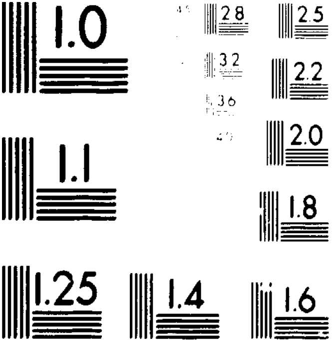

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13773

Venture Banking Activities in Chile,

The Case of Leasing Companies

by

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May 1984

2378

Project Description

Outline

I The Host Country

A Economic Policies

1. Financial Opening and liberalization

From 1974 through 1982 a radical process of financial liberalization reshaped the Chilean economy. Before this, the State regulated credit structures through the Central Bank and intermediaries through direct participation and intervention of commercial banks: furthermore, this system of "subordinate finance" went through a partial statization during the Allende government in 1971-1973. Thereafter the military government aimed at a radically new direction; the succession of the most significant events and policies may be summarized as follows:

a) May 1974: A non-banking segment is created when the economic authorities allowed free transactions with no restriction on terms and interest rates (Decree Law 455.) While banks remained subject to intervention and restrictions - particularly maximum interest charges. this change promoted the creation of a number of financial companies owned by local entrepreneurs which specialized in short-term monetary transactions.

b) In April 1975, free interest charges were extended to all market segments. During that year the government transferred 86% of banking shares through open biddings. The buyers were mainly the same groups of local entrepreneurs operating in non-banking sectors.

c) Debt/Capital ratios were progressively relaxed for placements in local and foreign currency, and by 1978 totally eliminated as operational requirements.

d) Reserve ratios on financial deposits and liquid accounts were also significantly during these years.By 1978, average levels ranged between 10% - 25%; only the State accounts and deposits (both central and decentralized agencies) were consolidated into one single account and subjected to an absolute reserve requirement. Financial Cos. were excluded from reserve requirements until 1976 when the collapse of three of these firms forced a rescue operation and the government applied controls for the sector - on capital and reserves; but still these were less strict than those prevailing for commercial banks. An then, between 1976-1978 there was a schedule uniforming reserve ratios for all different intermediaries in an attempt to shape equal competitive conditions.

e) Ownership and other restrictions regarding the control over financial firms existed in paper; originally no single person or firm could have more than 1.5% and 3% (respectively) of the shares of a firm in the sector. This was waived through layers of controlling firms in an intricate set-up that was only going to precede later distortions in the allocation of credit. The government bent to this actual concentration of ownership and eliminated all of these restrictions in 1978, stressing instead the same kind of restrictions on the allocation of credit.

f) Trade liberalization; by 1976 all import prohibitions were lifted and tariffs were scheduled for a progressive reduction down to a 10% even rate,to be reached by the end of 1980. In 1978, as policy makers expected massive surpluses of capital during the forthcoming years, the schedule was skipped. The lump down in tariffs was accompanied by a reduction in anticipated coverage payment for imports, a traditional charge of Central Bank for controlling imports.

Therefore, import transactions became suddently cheaper and easier than domestic production as financial charges on import orders were to be effected in shorter time and at lower dollar interest rates than orders on domestic production.

Export procedures were eased on the side of administrative procedures and some light tax incentives; this has been pointed out as only one aspect contributing to the expansion observed in 'non traditional' exports (fisheries,cellulose and logs, fruits).

g) Foreign Direct Investments

In 1974, the government introduced one of the most liberals codes on FDI's in Latin America (D.L.600), eliminating first all restrictions on profit remittances and further, lifting all constraints to entry into specific sectors- namely, the financial. Hence, Chile withdrew from regional trade agreement (The Andean Pact) as these measures violated concerted terms. While the decision may have been welcomed by the international financial community, it forced domestic producers to re-orient their market strategies as they had shaped their plants and equipment looking to regional markets.

D.L.600 granted equal tax treatment and no restrictions to foreign firms; their effectiveness in real sector activity, however, has been far short of expectatives. Mostly large mining projects have been materialized under the new laws, but really nothing important in industry.

h) Foreign Financing

But DL 600 left a wide entry to financial operations; the increase of financial inflows started to accelerate in 1978 when the Central Bank negociated and guaranteed foreign loans which were redistributed through the network of domestic commercial banks. From 1979 through 1981 the foreign financing was obtained directly by domestic intermediary firms, namely banks in what was publicized as "private transactions without State guarantees". The authorities arranged this, allowing domestic intermediaries to negotiate and allocate foreign loans freely - in domestic or foreign currency. (Actually these facilities were later extended to corporations alike, and the policy makers publicized the triumph of the private market in generating a steady flow of capital).

Apart from foreign lending, a special arrangement was introduced in 1974 with DL 600, permitting foreign investors to bring in funds obtaining a guarantee from the Central Bank (Art. 14 Decree Law 1272) for later remittance of gains and reimbursement of original capital.

This allowed, for example, to bring dollars, make peso denominated transactions earning the extremely high interest rates prevailing in short-term, speculative transactions, and reconvert indifferently gains and capital. A minimum period of stay of one year was applied in 1979, extended to 24 months in 1980 and then to 36 months in 1981; the constraint was aimed at improving the term profile of foreign liabilities and the composition of capital inflows.

i) The development of financial market was strengthened by the sweeping restructuring of the pension funds' system in 1980. A number or private administrative firms were established - again by leading domestic entrepreneurial groups. They were able to absorb funds across public and private laborers allocating them more freely into financial instruments; this amounts now to a feeding flow of large magnitude for the capital market. Together with insurance companies and private health insurance funds, these new pension funds contributed to shape the institutional characteristics of a "modern financial system".

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By 1981, the course of financial and trade policy making appeared to reach the zenith, and a state of euphoria was probably a good description of the conditions prevailing in the chilean economy.

But also, the economy showed signs of erosion. By then, policy making begins to restrict more things than it made flexible. They had started with minimum capital requirement for financial intermediaries, e.g. financial companies had previously no minimum, and by 1979 the requirements were US$ 4 million for banks and US$ 3 million for financial companies. The State also extended a depositor's guaranty covering up to approximately US$ 2.[illegible] account and went into the rescue of a few defaulting firms [illegible] successive occasions (1976, 1981, 1982). Actually, while [illegible] mic authority talked free market policies, the Central B[illegible] absolute aversion to 'free market' clearing mechanisms in the financial sector. Lending of last resort became a status function for the Central Bank. The supervisory authority begun to assume a role in banking, starting a classification system for lending portfolios and definition of insolvent clients, defaults, etc. in 1980. The term "bank provisions" begun to be heard of and the supervisory banking agen., started to control them.

There were efforts attempting to reduce spreads and interest rates on account of **inter**mediation deficiencies.A number of arrangements aimed at this, but they seemed to consolidate rather other kind of flexibilities ,and not to lower costs. The rationale of the liberalization policy became the target for growing criticism, as the stabilization of the markets shaped between 1974-1981 seemed to require a thorough reversal of policy orientation. Financial flexibility and "free market policies" ended closer to "instability" and "financial erosion" than to the anticipated goals of growth and economic development.

The explanation of such results may be derived from alternative interpretative frameworks. For the government it was the result of negative turn of events of the international economy since 1981. The rise of the interest rate imposed not only a wide market contraction for primary export goods but a higher burden on debt contracted at variable rates. This aggravated the perception of international lenders and their decision to stop financing.
In my view, the structural deficiencies involved in the model adopted in the Chilean case were insurmountable. The international crisis of 1981/1983 precipitated the unavoidable. There were two fundamental factors for this and they had been taking shape since much earlier.

One was the combination of financial expansion policies with monetary restraint. Another, the kind of re-structuring that took place in industry and enterprise. Let's see first the case of monetary restraint. Actually the assumption was that inflation had to be eliminated for financial development and stability, and that the instrument was monetary policy.

The extreme rigor explains two periods of "shock treatment". The first in 1974-1975, brought the GNP down by over 20 percentage points and unemployment up to over 20 per cent; yet, inflation - although slowed significantly - continued at "intermediate" levels over 30% after 1975. The second occurs in 1981-1984 when the crisis is managed by monetarist mechanisms,(initially, the quite orthodox mechanism of debt deflation; later,an ambiguous mélange of rigid constraints and lending of last resort) .

