BANK FINANCING TO SMALL AND MEDIUM ENTERPRISES:

SURVEY RESULTS FROM ARGENTINA AND CHILE

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Abstract

This study describes the main features of the supply side of SME financing by analyzing the perceptions of banks in Argentina and Chile regarding lending to SMEs. To do so, we collect new and unique evidence from a significant number of banks in each country (covering a large proportion of total assets) through on-site interviews, a tabulated questionnaire, and a data request. We find that the SME segment is a strategic sector for most banks. Banks are focusing on SMEs because they perceive the market as highly profitable, large, and prospects are optimistic. We also find that banks have developed coping mechanisms to overcome the obstacles in SME financing. However, they have not fully adapted their business and risk models to reflect the complexity of the segment; knowing the client is still crucial. SME financing is in the midst of a structural change, not just at a juncture. There seems to be an ongoing learning process through which banks are developing the structure and mechanisms to deal with SMEs, adapting their business models to reduce the high costs and improve the risk management of the segment. We conclude that there seems to be a new, profound trend developing: banks have discovered a key, untapped segment and are making substantial investments to develop the relation with SMEs. We expect that lending practices and risk management will change substantially in the years to come, as the involvement with SMEs matures.

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1. Introduction

The financing of small and medium enterprises (SMEs) has attracted much interest in recent years and has become an important topic for economists and policymakers interested in financial and economic development. This attention is driven by at least two factors. First, SMEs account for a very significant share of manufacturing employment, so their viability is important to overall employment levels in an economy.[1] Furthermore, most large companies usually start as small enterprises, so the ability for SMEs to develop and invest becomes crucial to any economy wishing to prosper. Second, SMEs tend to be financially constrained and lack of access to finance is an important obstacle to their growth. In fact, in both developed and developing countries bank financing to SMEs is not perceived to be significant.[2]

SMEs appear to be different from the rest of the private sector in terms of access to finance. Relative to other companies, SMEs are perceived to be left out of the formal financial channels. SMEs hardly raise funds in capital markets. Moreover, the banking system is thought to have developed a “U-shaped model” that leaves the SME segment underserved. According to this model, banks focus on the two extremes: consumer and micro-enterprises on the one hand and the corporate sector on the other, due to the SME idiosyncratic factors that deter their financing. Banks want to finance large corporations because they tend to be stable, have visible assets, their risk is easy to assess, and their management and projects are easy to evaluate. They constitute natural clients since they are main players in the economy. At the other extreme, there are consumers and micro-enterprises, which are atomized clients. Their very small size allows banks to diversify risk and to reduce costs (since they are mostly offered standardized products). Between these extremes are SMEs, which are not as diversifiable or homogenous as consumers and micro-enterprises, but are more complex and unstable than corporations. These reasons, in conjunction with the belief of lack of worthy demand and the weakness of the legal and contractual environment, support the perception of low bank involvement with and interest in the SME segment.[3]

In this study, we analyze whether this conventional wisdom of lack of financing opportunities for SMEs is supported by the data. In particular, we focus on the supply side of the SME loan market and study in detail the banks’ perceptions about lending to SMEs. To do so, we interview a wide range and a significant proportion of banks in Argentina and Chile. We concentrate on banks because they seem to be the main providers of external finance (from the formal sector) to SMEs in Argentina and Chile, and they can also provide key services that capital markets are unable offer, such as technological or administrative support. The comparison

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[1] Ayyagari, Beck, and Demirguc-Kunt (2003) show that from 1990-1999 the share of SME sector relative to GDP is above 35% for Latin American countries (53% in Argentina) and SMEs constitute over 60% of total employment in manufacturing in many countries.

[2] Beck, Demirguc-Kunt, and Maksimovic (2004) show that smaller firms finance a greater share of investments with informal sources of finance, such as moneylenders, family, and friends. However, the source of finance varies greatly across countries; for example, in Argentina 60% is financed through firms’ resources and 19% through banks (second source for total finance), while in the new member states of the European Union 66% of SMEs’ financial needs are satisfied by banks.

[3] See de la Torre, Gozzi, and Schmukler (2007).

between the two countries is interesting because they are neighbors, they are both growing, emerging economies, and they have implemented many financial reforms over the last decades. Both Argentina and Chile experienced the arrival of foreign banks during the 90s, which now hold a significant market share. Moreover, Chile suffered an economic slowdown after the Asian crisis, during 1998-99, while Argentina had a severe economic crisis during 2001-02, which involved reprogramming of bank deposits, the conversion of dollar deposits to peso deposits, and debt default. Both economies recovered afterwards, with their banking systems affected in very different ways and with heterogeneous perceptions about how the financial and contractual systems work in each country.

The approach we take to analyze banks is based on on-site interviews with banks' top management, the use of a tabulated questionnaire, and the collection of unique data on bank lending to SMEs, which are not available to the Central Banks of each country. The interviews and data processing are confidential, so banks felt practically no constraint in sharing their information, with the understanding that the data would be reported in an aggregate way, without disclosing each bank's strategy or positions. The questionnaire is designed to address three broad areas, which are described in this study. The first area tackles banks' involvement with SMEs. The second area focuses on the determinants of the degree of bank financing to SMEs, such as demand factors, competition, corporate strategy, and macroeconomic, regulatory, and institutional factors. The third area attempts to understand the business model and risk management process that banks use when working with SMEs.

To conduct the study we interviewed 14 banks in Argentina: six foreign, six domestic private, and two public, which account for 75% of the banking system's total assets.[4] In Chile we interviewed eight banks: four foreign, three private domestic, and one public, which represent 79% of the banking system's total assets. In each bank, the team tried to carry out separate interviews with the general manager (to understand the determinants of the bank's involvement with SMEs), the SME business manager (to assess the business model for dealing with SMEs), and the credit risk manager (to comprehend how risks are controlled). In general, we were given ample access to each bank and we were able to ascertain, with different degrees of detail, how banks deal with the SME segment, what business models they use, and how they conduct their risk analysis. Although at several banks we were not able to meet with all of the mentioned managers, we were still able to interview the person the manager had chosen to represent him/her. In other cases, more managers than expected joined the interviews. In a minor fraction of banks, we were not given the opportunity to spend enough time in order to complete the entire questionnaire.

Of the banks interviewed, all of those that have SMEs among their clients completed the questionnaire that we provided, although in several cases not all questions were answered. Areas that are not covered extensively in this study due to the lack of sufficient responses are those mainly related to provisioning and capital charges, the contribution of SMEs to the bank's revenues, costs, and risks, the growth projections of the segment, and information related to the non-performing loans portfolio. As for the data collection, in Argentina we were able to obtain hard data

[4] Total assets stands for liquid assets, public and private securities, loans, and other banks' assets.

from 12 banks, and from seven banks in Chile. However, most of the data we received are only partial; we could obtain complete hard information for a limited number of variables. This hampers our ability to reach certain conclusions regarding the evolution and the present situation of bank lending to SMEs.

In terms of the analysis of the information obtained from the questionnaires, the percentages presented in this study are always calculated based on the sample of total banks interviewed that have SMEs among their clients (13 Argentine banks and eight Chilean Banks). The percentages are usually calculated for the aggregate sample of Argentina and Chile, and when considered relevant, these percentages are presented by country or type of bank.