In 1977,policy makers identified the source of inflation with expectations formed on the basis of the exchange market; hence, they introduced first, in 1977, a programmed sliding exchange rate and later by 1979 a "fixed" single rate at Ch$39 per dollar. This, they argued,was to be the final answer to the inflation problem. Furthermore, they started to apply a "monetary approach to the balance of payments" for determining the issuing of money: this meant to issue money domestically in correspondance with the variations observed in the level of international reserves.

For a while, inflation showed signs of exhaustion; price stability was declared; and the economy experienced growth rates of GNP for the first time in almost six years; it grew from 1978 to 1981. And the employment levels improved somewhat. But high interest rates prevailed refraining real domestic activity. The situation was particularly worst for those domestic sectors which had to confront competition from imports, given the open trade system and low valuation of the dollar and tariffs. Agriculture and manufacturing were hit most seriously; as a result domestic investment ratios remained at historical lows. Exporters were also affected.

Actually, the growth experienced between 1978-1981 was primarily generated by finance and commercial activity, both receiving a massive inflow of external funds. The economy was in fact getting weaker in terms of its international competitiveness and poorer in terms of its productive stability. Total external debt increased from about US$ 6 billion to US$ 20 billion between 1977 and 1981. To a great extent, prosperity was a loaned illusion. Therefore, monetary restraint determined a number of "wrong" signals: in the cost of credit, in the contraction of demand for domestic products(because of shrinking incomes and exchange rates) which in fact weakened the income flows of borrowers. The structure of debt conformed under financial expansion policies, proved thoroughly inadequate.

A particular consequence of monetary restraint and financial expansion was produced in the sphere of asset valuation and its relationship with credit structures. Because these policies redistributed income and ownership towards the richer levels while the military provided a sense of security, the real appreciation of assets (real state, corporate shares, etc) accelerated . Values multiplied the original 1973 levels many times. Tax advantages together with the procedures of monetary correction for fixed assets enhanced this phenomena significantly.

Credit was extended in correspondence with the exxpanding value of collaterals; but the structure of the assets of this economy remained much the same- Actually, the period 1973-1987 shows the lowest investment ratios in record; although the economy showed signs of "modernisation" andhigher efficiency, this was due to factors such as greater labour discipline, a better organization of work and what some economists have called 'adaptive investments', improving existing operations with only some minor technological and productive adjustments. They were not enough to avoid an artificial valuation of assets, which served as a base for the structuring of an enlarged debt.

When the flows of foreign financing stopped in 1982, the inadequacy became apparent. Over extension and over valuation made increasingly difficult to manage a solution.

Initially, policy makers intended to adjust the macro economy through the course of debt deflation. The argument was quite orthodox: an economy spending more than what it earns should spend less, and prices - especially wages and salaries should be the first to adjust. Money had to be contracted accordingly. A wage cut was discussed while asset reallocation among the more efficient firms was anticipated to resolve the problems of massive bankrupcies. The price level actually showed signs of deflation during a few months. But price adjustments proved too slow. The foreign income flows stalled completely on account of a generelizing crisis in the region and the capital markets. While the loss of international reserves continued, monetary contraction followed course; interest rates shot up and the economy was again under shock treatement with GNP tumbling down by 14% in 1982 and unemployment figures scaling over 30%.

As defaults generalized, the financial system became totally out of control. Banks "bycycled" their funds in progressively mounting rollovers - easier for interrelated firms than for the common debtors who faced judicial bankrupcy procedures. Between Dec. 1980 - May 1983 the percentage of uncollected loans in the banking system's portfolio went from 10,5% to 113% of capital and reserves. The adjustment of this wide disequilibrium has gone through different stages and spheres. Essentially they show the dangers implied by the radical liberalization policies and the high costs of orthodox monetarism.

2. Crisis Management

By June 1982 the authorities decided to abandon the fixed valuation of foreign exchange. They "fixed" a new level at Ch$ 47.50 and then adopted an indexation of the dollar according to inflation terms (both domestic and in the U.S.) Without complementary arrangements for dollar financial contracts, the June devaluation meant a tremendous disorder in the market. A differential compensation was later introduced. as the Central Bank set a special ex- [illegible] foreign denominated currency.

Towards the end of the year, the position of banks was completely out of control. The government decided to intervene. With the sanction, many intermediaries became insolvent immediately: this was the case of mutual funds and broker markets dealing in corporate shares and direct placements, who were faced with liquidation. Actually, the government had already forced into liquidation three banks in December 1981, and thus it just appeared normal to continue doing more of the same. Massive allocation of emergency lines of financing for intermediaries through 1982 proved insufficient to restore order and the impact of monetary restraint and of devaluation upon the incomes of debtors simply worsened the collection of programmed flows. In January 1983 ten more banks were intervened. Today five banks are in liquidation, eight intervened and practically liquidated and two more are under "inspection". The two largest commercial banks in the country were among those intervened; these (Banco de Chile and Santiago) were in turn controled by the two largest entrepreneurial groups. A number of financial companies also suffered the same fate.

Through this process of financial erosion the State re-emerged as a central agent in securing the stability of the economy -stabilizin the links with the international financial community and the domestic links between debtors and depositors.

On the one hand, the State assumed the management of the entire banking system's liabilities, i.e. external debt. This happened partly when it devalued and introduced a compensatory refund payment for foreign currency debt payments, and entirely, when as a result of its intervention of banks took management of their liabilities with foreign creditors. Faced with balance of payment pressures, the State extended a complete guarantee over the entire sum of "private" foreign debt; this showed that the "private" nature of business transactions is more endurable for profits than for losses.

The government succeeded in avoiding the Club of Paris as a negociating framework by naming a commission of 12 banks (the leading creditors) who managed the refinancing of 1983 and now for 1984 (-charging though a fee for the job). This new 'syndic' operates in in reference to the annual IMF negociation of stand bys and other terms of the 'stabilization program' agreed with the Government. (Indeed, such management of the macro economy has proven beyond the ability of three economic ministers named succesively) in less than two years).

Domestically, the State has assumed the refinancing and the jobs of clearing up through the function of the Central Bank as a lender of last resort. The rescue was performed ambiguously in the beginning, coexisting with debt deflation policies in other spheres, but lately the programs tend to include the whole set of agents involved in the debt structure.

The cost of these programs has been enormous. The coverage of programs will extend over an equivalent of US$ 8 billion when the total is considered, although the cost for the Central Bank may be significantly less (around US$ 2 billion) as it is refinancing through non-monetary mechanisms. The roll-overs extend one or two grace years and lower interest rates. The intangible costs, however, are difficult to assess.

The government also decided to intervene the largest entrepreneurial groups during 1983. Their manipulation of banking resources provoked this as they had concentrated most of their funds in credits to inter-related firms. With this, the State intends to clarify the final patrimonial position of banks, holdings and creditors - including the State itself.

Monetary restraint has been gradually relaxed and the Central Bank started to "fix" referential interest rates by mid 1983. The level of the State deficit, however, is being decermined under "stabilization programs" defined with the IMF and its annual terms.

With the last cabinet change in April 1984, the government is openly shifting from monetarist views, adopting a more pragmatic and flexible management of policies.

The degree of State participation in economic affairs has grown correspondingly; but also government officers have stated repeatedly that these measures are transitory, aiming to restore the order for private business. This is expected by local and foreign

B - The Financial Sector

Description - The sector of financial services of the chilean economy presents most of the characteristics of a "modern" sector with multiple firms and instruments. Most of the intermediation of funds is realized within formal structures: (i) Banking, which includes commercial, mortgage and investment banks; (ii) non-banking segment which includes a) financial companies specialized ub short-term financing and consumer's credit, b) insuraance companies and health insurance funds c) pension funds d) mutual funds e) cooperatives savings associations f) broker's transactions in the local stock market where corporate shares, bonds and gold are transacted daily.