The main findings regarding how banks perceive lending to SMEs in Argentina and Chile are the following. First, SMEs have become a strategic sector for banks. This reflects a gap in perceptions since it contradicts the common belief that banks are not interested in serving the SME segment. Second, banks are focusing on SMEs because they perceive that the segment's elevated profits will more than compensate for the higher implied costs and risks; they consider that the SME lending market is large, unsaturated, and prospects are optimistic. Third, since banks have developed coping mechanisms, there are no significant obstacles impeding banks from entering the segment. Fourth, risk management is separate from sales, mostly centralized but not largely automated. The business and risk models do not yet reflect the complexity of SME lending, so knowing the client is still crucial. Fifth, we believe we are in the middle of an on-going learning process, where banks are developing the structure to deal with SMEs: they are adapting their business and risk models to reduce the cost and risk of the segment. We conclude that there seems to be a new, profound trend developing: banks have discovered a key, untapped segment and are making substantial investments to develop the relation with SMEs. We predict that the models to work with SMEs will evolve significantly as the involvement with the SME segment increases.

The study is organized as follows. Section 2 presents some stylized facts on bank involvement with SMEs. It explains the criteria to define the SME segment and describes the extent of SME lending. Section 3 addresses what is behind these stylized facts. It describes the drivers and obstacles, government programs, and characteristics of the market environment. Section 4 focuses on how banks engage in lending to SMEs, describing their business models and their risk management. Within the business model, the general structure and the products offered to SMEs are specified in detail. Within risk management, the organization of risk analysis, the monitoring and credit exposure analysis, and the management of the non-performing loans portfolio are evaluated. The last section concludes by making some final remarks and describing ways to complement and improve the analysis presented in this study.

2. Some stylized facts on banks' involvement with SMEs

In this section we present some stylized facts on SME lending. First, we examine the criteria banks use to define the SME segment. Second, we describe the extent of banks' involvement with the segment in Argentina and Chile. We illustrate the type of relation banks are developing with SMEs and the products and services banks are offering to them. We also assess the contribution SMEs are making to banks in terms of income, costs, and risk.

2.1. What is an SME?

All the banks interviewed use average annual sales to classify the SME segment. However, a variety of ranges is observed, indicating that there is not a unified criterion to define the segment as a whole. In Argentina, the Central Bank and the SME Secretary (SEPyME) have established their official definitions for small enterprises (SEs) and medium enterprises (MEs), but most banks do not follow either of them. The fact that banks do not adopt similar definitions for SMEs reflects the heterogeneity of the banking system. For example, large international banks usually serve SMEs with high average sales, while small banks tend to focus on smaller SMEs.

The ranges of average annual sales used to classify SEs and MEs differ between Argentina and Chile, reflecting the different size of their economies. In Argentina, a company is considered to be an SE when its average annual sales are approximately between US$300,000 and US$5,000,000. MEs are those with annual sales between US$5,000,000 and US$30,000,000. In Chile these ranges have lower values: SEs have average annual sales of approximately US$90,000-US$1,600,000 and MEs of US$1,600,000-US$2,3800,000.[5] See Table 1. All the companies with average annual sales below these ranges are considered to be micro enterprises and those above belong to the corporate sector. It should be noted that in Argentina, loans of AR$500,000 (US$ 166,667), or less can be treated as consumption loans according to Central Bank (BCRA) regulations, even when they are granted to a company (as long as the total debt the client has with the bank does not exceed this amount).

In the rest of the study, we ignore the heterogeneity of ranges observed in the definition of SMEs and use whatever definition banks use to define them. To some degree, this makes the comparison across banks with very different definitions difficult. Nonetheless, it is useful to analyze how banks conduct business with what they consider to be SEs and MEs. Moreover, it would be very difficult to construct another working definition.

2.2. Extent of SME lending

Banks' involvement with SMEs in Argentina and Chile appears to be significant. All banks interviewed have SMEs among their clients, with the exception of one Argentine bank, which is planning to enter the middle-market segment ("MEGRAS," which stands for medium and large enterprises). See Figure 1.A. The

[5] These ranges were calculated as the average minimum and the average maximum values of the criteria banks use to define SEs and MEs.

importance of the SME segment has increased to the point that more than 80% of the banks interviewed have created a separate unit to serve it.[6] In both countries there appears to be an integral relation with SMEs. Approximately 86% of the banks interviewed offer SMEs deposits, loan products, and other services, such as payrolls or cash management. See Figure 1.B. Some banks offer services first as a way to get to know the client and then offer investment products. Other banks prefer to attract clients with lending products and then offer payroll or cash management services to increase cross-sale.

Bank lending to SMEs is mainly short term.[7] The most important lending products are short-term loans and overdrafts both in Argentina and Chile, followed by leasing and investment loans, as indicated by Figure 2. Pre-trade financing is also considered important in both countries. Document and check discounting is the second leading product in Argentina but is not mentioned at all by Chilean banks, while factoring is a very important product in Chile but is not considered significant by Argentine banks. However, these products are similar since they enable companies to receive payments in advance at a certain discount. The main difference between check discounting and factoring lies in the instrument that is being discounted: in Argentina it is relatively easy for the bearer of a check to claim the corresponding payment since the check is an "executive title," while the bearer of a company receipt is unable to do so because company receipts are typically not executive titles.[8] In Chile "the use of factoring has been facilitated after a recent legal reform that made the *factura* an executive title."[9] Differentiating by bank type, foreign banks seem to offer SMEs the largest variety of products, while private domestic banks mainly offer leasing, short-term loans, and investment loans. Public banks focus on pre-trade financing and also short-term and investment loans.

Banks have a significant level of exposure to the SME segment in terms of loans, and this exposure is higher in Argentina than in Chile. The exposure to SMEs is measured as the ratio of SME loans to total outstanding private sector loans (including retail). In 2006, SMEs represented 37% of total bank loans to the private sector in Argentina and 14% in Chile.[10] These ratios are very similar for 2005. See Figure 3.A. Also see Figure 3.B for a scatter of the information provided by individual banks from Argentina and Chile for 2006. The level of exposure of the *most involved* and *medium involved* banks is unexpectedly high, representing on average 62% and 28% of the banks' loan portfolios respectively.[11] See Figure 4.A. On average, private domestic

[6] In Argentina 77% and in Chile 87% of banks interviewed have separate SME, or SE and ME units.

[7] For 111 institutions of Latin America and the Caribbean, a survey conducted by FELABAN (2004) shows that 52% of the banks offer short-term commercial loans for working capital investments, 14% of these banks include long-terms loans, and 18% do not have an active credit policy.

[8] An instrument is an "executive title" if it is established by law that the payment obligation it represents must be met. This category cannot be established by the parties involved in a transaction, but rather it can only be designated by law since it reflects a public interest that the obligations in certain types of instruments are fulfilled. Therefore, the holder of an "executive title" can forcefully demand the compliance of its payment. In Argentina some receipts can become executive titles if they are certified, which are then called "facturas conformadas," but this is not usually done in practice.

[9] Quoted from bank interviews in Chile.

[10] The banks that provided this information and that are considered in this average account for 64% of total private sector loans in Argentina and 80% of private sector loans in Chile.

[11] These are simple averages of the ratio of SME loans to private sector loans for the banks that belong to each category: *most involved* and *medium involved* banks. The *most involved* banks are the top third

banks are the most exposed to the segment in both countries, with a level of exposure of 56% in Argentina and 16% in Chile. In Argentina, private domestic banks are followed by public banks (31%) and foreign banks (27%), while in Chile they are followed by foreign banks (12%) and public banks (6%).[12] See Figure 4.B.

Despite the increasing importance of SMEs, most banks are not yet able to measure their exposure to the segment in terms of income, costs, or risk. Almost half of the banks do not keep track of the share of total net income generated by SMEs nor the SME revenue breakdown between deposits/account management, credit, and other transactions and fee-based services. Furthermore, most banks (around 70%) do not have an assessment of how much SMEs contribute to the banks' total risk or to the banks' total costs. Many banks claim not to have adequate mechanisms in place to obtain this information, but are actively trying to develop them. This suggests that banks are experiencing a learning process about how to deal with SMEs. Through this process, banks adapt their structures to increase profits and reduce the associated costs and risks of the segment.