However, most of the intermediation is controled by commercial banks. They have evolved into a highly integrated system with large networks in Santiago and through the main provincial cities, . offering a wide array of services; their computational services are at competitive levels including (in the case of some leading banks) cash-cards and automatic tellers.

Actually, after policy making shaped some degree of specialization, all of the differential regulations affecting financial intermediaries were eliminated by 1980; nevertheless a degree of segmentation prevails and some banks cover specific segments of banking - such as the corporate sector or the small firm's sector.

Structure - Table 2 shows the distribution of financial liabilities sector by sector at the end of years; this approximates the importance of cash segmentsin the market, and their evolu tion in the last years. Banking has a predominant role in the system, and the percentage share of banking liabilities increase from 30.1% in 1973 to about 47% in 1983. The importance of corporate instruments (shares) is also apparent; valued at market prices the figures indicate the sweeping effects of the 1981-1983 crisis, when they decreased its share by almots 20%. Actually

Financial Liabilities
(non monetary)

Sectors	Year 1973	1978	1979	1980	1981	1982	1983
1. Public Sector (Notes, bonds etc)	7,2	12.2	12.5	7.9	5.9	3.9	10.83
2. Banking	30.1	28,4	24.8	25.1	38.2	47.3	36.7
3. Financial Cos.	-	38	4.6	4.4	3.4	2.0	1.7
4. Development Banks	0.1	1.9	3.0	5.1	8.6 1/	-	-
5. Corporate Shares	-	43.7	48.9	53.5	38.7	39.0	32.8
6. Others *	62.6	10.0	6.2	4.0	5.2	7.7	7.1
7. Total in %	100.0	100.0	100.0	100.0	100.0	100.0	100.0
8. Total in US equivalent (US$ thousands)	6.307	5.377	6.474	8.674	8.227	7.937	7.324

1/ Dev. Banks' accounts were integrated to Banking in 1982.

12

the values of corporate shares skyrocketed since 1973 as domestic firms made accommodations of corporate accounts in order to enlarge the collateral base for credit and obtained strong tax incentives to revalue their assets. The present level understates the net value of many corporations but it is probablya closer approximation to real economic values. Also, in 1983 the participation of State liabilities starts to increase; this is indicative of the reversaal of economic policy and stresses the present role of government - atabilizing the financial system. The expansion of the financial system as a whole can be estimated from line 8 showing the total sum in dollars terms; in spite of the many problems of exchange valuation and of economic measurement of these variables, the proportions are indicative of the real change. They suggest a growth by 15 times between 1973-1980, and stagnation thereafter.

The characteristics of credit, on the other hand, evolved significantly; a change in composition occurred as the private sourcing and intermediation of funds replaced the earlier and traditional role of the state agencies. By 1978, the portion of the Central Bank in the generation of funds and of the State Commercial Bank in the allocation of credit through special credit lines became secondary. Credit was largely controlled by private agents and had a main source in foreign capital flows and in the flexibilization of reserve requirements.

But the term - structure remained extremely short, as monetary restraint generated high interest rates and depositors capitalized on short monetary placements and speculative opportunities. These factors are shown below indicating credit volume at the end of year, the share of banking credit and of the Central Bank as a percentage of GDP. (In 1982 the Central Bank credit more than doubled as a result of rescue operaion and will probably continue to increase through the end of 1984.

The term structure of credit and deposits is shown in Tables Local currency operations had shorter term than the foreign ones, but some extension of deposits and placements started to be noticed in 1982; however this already occurred under measures of intervention and restriction by the policy authority. Under the free market, the cost of credit, as we have already pointed out, remained at extremely high levels until 1983, when interventions and regulations by the Central Bank re-structured the intermediation system. The high cost of credit in local currency until 1978 deterred investment with real levels in the range of 35-60 percentage points, and complicated significantly the attempt of the authorities to consolidate the financial system as a coordinating sector for the economy. The short term position of the systen, coupled with the higher interest rates on monthly or weekly transaction provoked massive bankruptcies during those years. Determined to maintain monetary restraint, the economic authority stimulated the use of foreign financing, accommodating the norms and regulations for direct and indirect intermediation.

From 1978 there was a strong shift to finance working capital and other activities through borrowing in foreign currency, namely US dollars. Simultaneously the exchange rate was forced, so that with a percentage of domestic inflation the real cost of credit in foreign currency diminished significantly, and became negative in 1980. There was a differential access to foreign sources, and naturally the largest firms in industry and banking had a much easier access to this source of capital. The structure of debt was changed during 1978-1981 with a shift to dollar denominated contracts. This proved to be a bad medicine when the government had to devalue in 1982 shooting up the cost of these credits to almost 50% in real annual term.

Total Placements (Monetary System)

Year	Total		Banking	Central Bank
	Thousand millions	% GDP	% GDP	% GDP
1970	53.4	18.9	8.4	10.5
1975	92,7	39.0	6.4	32.6
1978	130.4	41.9	20.3	21.6
1979	150.0	44.5	30.3	16.3
1980	182.8	50.7	42.1	10.5
1981	234.8	61.5	51.9	6.6
1982	251.9	76.3	69.9	14.6
1983	262.7	80.0	-	-

Source: Arellano, "De la Liberalización a la Intervención Financiera" 1983, CIEPLAN.
Central Bank Monthly Report,

(non consolidated)

TERM STRUCTURE OF CREDIT AND DEPOSITS

i) Local Currency

End of	Deposits		Credit	
	(% 1 year)	(% 1 year)	(% 1 year)	(% 1 year)
1978	86.8	12.1	77.3	22.7
1979	85.1	14.0	74.6	25.4
1980	85.3	14.7	72.4	27.6
1981	82.9	16.1	66.6	33.7
1982	76.1	23.9	54.9	45.1

Source: CENTRAL BANK; Monthly Reports, and Arellano, "De la Liberalización a la Intervención Financiera", CIEPLAN, Santiago 1983-

ii) Foreign Currency

End of	Deposits		Credit	
	(% 1 year)	(% 1 year)	(% 1 year)	(% 1 year)
1978	53.3	46.7	58.7	41.3
1979	45.8	54.2	56.5	43.5
1980	43.6	56.4	52.0	48.0
1981	33.6	66.4	46.7	53.3
1982	30.3	69.7	32.4	67.6

Source: CENTRAL BANK: Monthly Reports, and Arellano, "De la Liberalización a la Intervención Financiera", CIEPLAN, Santiago 1983

Cost of Credit

	Foreign Currency		Local Currency
	Nominal in US$	Real in CH$	Real in CH$
	(1)	(2)	(3)
1975	13.9	-21.6	51.2
1977	13.9	- 0.8	39.4
1978	16.1	2.7	35.1
1979	20.7	-0.1	16.9
1980	19.9	- 8,6	12.2
1981	22.2	11.6	38.8
1982	20.3	46.9	35.2
1983	16.2	20.0	15.9

Source: Central Bank

(1) Credits under Art. 14 plus 5% spread

(3) Adjusted, from Arellano, "De la Liberalizaci6n a la Intervenci6n", CIEPLAN, Santiago 1983

C - Foreign Participation

In spite of having adopted in 1974 one of the most liberal codes on FDI's in the region, the activity of foreign investors in direct participation has been shifted to the financial sector; only a few operations have occurred in mining and other non-banking sectors mainly in industry and energy related sectors. Throughout the last years, however, the trends of foreign capital participation in the financial structure of the economy and in the financial sector as such have reshaped the economy and its stability.

Actually, the role of foreign financing is apparen t in the figures showing the evolution of the external debt. Table . It seems important to stress that the increase in total debt experienced between 1978-1981 is explained almost entirely by the growth of credit demands within the same financial system namely from banks.

External Debt
(Nominal debts in millions of US$)

		% GDP nominal	Cost of Debt average
1973	4.043	57.9	n.a.
1978	6.911	45.2	7.2
1979	8.463	40.4	8.8
1980	10.987	42.9	10.8
1981	14.738	50.0	13.0
1982	17,153	65.9	13.2
1983	17,454	89.0	9.1

Source: Central Bank

Direct participation in banking

But foreign banks are using all of the advantages granted by the foreign investment codes in the sphere of banking; they participate widely in this market and face an equal to equal position vis a vis local banks with respect to all aspects of banking, including the use of Central Bank resources.