SMEs contribute to 17% of banks' net income in Argentina and 24% in Chile (but consider that we only received this information from half of the banks in each country).[13] See Figure 5.A. In 2006, for 25% of the banks, SMEs represented less than 25% of the bank's total net income and for 20% of the banks the contribution was between 25% and 50%. See Figure 5.B. As for the revenue breakdown, all types of products seem to have a significant importance in the total revenue generated in the banks' SME segment, with a slightly higher proportion coming from credit products.[14] On average, credit represents 38% of the banks' SME revenue, while deposits and account management represent 25% of the revenues, and other transactions and fee-based services account for 29% of the revenues.[15]

3. What is behind these stylized facts?

This section aims to describe the factors that drive banks' increasing focus on SMEs. First, we present the drivers that foster this involvement and, second, the obstacles to SME lending, as identified by banks. Third, we examine banks' perceptions of the market environment regarding size, prospects, level of competition, and demand. Fourth, we explain banks' assessment of the main government programs that aim to increase SMEs' access to finance.

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of banks with the highest share of SME loans as percentage of total loans. The l*east involved* banks are the bottom third of banks with the lowest share of SME loans as percentage of total loans. The *medium involved* banks are the ones that do not fall in either category.

[12] These ratios are calculated as the sum of SME loans over the sum of private sector loans considering the banks belonging to each category of bank type (public, private domestic and foreign).

[13] The banks that provided this information and that are considered in this average account for 23% of total private sector loans in Argentina and 41% in Chile.

[14] Wyman (2006) estimates that small banking generates 16% of global total banking revenues and this percentage is expected to grow at around 10% per annum for the next three years. This, however, is an underestimate given that part of small banking revenues is accounted as retail banking revenues.

[15] These percentages do not sum up to 100% due to the fact that each value is the average of the percentages reported by banks for each product category, and some banks have not provided answers for all categories.

3.1. Drivers

To understand their interest in SMEs, banks were asked to indicate the drivers of SME lending and to describe how significant these factors are in defining their level of involvement with the segment. We find a clear agreement in both countries on four main drivers that we describe below. See Figure 6.

First, banks are motivated to have SMEs as clients by the high level of perceived profitability of the segment. A large majority of the banks consider that they will attain elevated profits that will more than compensate for the higher costs and risks of the segment. The high profitability of working with SMEs not only derives from lending products, but also from the potential for cross-sale. Once the relation with the company is established, banks offer clients a variety of services and obtain an extremely significant proportion of their revenues from the fees they charge for these services. The potential for cross-sale that SMEs entail does not imply higher risk because no lending is involved. Furthermore, many banks perceive the SME segment to be more profitable than corporate banking. One possible explanation for this could be that in the latter spreads are near zero due to high competition in both countries, so banks are looking for new markets to diversify their income sources. It can be noted that in Argentina the perceived risk of the corporate segment has increased due to the fact that SMEs performed better than large companies during the 2001-2002 crisis. The Argentine crisis was particularly harmful for large corporations, especially utilities companies, although the recession the country experienced affected all the sectors of the economy. In this context, SMEs did not default by as much as large corporations, they made efforts to comply with their debt payments, and they recovered more quickly from the crisis.

Second, one of the most frequently mentioned driver of SME involvement in Argentina is the possibility to seek SMEs through relations with existing large clients. However, in Chile this is considered as a driver by only one fourth of the banks interviewed. Banks systematically ask large clients for references on their best clients and suppliers. With a list of potential clients, banks contact these companies and try to convert them into clients by offering services or lending products, depending on the banks' strategy. The benefit banks reap from this is not only that banks obtain an assessment of the quality of these SMEs from large clients, but also that these SMEs are supported by operating with these large corporations, who in some cases also provide guarantees. Thus, banks gain very useful information and reduce the risk of seeking new clients.