Furthermore, the registration of the initial investment for opening a branch (US4 m minimum) or for buying a local firm under the foreign investment laws allows for full remittance of profits (after taxes). This presence started by 1978 and grew significantly thereafter: by 1983 there were 21 foreign banks operating as full scale organizations. This represents a larger number than that of local banks (18). Their importance in the extension of credit and in the competition for domestic funds can be derived from below, showing that after 1981 the segment is taking a significant share in the domestic intermediation of funds. The collapse of several domestic banks and financial companies has strengthened their competitive standing, since these banks offer, on the one hand, greater securities for the general depositor and on the other, because their managerial standards have been withheld and probably iuproved while those of local banks have been affected by their intervention and liquidation.

Porcentual Participation of Foreign Banks in the Banking System', (balance at the end of each year)

	1978	1980	1981	1982	1983
% share in credit					
credit in L/C	0.1	0.3	5.5	10.8	12.9
credit in F/C	0.1	3.8	5.1	7.7	7.2
% share in deposits					
Deposits in L/C	0.0	2.3	5.9	14.4	15.2
deposits in F/X	0.0	5.0	14.5	22.1	28.9

Source. Central Bank

It is possible to distinguish specialization trends, although the 1981-1983 crisis in the financial system has complicated this kind of interpretation. But still, judging what kind of operations they avoid, one can draw distinctions. Six of these firms are actively competing in all purpose banking, fully integrating their branches (and expanding them across the country e.g. Citicopr); these banks seem to be out competing for a leading position within the system, attempting to make a business in banking. Five other appear operating as corporate banks, i.e. rejecting the small market and competing for the accounts of large firms mainly export and multinational corporations eatsblished in Chile (e.g. Chicago Continental). Nine other actually support trade financing and corporate accounts and only one firm has specialized in investment banking. These are obvious crossovers since they can perform all kind of intermediation and financial services: this is apparent in the field of corporate financing and investment banking.

Most of the foreign banks have attempted to develop this field setting up special departments or joint operations as is the case of Citicorp and Morgan. But by an large this field's activity has been minor compared to other operations but the prospects for future development persist, since the management of financial intermediation and industrial financing after the crisis will demand it and the organizational capabilities of these banks in this segment remain intact.

The measures of intervention and liquidations in banking during these last years have created opportunities for those foreign banks who wanted to expand rapidly and with lower start-up costs. In fact, several mergers took place, led by foreign banks acquiring full commercial banks from the government. These operations normally consisted in the acquisition of the asset side (net of losses and valuation problems), i.e. the buildings, equipment, the accounts, etc., leaving the liability side to be cleared by the liquidating commission. The personnel was "attached" to the deal not simply because of a protection to employers, but mainly because this represent an 'intangible' of considerable value especially in commercial banks.

These kind of opportunities will again appear within the coming months, as the authorities prepared the procedures for the sale of three or four more banks affected by the January 1983 measures. During 1983 the conversion of debt into equity appeared very likely, and in the case of banks it could have allowed a direct take-over from foreign creditors. But the mechanisms of renegociation are such that other mechanisms appear more advantageous. Foreign creditors have obtained state guarantees for the amounts renegociated during 1983/1984; this "forces" them to stay longer to collect but also changes the quality of their own portfolio - which may induce them to stay, participating more actively in the banking business as such. Indeed, after the negociation the only one in a position to capitalize debt could be the Central Bank and not the original creditors, because it has rescued all of these intermediaries through massive allocation of credits far exceeding their own capital.

D - The effects of the 1981-1983 crisis

The impact of the last recession on the financial mechanisms for all markets and firms has been significant; the wave of bankruptcies in manufacturing and agriculture started in 1981 and in the end extended its effects to finance and banking.

The financial collapse, however, has not been complete. On the one hand, the economic authority realized massive rescues by lending of last resort and by arranging for wide re-negociations. first with specific domestic and foreign sectors and finally extending a general roll-over; on the other, it finally decided in 1984 to abandon its dogmatic use of monetarist policies. The stability of poiitical authority has been affected, but not to that extent which would disable the government to command an economic stabilization. In fact, the government has re-introduced a number of supporting measures oriented to generate a faster economic recuperation.

But for this economy the ultimate success of any stabilization attempt (even for a statu quo) seema to be determined by the world economy , in particular of the metals market and of the evolution of the interest rate. The present government has declared its intention to honor de ts and at the same time, it expects to withdraw from its present interventionist standing as soon as possible - allowing private sector firms to regain a more active role. Yet, the economy has become again a declared "mixed" system.

The possibilities of stabilization probably depend more from a readjustment of domestic policies than for external factors; this has been demonstrated after the government re-introduced in 1983 an adequate level of protection for agriculture and supported its activity with appropriate financial and policy mechanisms. But for re-taking a path of economic growth, the provision of additional foreign capital appears to be essencial, if the government uses the foreign exchange available for paying past debts, then it will have no resources for other purposes during <u>at the least the next 5 years</u>.

In this context, after the effects of the debt crisis are resolved by rescheduling and lending of last resort, the role of the financial system will have to recuperate an importance for stability and growth. The sector will obviously be a lot different than that envisioned years ago by policy makers; two years of crisis swept most of its resources' capabilities and destroyed its capitalization. Most remarkedly, a run on the financial markets did not occur, and the defensive immunity is now in place to avoid it.

It is apparent then that the results of the years of expansion - apart from enlarging debts- have indeed generated an intermediation network with an ability to channel domestic flows of capital. The system is n ot yet appealing enough to stimulate the repatriation of capital(in abroad deposits) - estimated at US$ 3 billion - but will have a resource base in domestic deposits. Moreover, it will be fed by the flow from pension funds and other savings.

It is apparent then that the authorities will atttempt to re-orient the financial system, in an effort to accommodate financing required by the recuperation of activity.

II Venture Banking Activities

A Merchants and Investment Banks.

Although most of the activities of foreign banks in Chile took place in financial lending and in direct branching, a number of other financial firms have been developing alternative activities in the field of venture banking. Merchant and investment banks, leasing and insurance are the main fields of tbis alternative participation of foreign firms, in a field which may be characterized as "venture financing". The field suggests a determination to seek opportunities with higher returns, less exposure of funds, although they represent just another form of exposure. Indeed, foreign banks must participate contributing with managerial and organizational capabilities, attempting to make innovative financing in fields not reached by the normal operation of a commercial bank; and their contribution of capital, however small it may be, it is not generally guaranteed by a second party with a third party collateral. These activities suggest that the role of foreign banks is much greater in the evaluation of the business, the control over negociations and then the participation and management of the venture. A brief description of the main examples follows.

1. In 1979, Morgan Guaranty (USA) bought 50% of FINANSA, a local financial company controlled by one of the leading domestic entrepreneurial groups, BHC. FINANSA specialized in the field of corporate financing, and was then the second largest firm in the segment. MORGAN paid US$ 10 million to BHC and then assumed a relatively secondary role in the company, participating in the sourcing of international funds but not in management. FINANSA made two issues of bonds in the international market and obtained important loans from other banks. In 1980, FINANSA made over US$ 20 million profits, an increase of proportion from the US$ 1.5 million profits in 1979.

In 1981 the venture's prospects were promesing, and the board decided to take advantage of the banking regulations, changing its status to that of an institutional bank MORGANFINANSA. This could allow to make foreign currrency credit transactions; the bank redefined its competitive profile maintaining the corporate sector but estending full banking services to checking and investment accounts for business executives. MORGAN continued to have a pasive role in management.

But the BHC group - as it will be explained later in more detail - faced problems since 1981, pulling the venture with them. MORGAN-FINANSA allocation of credit to inter-related BHC firms increased above permitted levels, and the bank faced the risk of intervention in 1982. BHC accepted to negotiate in order to avoid intervention and the filing of bankruptcy procedures; Banco de Chile, one of the largest creditors and the government later when this bank was also intervened, replaced BHC. The final outcome of this conflict will be resolved after the government determines the liquidation procedures for all banks intervened during 1981-1983. There have been multiple preliminary negociations, and Morgan has expressed its interest in buying the other 50% of the bank and the government has, on its part, expressed its intention to accept it. The transactional aspects will probably consist of a promise by MORGAN to capitalize the local firm.

MORGAN FINANSA

Credits and Deposits

(millions)

	1979	1980	1981	1982	1983
Credit					
Local Currency (Ch$)			10.026	8.842	9.364
Foreign Currency(US$)			55.6	89.1	69.2
Deposits					
Local Currency (Ch$)			10.073	8.082	8.381

2. Morgan Grenfell, a british merchant bank has been actively involved in several projects in the energy field. It has participated in brokerage, assisting mergings and acquisitions. One example is in the case of the Methanol Project in the Southern Straights, where SIGNAL-Methanol Inc., a subsidiary of the SIGNAL Co. Inc. of La Joya Cal will invest US$ 410 million in building and managing a plant for the production of 2300 metric tons of methanol per day. Morgan Grenfell participated in a negociation with ENAP, the national petroleum Company, which owns vast gas reserves, for the provision of gas for the 20 years' life time of the project. ENAP will invest US$ 40 million in a pipeline with funds from the IDB.

3. Another british bank Nathan Rotschild V.A. is involved in an association with Banco Industrial y Comercial de Sao Paulo (Brazil) and Banco de Industrie y Comercio BICE (Chile) in a venture banking organization. They have been promoting two large projects in energy and mining , financing or arranging for the financing of the feasibility studies (which in these sectores are quite significant).

4. In the financial sector, the Corporation of International Finance took a 20% share in INVERCHILE with other local investors. The firm has been involved in financial intermediation, with the CIF attempting to develop the 'capital market'. Apart from operating in the issue of financial instruments, INVERCHILE has participated in mergings and assisted take-overs in the financial system.

5. Transforming Debt into Equity.

The massive defaults and liquidations have created many situations where the creditors are confronted with an opportunity to transform their unpaid debts into an equity position. The case has been typical in banks and domestic corporations with large debts with foreign banks; however, Central Bank dissipated the idea by rescuing many of these banks and extended massive roll-overs to corporations; foreign creditors have preferred to renegociate these loans with the government when they can and accept probably longer collection terms but better guarantees. Only selectively there have been cases where this did not happen. One example is the Allied Bank (USA) which accepted a 10% (10.3 million shares) of Banco de Concepción

B. Leasing Operations

1. General

Since 1979, a number of private leasing companies have been established in the country. These includes the following, showing the year of establishment, the origin of shareholders, the market segment they are oriented and an estimate of the total amount of leasing contracts placed during their operation:

	Year of Establishment	Shareholders Local	Shareholders Foreign	Market Segmet	Total Accrued Placements
Leasing Andino S.A.	1978	50	25.0 Orient Leasing (Japanese) 25.0 Liscaya (Bco. de Vizcaya,) Spain	General Financial Leasing	US $ 130 m
Cia. Chilena de Leasing	1978				
Republic Leasing S.A.	19	-	100;Republic Bank	Financial	
Cia. General de Leasing S.A.	1980	-	100,o% Bank Minas Gerais (Brazil)	Financial Leasing	US$ 15 m
INTERALIA	1981	60	40% Kleinworth-Benson Ltd. UK	Financial	US$ 30 m
ITAU	1972		100,0% Banco Real (Brazil)	Financial (Transportation equipment)	US$ 15 m
Manufacturers Hanover Leasing	1982		100% Manufacturers Hannover Bank	Financial	
RIO GRANDE LEASING SA	1981		Brazil		

Leasing operations emerged as a natural complement in the highly differenciated market of the last years.

Furthermore the increasingly prohibitive costs of local banking credit was a strong incentive to start the financing of investment spending in equipment and fixed assets through other means, especially in foreign currency. Leasing became an interesting option for several reasons: 1) for those local firms which were unable to obtain direct financing abroad; facing domestic interest rates exceeding the 50% annual level, a fixed exchange rate and little domestic inflation, the external sources became for local firms strongly competitive; 2) because for many existing firms there are strong restrictions for the acquisition of fixed assets and equipment. This is the case of many multinational companies and governmental agencies. Through leasing contracts they are able to"hide" assets as rentals expenses; 3) Tax advantages.

In spite of these many apparent advantages and the interest shown by foreign banks, leasing companies were relatively slower to develop, as they needed to introduce the concept and market themselves with new and unknown services. Still, their operations gew from nothing by 1978 to over US$ 200 million in placements by 1983.

2. The Legal Framework

Under the norms of a highly liberal financial legislation, leasing was defined not as a financial intermediary but simply as a "service firm". Hence, it is not a requirement for them to present reports or balance sheets to any supervising authority, but only to the tax authority in which they remain then secret - just as with any other firm. Only "open" corporations which trade shares at the stock market are required to make public their accounts. "Closed" corporations and limited companies only report to the central tax authority. *

In the case of being a company formed by foreign capital, the legislation allows equal tax conditions to those of domestic firms (with a 50% corporate tax on profits) and complete availability of foreign exchange for profit remittances if the capitals are registered under the foreign investment laws (DL 600). With a single banking exchange rate, profit remittances can be made at the entire disposition of the foreign investor.

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* In fact, only one leasing company makes public reports on its own compulsion. All of the rest remain secretive and maintain a tight control of internal information.

Leasing presents some characteristics which in these times of default prove to be of much convenience. The leasing firm keeps the ownership of allocated assets until the contract is finished, renewed or liquidated as opposed to banks or suppliers credit-which lend the funds and may keep guarantees over the different categories of assets, but not the ownership over them. And collaterals result to be a lot different than deeds when the lender has to collect from a defaulting firm; leasing firms do not have to demonstrate ownership over the goods since they have never transferred it; it is only the rental contract which falls into default. Recuperation of goods is then immediate avoiding all of the hazards and uncertainties of judicial collection, allowing for reallocation or resale at a spot price. Because of this reason, many suppliers of equipment are today favoring leasing arrangements instead of the traditional supplier's credit mechanism and banks may become in the near futu interested in channelling loans for the acquisitions of fixed assets through leasing.

3. Tax Advantages

For a firm there are restrictions in the classification of expense accounts and capital expenditure. But the entire payment of a leasing contract can be charged as an expense under current legislation; the residual value of the goods may be transferred (if that happens to be the case) from the lessor at book value - which is therefore a residual accounting value. This may present advantages, especially for profit making firms; the reasons may be of two kinds.

A firm which finances the acquisition of an item increasing their fixed assets with a banking loan will be able to charge as expenses only interests, sales taxes and deduct depreciation charges (a minimum of 3 years in case it opts and obtains a deal for accelerated depreciation). The amortization of capital is not a deductable expense; therefore it has to be drawn from current income flows and eventually from profits - which are subject to a prior 50% corporate tax. Hence, for a profit making firm, there may exist an advantage in opting for a leasing contract if it finds convenient to change the leasing payment as an operational expense at a lower cost of that of a banking loan.

A second explanation of a tax advantage is because fixed assets are subject to monetary correction: thus with inflation, profits and income increased [illegible] only nominally and still, will be subject to corporate taxes.

4. The Relation with Government

Leasing firms have kept a secondary place among Financial intermediaries; there is an international association of leasing companies presided by the current general manager of Leasing Andino, and its activities are mostly marginal. Actually, the legal framework seem to be perfectly comfortable for leasing firms' operations and for the participation of foreign investment in the segment; the provision for secrecy implied by their "non-financial" nature in the eyes of the economic authority may, however, represent a problem promoting what financial institutions and activity need the least: a lack of transparency. The trauma lived during the current crisis had serious effects on the public and on the government perception of financial activity and this "double standard" may prove to present more disadvantages than conveniences.

5. Case Study: The Leasing Andino S.A.

This firm is a representative case for analysis; it has been the leader in market share (over 50% of leasing operation) and presents us with a full set of accounting and commercial information.