Third, more than 40% of the banks (exclusively private ones) consider the SME segment to be a strategic sector. This is the third most mentioned driver in Argentina (54% of banks), while in Chile is the fourth (25% of banks). The increased interest in the segment can be understood as a result of the change in industrial organization that Argentina and Chile have witnessed in the past few years. In the early 1990s, companies tended to be vertically integrated, so by serving a large company banks were able to service the entire chain of business. However, in the past five years large companies started to outsource processes to the SME segment, tending towards a modular integration, in which SMEs carry out these outsourced processes. At the present, if banks want to service the entire chain of business they may need to lend to the SMEs that are responsible for the outsourced processes.

Banks seem to have a new role as financial entities: to finance the SMEs that carry out the outsourced processes and that tend to be supported by large corporations.

Fourth, another key driver, mentioned by more than a third of the banks as a reason for their interest in SMEs, is intense competition and exposure to the retail and/or corporate sectors. In Chile, the excessive exposure to other segments appears to be extremely relevant, since 75% of the banks consider it a key driver. The decreasing profitability noted in other segments, which is due to high competition, has induced banks to focus on SMEs. This is particularly the case for the corporate segment, where spreads are near zero. A similar phenomenon is also observed in the consumer and micro segments in Chile. In Argentina the consumer segment does not show decreasing profits; nonetheless, bank participation has grown in that segment at a rapid pace for the last five years, so it may be near saturation. This could explain why the future growth of Argentine and Chilean banks appears to rely strongly on the SME segment. In Chile some banks indicate that they have "no other choice" than to start serving the SME segment since competition and exposure in other segments are the main factors banks mention, while in Argentina a broad variety of drivers is considered.

Some banks lend to SMEs because they define themselves as universal banks and aim to serve all the economic segments (consumer, small, medium, and large enterprises), while others are targeting the segment because of the synergies generated when reaching out to the SME labor force as consumer clients. All public and cooperative banks state that they lend to SMEs because they have a social objective to do so. As one Argentine banker stated, "the idea is to grow organically in the business, instead of through acquisitions."

3.2. Obstacles

We now turn to a discussion of the obstacles banks encounter when dealing with SMEs. Surprisingly, many of the obstacles often viewed as deterrents of engagement with SMEs are not considered significant by most banks. There are also some differences in perceptions across countries, which we highlight when significant. We proceed now to list the five most important obstacles and to illustrate how they are perceived in Argentina and Chile.[16] See Figure 7, Table 2, and Appendix Figures 5, 6, and 7 for more detailed information.

First, one of the obstacles to serving SMEs is related to SME-specific factors. These are factors related solely to SMEs and not to other firms that operate within the same regulatory and contractual environment. SME-specific factors are the only obstacle considered significant by both Argentine and Chilean banks (50% of the banks in each country). As for the SME-specific factors considered most important, informality and low quality balance sheets in Argentina, lack of quality information in Chile, and lack of adequate guarantees in both countries stand out.[17] Note that lack of quality information is not mentioned at all by Argentine banks, but it is likely implicit

[16] Obstacles are ranked based on the importance they have in the aggregated sample of Argentina and Chile.

[17] To increase the level and quality of information available to banks on firms (large corporates and SMEs), the Central Bank of Argentina is working towards the establishment of a "central de balances." This database will contain economic and financial information about the business activity of firms.

in the response related to informality. In Chile, when explaining the lack of quality information, banks mention that SEs have limited and non-standardized information and that financial statements are prepared only once a year (mainly for tax reporting purposes); besides, the cost to improve the information on SMEs are high and must be absorbed by the bank. Other factors stated are problems related to evaluating SME risk, the weakness of family management, the lack of SME associations for cooperation, and the fact that SMEs auto-exclude themselves from the banking system.