Shareholders

The original shareholders included two local banks, B.H.C. (Banco Hipotecario de Chile) and Banco de Chile, the largest commercial bank in the country, two local investment companies, Inversiones Huelen and Soc. de Inversiones y Servicios CPA. And also Banco de Vizcaya which has the largest leasing firm in Spain, Leasing Vizcaya LISCAYA

This structure reflected the leadership of the BHC group who brought in Lizcaya and arranged for the completion of the initial paid-up- capital with other local firms related to BHC's holding. The two investment companies were 100% owned by BHC's owners, while Banco de Chile was then under their control.

In January 1980 Banco de Vizcaya reduced by half its share transferring it to Orient Leasing Co., a leading Japanese leasing firm, with more than 20 international subsidiaries.

Shareholders	% of Shares 1978	1980	1983
Banco de Chile	10.0	10.0	7.36
Inmobiliaria	-	-	17.65
BHC	15.0	15.0	7.26
Inv. Huelen	10.0	10.0	11.03
Inv. Valle Central	-		6.60
Soc.de Inv. y Serv.CPA	15.0	15.0	-
VIZCAYA (Bco. Vizcaya)	50.0	25.0	25.0
Orient Leasing	-	25.0	25.0
	100	100	100

During 1982, as a result of the intervention of BHC and Banco de Chile by the state authorities the situation of this company changed significantly. On the one hand, the government named an intervening commission for the entire of BHC's holdings, including the bank and inter-related firms - among them the two companies associated in the Leasing Andino. This Commission forced into bankruptcy BHC, the bank, and started to liquidate the local investment Companies which were transferred to the control of Banco de Chile.

On the other hand, Banco de Chile, the largest domestic commercial bank, was too important to be sent into bankruptcy, and for its rescue the Government named another intervening commission. This commission reached a business agreement with the BHC group, displacing them entirely from the board of directors. The patrimonial inter-twinnings were too complex for a rapid solution; so far some deb have been transformed into equity as is the case with Soc. de Inversiones y Servicios CPA and others have been given in payment to the Banco de Chile as a creditor. Actually, the final outset of this property conflict has not been settled yet; the government's options are divided: one is of direct statization of the whole bank as the entire position of the bank is <u>de facto</u> supported now by the Central Bank. The other is of an interim period where the State manages the bank and does not apply ownership's sanctions to share-holders, until some degree of normalization allows for a return to private

The second alternative has so far prevailed. For Leasing Andino this means that the entire 50% of local shareholders are identified with the current administration of Banco de Chile, this is to say, the intervening commission named by the State.

ii) Organization of Management

Leasing Andino was promoted by the BHC group, then a highly diversified and very aggressive holding led by a local entrepreneur (Javier Vial). The group saw the opportunities in the leasing business, having many of the potential clients among their own inter-related firms; they lacked, however, an experience in leasing. Hence, the association with Banco Vizcaya; they had Lizcaya, a leading firm in Spanish leasing while the bank had a goo presence in the international financial world. Banco de Vizcaya had a representative office in Santiago, which participated in financing agreements with the BHC Group.

BHC took the responsibilities of management; the foreign associates accepted to participate only at the board level. At the beginning, the executive board was constituted by 8 members, 4 representing local interests and 4 from Bco.de Vizcaya. The President has been a BHC representative and the vice presidency a man from Vizcaya.

The members of the local group were simply general administrators with experience in handling BHC's business; the members of the Spanish group turned - generally - to be staff executives of the Banco de Vizcaya, Representative Office in Santiago. Also there is an executive committee with 5 members (a local general manager, and 4 board members), whose task was to maintain a closer scrutiny over the operations. Within this Committee one of the two Spanish executives was brought from Lizcaya; the other was a representative from Bco. Vizcaya office in Santiago.

The General Manager has always been a staff member of the BHC group; in a working relationship with the board president, this presents the advantage of having an administrator with a strong knowledge of the potential clients in BHC's holdings and a direct access to decision making levels within these other companies.

The contributions of Bco. de Vizcaya - and Lizcaya - seem to have proven short of BHC's expectations. The presence of leasing experts in Santiago was limited, weakening the possibilities for a wide transference of leasing techniques; Banco de Vizcaya seems to have participated more through their Representative Office in Santiago than through Lizcaya. And the contribution in tapping financial sources for Leasing Andino also seem to have resulted much limited than expected. In fact, besides the normal capital contributions, Banco de Vizcaya only loaned a token half of million dollars and only for a short term during 1980-1981. Much of these results may be attributed to evolution of business not simply in Chile, but in Spain as the rush of private capital to move out after the death of Franco diminished.

Apparently, BHC and Banco de Vizcaya agreed to search out for a third associate who could contribute with technology and contacts for obtaining additional financing. In January 1980, Vizcaya yielded half of its share to Orient Leasing Co. from Japan. This introduced a modification in the organization of management over Leasing Andino S.A. : two japanese staff officers were brought into the board, one as an executive advisor. They had no prior international experience but were company executives in the Japanese sense of the term; they have been more involved in the operations of the local company, participating more in strategical assessments and in the negociation of new and important loans with banks, especially with Japanese banks.

Leasing Andino shows a high turn over of management executives; the fundamental principles ruling the structure of the board and of management have remained basically the same, but in 4 years there was a succession of 3 presidents and 3 general managers, which obviously affects the company's consolidation, and the relationship with the foreign associates. These latter, instead, have maintained practically the same representatives at the board level. But considering that BHC's problems have been so devastating, the present situation is of relative'normality' for the leasing firm; furthermore the last restructuring of control over Leasing Andino's local owners has not implied a change of president or of general manager, who remained reporting to the interests of the new authority, Banco de Chile.

The company now will have to seek and compete more for leasing contracts, since they no longer enjoy the advantages of a captive users' market. Probably, because of the collapse of BHC, board members and managers will stay longer now with the leasing firm; now, there is no exposure to the standard personnel norms promoting executives through the ranks of the holdin from within different companies and positions. Banco de Chile's more conservative managerial structure has been reinforced after the shakes of intervention.

For the foreign participants, the venture has proven quite rewarding in spite of the costs infringed by BHC's bankruptcy and dismantling. Currently there is a sort of transition towards years of more dynamics and competition which must be used to consolidate a strictly professional management detached from the kind of extensive control exerted by any particular local or foreign group.

iii) Choice of specialization

Leasing Andino has developed financial leasing, with no particular specialization in any specific field. Originally, it expected to concentrate its operations equipping offices for other firms related to BHC; but in fact for most of the years reported, the firm shaped a rather stable portfolio with one third allocated for industrial equipment and machinery, one third in real state and the other in computing equipment. Such distribucion proved to be an advantage for the firm vis à vis many of its competitors which specialized in leasing e.g. transportation equipment and construction, sectors which suffered massive defaults because of the 1980-1982 crisis. This distributed portfolio shows two exceptions: in 1982 when real state contracts represented almost a third of allocated contracts and 1983 when over half of the leasing contracts realized during the year corresponded to computers. The situation observed in 1982 reflects a highly abnormal operation, apparently realized under BHC compulsion, which also had a serious impact on that year's profits.

Sectorial Allocation of Leasing Contracts
in percentage

	1980	1981	1982	1983
Industrial Equipment	24.1	18.8	13.8	21.2
Transport, Equipment	12.1	7.7	3.2	0.7
Construction Equip.	19.3	8.5	6.0	0.5
Real State	5.9	18.3	30.3	1.6
Vehicles	15.5	13.2	6.8	10.0
Telecommunicatiob Eq.	4.2	8.9	5.0	6.0
Computing Eq.	17.3	11.7	23.6	60.0
Other	0,6	1.9	11.2	-
	100.0	100.0	100.0	100.0

iv) Operations

For Leasing Andino, business meant obtaining medium and long term financial loans at competitive conditions vis a vis commercial banks and other financial intermediaries and placing leasing contracts at a stable spread.

There existed another potential source of operational income which could be realized to the extent that the sourcing of funds determined liabilities of a longer profile than the collection of leasing payments from its allocated contracts; this explains a transitory but effective over abundance of funds, which could be used to extend further leasing contracts without having to demand equivalent additional credits on other financial investments generating higher returns than related costs.

Indeed, Leasing Andino obtained most of its funds at 4-8 years and Libor + 2 % while leasing contracts were 24-36 months with interests of Libor + 8% in the case of dollar denominated transactions and +18% in the case of Ch. peso denominated contracts . Most of the company's financing involved dollar liabilities or fixed dollar denominated contracts and, using the flexibility of an indifferent denomination of monetary obligations for domestic firms, allocated mostly dollar denominated contracts, except for about 10% equivalent to peso denominated credits obtained from local banks and other currencies. The interest rates are currently mostly variable with a few exceptions given the unstable evolution of the exchange markets since 1982.

The structures of assets/liabilities can be derived from the company's public reports 1980-1983.

On the side of assets, the outstanding operational characteristics were the following.

1. Fixed assets have remained practically the same required for the initial investment, showing that the start-up expenses required were a sort of a lump sum expense not subject to correlation with a growing volume of operations; most likely the dimensioning of fixed assets requirements allows even for more expansion.

2. Circulating Assets. The most important characteristics suggest a relatively stable evolution of the firms investments in leasing. The short term components have been maintained between 15 million and 30 million; their contracts in 1983 shows the effects of stagnatant trend in the Chilean market and of Leasing Andino since 1982, but this is also the explanation of the significant growth observed by short term deposits, assets which only reflect the company's over abundance of funds as a result of the gap between long term liabilities and leasing contracts; in fact, the bank deposits exceeded 10 million by the end of 1983 and continue to dominate to the present day the operation of Leasing Andino.

3. Other assets. Other longer term investments in financial leasing show the same trend than evolving from approximately 24 m in 1980 to 56 m in 1981 and then began to diminish.

Leasing Payments Forthcoming (US$ thousands)	1980	1981	1982	1983
Circulating	12.537	17.156	23.334	13.340
Other	16.072	38.041	22.155	14.620
	28.605	55.197	45.489	27.960

Leasing Debts (US$ thousands)	1980	1981	1982	1983
Circulating	3.069	7.892	7.332	5.447
Other	7.580	17.478	14.981	5.733
	10.649	25.391	22.313	11.180

On the other hand, the structure of liabilities indicates the importance of banking financing, mostly in dollar denominated loans.

Structure of Liabilities (US$ thousands)	1980	1981	1982	1983
Short term	5.371	7.949	2.962	6.019
Local Currency	418	1.125	616	862
Foreign Currency	1.069	4.776	4.441	1.842
Long Term	21.713	35.291	33.655	29.910

The figures of Asset/Liabilities show the period of rapid expansion of Leasing Andino until 1981 and the rapid contraction during 1982/1983. The company was able to increase the annual placement of leasing contracts from zero to over US$ 60 m by the end of 1981 earning interest in the differential transactions allowed by their arrangements of a long term financing.

Leasing Contracts (Placements at end of year) and interest earned (US$ million)

(US$ millions)

	1978	1979	1980	1981	1982	1983	1984
Leasing contracts	4.8	13,3	29,7	62.0	23.5	6.3	12.0
Interest earned	0.5	2.9	5.2	10.1	11.6	6.8	-
on leasing	0.5	2.8	4.7	9.1	9.8	6.1	-
on bank deposits	-	-	0.6	1.0	1.8	.7	-
Interest paid	-	-	2.9	5.8	8.6	4.7	

Actually, the profitability of this operation can be derived from the evolution of its capital account and other financial statements.

Operational Results

(US $ millions)

	1980	1981	1982	1983
Operational results	2.5	4.30	1.56	2.1
Adm.expenses *	1.1	2.1	0.1	1.2
Net result	1.1	2.1	0.1	1.2

* excluding depreciation administration

Net Operational Profitability

(%)

	1980	1981	1982	1983
Net Operational result over Assets	3.1	3.7	0.02	2.7
Net operational result over capital	40.0	44.0	0.31	38.0

The efficiency of expenses is actually quite significant. The effects of the devaluation of the chilean peso obviously improved the situation as the company went through extensive rationalization and moderation because not only of the general economic situation but also because of the particular situation of BHC' holdings.

An unexpected advantage was presented during 1983, as the Company was granted the opportunity to renegotiate all of the F/C liabilities under the broader terms obtained by the government with foreign creditors.

The total debt reprogrammed during 1983 excludes only that with Banco de Chile because of regulation against inter-related firms. This is in dispute; the term is quite favorable; a 7% interest charge; a one year grace period over schedules liabilities. This reduces considerably the cost of long term liabilities, originally obtained at higher rates, and therefore improves the projected earnings of the company within the coming years. With the reduction in rates observed in the international markets and the structured rates changed in allocated leasing contracts, these trends have allowed the generation of sufficient funds to cover losses and provisions generated by the 1982-1983 crisis and improve the profitability expected for the coming period.

v) Capitalization

Capital Accounts, Leasing Andino S.A.

(thousands of US dollars)

	1979	1980	1981	1982	1983
Paid-up Capital (Net Balance)	781,6	782,2	2.258,1	4.368,0	2.652,9
Capital Reserves	505,6	505,6	505,6	505,6	505,6
Other Reserves	14,1	14,1	14,1	18,0	18,0
Capital Increases	-	998,4	1.000,0	-	-
Profits (67,4)	(67,4)	477,5	1.113,9	(1.714,6)	45,7
Total Equity	1.122.9	2.777.8	4.891.7	3.177,0	3.222.7

Originally, the Leasing Andino was established an investment of approximately US$ 1 million. But the shareholders were committed to subscribe a total capital of US$ 4 million. During 1978 and 1979 there were slight losses expected because of start-up and market introduction. During 1980 the shareholders capitalized all of that year's profits and added US$ 1 million more in capital contribution; total paid-up capital increased to US$ 2.78 million.

Again, 1981 profits were capitalized and this time the shareholders, including the new Orient Leasing, added about US$ 1 million in capital contribution, increasing paid-up capital and reserves to US$ 4.9 millions. During 1982 Leasing Andino lost about US$ 3 million in one single contract (with one of BHC firms) and overall losses for that year were US$ 1.7 millions, reducing the firm's equity to US$ 3.1 million at the end of 1982.

The situation has not changed since then; the last year was a break even as profits became slightly positive. But, in fact, during last year, 1983, Leasing Andino improved its portfolio, writing-off many contracts and re-selling immediately the assets recuperated while it made adequate provision to cover shaky contracts. Thus, the structure of the firm is healthier now in spite of the reduction in profits observed. 1984 will be a highly profitable year for them.

vi) Financing

The structure of liabilities shown in table 2 of the Appendix indicates the relation between short term and long term financing. The following list shows banking lenders and the use of supplier's credit by year end. An important characteristic is the prominance of Banco de Chile and Banco Andino (Panama) as lenders to Leasing Andino. Both banks represent local interests originally controled by BHC and now in the process of liquidation or intervention by the

Chilean government; their involvement in financing has exceeded by far that of any particular foreign associate. Apparently, with the introduction of Orient Leasing in 1980, the presence of both foreign associates was intended to extend the access of Leasing Andino to the credit markets, but the turn of events in Chile and in particular of BHC prevented this to materialize; nevertheless, the profitability of the leasing business as such and the consolidation of Leasing Andino as a solid firm,allowed for a ready access to local lenders.

Long Term Financing
(Thousands of US dollars)

L/T Liabilities	1980	1981	1982	1983
Bco. de Chile	6.279.4	15.710.7	12.872.2	11.780.3
Marine Midland	2.000.0	2.000.0	2.000.0	1.430.0
Banco Andino	571.4	285.7	5.571.4	5.142.9
Libra Bank S.A.,	1.000.0	666.7	333.3	-
Bco.de Ind. y Com. Sao Paulo	500.0	300.0	100.0	-
Bco.Sud Americano	1.709.9	1.477.0	1.058.1	915.3
Crocker Nat.Bank	333.3	-	-	-
Bco.Urquijo(Spain)	500.0	500.0	-	-
Bco. O'higgins (Ch)	466.7	388.9	233.4	233.4
The Marbar Corp.	1.333.3	-	-	-
Bco.de Stgo.(Ch)	2.450.0	3.829.1	3.680.0	3.177,0
Bco.do Stado de S.P. (Brazil)	240.0	120.0	-	-
BHC	17.8	10.5	-	-
Bco. BICE	-	761.9	590.5	335.3
The Sauwa Bank	-	-	2.000.0	2.000.0
Bk.Européene pour L'Amerique Latine	-	-	1.000.0	1.000.0
Bank of Tokyo	-	-	2.428.0	2.728.0
Suppliers	-	1.422.0	827.0	539.9

With scheduled obligations going much beyond the scheduled collections and profiting from interest rate differentials enlarged by renegociation processes, Leasing Andino is in the best of positions for a period of consolidation and expansion.