Second, competition in the SME segment is considered a significant obstacle by 70% of the Argentine banks while in Chile it is not regarded as significant (only 13% of the banks mention it as an obstacle). This of course is based on the banks' perspective; while high competition is perceived as an obstacle by banks, it benefits SMEs. Narrow margins and the distortions generated by public banks are considered to be important issues related to the high competition in the segment. The existence of niche banks and regional banks, the unfair competition of large private banks, and the fact that private banks usually dominate the high quality segment are also mentioned. In Argentina, large and public banks are considered price-setters; they are perceived to set "predatory prices" to capture a larger share of the SME segment. This is particularly harmful for small and niche banks that do not have enough margins to compete with low rates. One important finding is that interest rates on loans do not necessarily reflect the risk of the client: they are established by the high competition among banks. Domestic private banks consider competition in the SME segment as a key obstacle, while foreign and public banks do not. As mentioned above, foreign and public banks (and also the largest domestic private banks), are the main price setters in the market. Therefore, the small and medium domestic private banks have to compete with low rates to stay in the market and increase their market share.

Third, another relevant obstacle mentioned is macroeconomic factors, which is considered significant by almost half of the Argentine banks, and by only 13% of the Chilean banks. Long-term instability, taxes, disincentives to foreign investors, and exchange rate risk are the main aspects banks mention in terms of macroeconomic obstacles. In particular, foreign banks give macroeconomic factors the greatest importance, while public banks do not even consider them impediments. One possible explanation for this could be that banks have developed coping mechanisms to deal with long-term instability, such as using short-term loans, secured loans, and variable rates. It is surprising that the other half of the Argentine banks do not consider macroeconomic factors significant, given that the Argentine crisis occurred only six years ago.

Fourth, regulations are regarded as significant by half of the Chilean banks, but by only 20% of the Argentine banks. In Chile regulations are considered to be the second largest obstacle to serving SMEs. The interest rate ceiling that banks face in Chile is the most frequently mentioned factor. In Argentina, although banks consider regulations to be reasonable, they also argue that many regulatory aspects could still be improved. First, documentation requirements continue to be costly for SMEs and could be simplified to some extent. Second, regulations impede banks to lend to SMEs with pension debts or tax arrears. Third, more flexibility to deal with the large informality of SMEs (especially the smallest ones) is mentioned. Fourth, regulatory requirements are more demanding for banks than for other financial intermediaries such as *mutuales* and cooperatives (which are not regulated by the Central Bank), leading SMEs to obtain financing outside of the banking system and, consequently, to observe “regulatory arbitrage.” Fifth, taxes on financial transactions in Argentina and Chile (check tax and stamp tax, respectively) have a negative effect on SME lending because they deter financial intermediation of SMEs. This reduces the ability of banks to learn about some clients by looking at their history of banking operations. Although the stamp tax is only mentioned by Chilean banks, some Argentine provinces are also affected by a stamp tax. In neither country do public banks consider regulations to be a significant obstacle, while domestic private banks in both countries claim that regulations are an impediment.

Fifth, lack of adequate demand is thought to be significant by half of the Argentine banks interviewed, while none of the Chilean banks see it as relevant. Although some banks consider demand to be strong, they point out that many SMEs are not creditworthy (or not as creditworthy as they could be) due to the high levels of informality. In Argentina, anecdotal evidence from the interviewed banks suggests that around 30% of the SMEs are served by financial entities. Most banks believe that there are plenty of worthy enterprises among the 70% that are underserved and that for unknown reasons do not approach banks.[18] Hence, there is strong competition over the high-quality SMEs that are already in the market and a strong outreach to those that are creditworthy and are still outside the market, in an attempt to increase their involvement with the segment. Also, banks state that SMEs demand mostly long-term loans with low fixed-rates, while banks primarily offer short-term variable-rate loans. Only one Argentine bank mentions that SMEs still lack confidence in banks after the crisis and that they prefer self-financing. Interestingly, banks declare that a large portion of approved credit lines are not fully used.