Profile of Banking Obligations					
	1982	5.094.8		-	-
	1983	3.579.3	6.349.6	-	-
	1984	3.573.3	6.689.7	8.047.3	-
	1985	3.130.3	5.991.9	9.253.1	8.509.9
	1986	1.774,1	5.706.0	6.027.3	5.310.3
	1987	757.8	2.916.7	3.123.7	4.739.9
	1988	-	2.135.1	2.634.1	3.809.3
	1989	17,910.4	1.167.8	1.682.1	1.782.7
	1990		1.342.9	1.231.9	1.988.2
	1991		1.544.5	1.544.5	2.198.8
			33.785,4		
Average Cost of Credit		LIBOR +3.03	LIBOR +2.64	LIBOR +2.25	LIBOR + 2 *

* renegociated

However, there is a considerable inflexibility to transfer these advantageous factors to potential users of leasing. Indeed, current rates remain quite high; this is partly explained by an overcautious assessment of the markets and partly because in 1984 there is still no clear evidence of : 1) where will the international financial market go in the coming months - with a prediction of a scalating lending rate towards the end of the year; and 2) where will the domestic market go as exchange rates are predicted to devalue and inflationary conditions, to generate extensive changes in the stability of the economy and of potential users.

Hence, Leasing Andino seems more prepared to face a period of non-operational financial gains from accrued funds and incoming funds than from an aggressive attack on the market. The reactivation of the domestic economy is beginning to strengthen the demand for equipment and capital goods and leasing could play a strong role as a financial mechanism, but rates would have to come down significantly, in order to tap the market vis a vis other lenders. In the post crisis period,it seems apparent that the role of government will be stronger,coordinating financing indirectly through the banking and credit system and therefore leasing may be confronting a tough competition.

The present strategy of Leasing Andino seems to point out towards a standstill in face of coming events waiting for this transition period to show a definite course not only of economic trends, both at the domestic and international level.

vii) <u>Strategy and Conslusion Remarks</u>

Leasing Andino's business have been consolidated in spite of the many set backs infringed by the 1982-1983 crisis and the collapse of the main local shareholders, BHC. There are good prospects for the future, as the firm has strengthened significantly its financial position and has cleared its portfolio. With larger provisions and much lower costs for its liabilities, the current sense of consolidation within the Company appears justified.

APPENDIX

Leasing Andino S.A.	1980	1981	1982	1983
Total Assets	36.043.3	57.908.0	47.353.0	44.683.8
(Thousands of US dollars)				
Circulating Assets	15.747.1	23.456.7	23.323.8	27.831
*Cash Bank Sight Deposits	817,3	107,0	154,5	197,1
*S/T Bank Deposits (net)	1.606,5	1.282,5	1.484.9	10.801,9
*Collection	-	7.040,2	-	-
*Investments in Financial Leasing (net)	11.126,0	11.939.8	16.813,6	13.339.9
(Leasing payment forth-coming	(12.532,5)	(17.155,0)	(23.334,0)	(18.180,6)
(Leasing debts contracted)	(3.068,6	(7.891,6)	(7.332,1)	(5.445,6)
(Non collected income)	-(4.399.1	-(9.212,9)	-(8.862,5)	(5.718.8)
(Non collected IVA)	-	(3.883,8)	-(4.690,6)	(3.655.8)
(Provisions)	-(76.0)	(61.0)	-(299.5)	(911,6)
*Debtors	(512.9)	734.2	1.585.3	781.2
*Taxes reimbursables	1.115,6	1.300.3	61.2	-
*Anticipated paid expenses	488.8	661.8	971.1	248.4
*Central Bank anticipated retention	-	390.9	333.7	107.9
*Materials for reallocation	-	-	1.919.5	2.254.4
Fixed Assets	722.7	722.7	716.4	677.5
* Real State	410.0	411.0	410.6	511.1
* Furnishings, installations	228.0	369.7	408.3	223.1
* Vehicles	183.4	-	-	-
Accrued Depreciation	- (60,0)	-(27,0)	- (57.7)	- (29.2)
Depreciation	- (31.0)	-(30.6)	- (44.8	- (27.4)
Other Assets	19.566.8	33.728.6	23.312.8	16.175.0
* Investments in Financial leasing (net)	18.483.3	31.937.8	21.154.7	12.117.0
(Leasing payments forth-coming)	-(16.071,9	(38.041.4)	(22.155.1)	(14.620.7)
(Leasing debts contracted)	(7.530,4)	(17.498.1)	(14.980.8)	(5.733.)
(Non-collected income)	(5.040,9	-(17.761.4)	(11.646.3)	(6.173.6)
(Non-collected sales tax	-	-(5.679.5)	(3.958.1)	(2.063.1)
(Provision)	-(128.01)	-(161.5)	(376.8)	-
* Central Bank(retention)	693.1	355.9	622.1	514.3
* Reimbursable taxes (difered)	327,6	104,4	49,9	50.0
* Start up expenses	62,7	38,3	12,3	-
* Other anticipated expenses	-	1.292,2	1.473,5	472,5
* Other rentals	-	-	-	3.352,2
* Long Term Deposits	-	-	-	183.3

Leasing Andino S.A.

Total Liabilities

(Thousands of US dollars)

Circulating liabilities	11.552,4	17.725,6	10.520,8	11.550,8
* Banking Creditors	5.370,9	7.949,0	2.961,8	6.018,7
* L/C Accts.coming due	417,7	1.235,1	616,1	863,4
* F/C Accts. due	1.069,3	4.775,6	4.440,7	2.842,1
* Provisions	37,7	674,3	578,1	500,4
* Taxes due (sales tax)	2.506,7			
* Interest provision	784,5	1.500,4	1.446,5	965,2
* Provision for acquisitions.	1.194,5	1.591,1	477,6	181,4
* Other provisions	170,4	-	-	179,7
Long Term Liabilities	21.713,2	35.290,8	33.655,2	29.910,3
* Banking creditors	14.507,9	23.239,9	24.638,8	23.188,5
* F/C Accounts due	3.402,6	10.545,5	9.016,4	6.538,6
Capital and Reserves	2.777,7	4.891,6	3.177,0	3.222,7
Capital	782,2	3.777,7	4.891,6	3.177,0
Reserves	14,0	18,0	-	-
Revaluation,accrued reserves	505,6	-	-	-
Capital increases	998,4	-	-	-
Profits	477,5	1.113.9	(1.714,6)	45.7

LEASING ANDINO S.A.

* Financial Statements
(Thousands of US Dollars)

	1980	1981	1982	1983
* Gross Operational Income	5.321,7	10.109,8	11.610,3	6.765,6
* Leasing interests	4.668,3	9.120,8	9.769,2	6.105,8
* Banking interests	656,4	988,9	1.841,1	659,9
* Operational Costs	2.875,0	5.805,4	8.593,4	4.705,7
- Interests paid	2.698,0	5,662,3	8,158,8	4,070,2
- Banking commissions	176,9	143,1	434,3	635,5
* Gross Income	2.446,7	4.304,4	3.016,9	2.059,9
- Adm.& Sales Costs	1.337,8	2.149,9	1.447,0	838,4
- Depreciation & Prov.	216,2	75,7	5.258,1	45,5
* Net Operational Income	847,7	2.078,8	(3.588,3)	1.176,0
* Non Operational Income	103,0	87,2	1.873,6	9.5
- Non Operational Expenses	19,9	-	-	1.139,8
- Tax provision	453,3	1.052,0	-	-
* Net Profit	477,5	1.113,9	(1.714,6)	45.7