The obstacles given the lowest importance are the legal and contractual environment, the lending technology to SMEs, and bank-specific factors. Banks in Argentina acknowledge that the lending mechanisms and procedures are not simple, but they have developed know-how so that this does not represent an important obstacle. Some issues related to the legal and contractual environment are: the judiciary inefficiency, the weakness of contract and collateral enforcement, slow and costly bankruptcy procedures, and the weak protection of investors and property rights. Banks have adapted their products to counter such obstacles by offering short-term, secured products that can be easily converted to cash, and usually by demanding a personal guarantee from SME owners (or their spouses). They also avoid filing for bankruptcy, and they generally carry out debt restructuring and out-of-court settlements. The current macroeconomic situation, characterized by excess liquidity and low levels of default, is very favorable and mitigates these institutional deficiencies. Bank-specific factors are mostly mentioned by public banks, which recognize that they are more inefficient than private banks (in particular foreign banks), and they believe that this inefficiency discourages good SMEs to approach them. The lack of qualified personnel is mentioned by both Argentine and Chilean

[18] Another study (Fundación Capital, 2006) presents alternative reasons to explain the lack of demand for credit from SMEs in Argentina. Among them we can find that 45.3% of SMEs do not apply because they are using other sources or do not need financing, 13.4% consider that interest rates are too high, 4.3% think that banks ask for too many requirements like balances, cash flows, fiscal situation of the firm and years as a bank’s client, 3.4% of SMEs do not have a collateral and 2.6% do not trust in banks.

banks as an obstacle for bank involvement with SMEs. Other bank-specific aspects mentioned are the fact that banks are learning to do business with SMEs and that the geographic presence of banks is limited. As for the nature of SME lending technology, banks point out the high fixed-costs, the difficulty to standardize risk management and apply scoring, and the difficulty in standardizing products.

When asked about possible areas in which government action could help to enhance banks' appeal to SME lending, banks mostly mention the judicial, legal, and regulatory areas. See Figure 8.A. Regarding the legal and judicial areas, Argentine banks consider that judicial processes are slow and that bankruptcy and insolvency laws are ineffective, while Chilean banks mostly mention the distortive effects of the stamp tax. Regarding regulations, Argentine banks highlight the need to improve the definition of guarantees and consider that the frequency of information requests should be lower in some cases, while Chilean banks mention that the interest rate ceiling should be removed and would like to be able to share guarantees. In general, banks both in Argentina and Chile wish to increase guarantees or subsidies, and both are fairly comfortable with the institutional environment. Some of the institutional improvements that Argentine banks consider would be beneficial are related to law enforcement and collateral execution processes, which banks point out, are hindering long-term financing. According to Argentine banks, the government should continue promoting the development of reciprocal guarantee societies (SGRs). On the other hand, Chilean banks demand for an expedited payment of FOGAPE guarantees. (See Appendix Table 1 for a description of this program). More government work is needed to enhance credit bureaus, but the majority of the banks consider that the existence of public credit bureaus already plays a crucial role in facilitating SME lending. See Figure 8.B. In particular, Argentine banks state that the quality of the information should be enhanced and they would also like more information on companies, such as total amount of credit lines and guarantees in the banking system. Chilean banks would like financial statements to be available in order to assess companies' income-generating capacity.

3.3. Market environment

The SME market is promising, according to most banks. However, there is no agreement on the size of the market, even within the same country. The market is large according to 70% of the banks in Argentina and 50% of the banks in Chile, while it is considered to be small by around 30% of the banks in both countries. See Figure 9. This discrepancy is likely due to the fact that the SME universe is not clearly identified in either country. In Argentina, as an approach to resolving this issue, a program by SEPyME called "MAPA PyME," is being launched. This SMEs Sub-Secretary program tries to describe the SMEs' universe based on an assessment of all formal SMEs in the country.

Banks still have a fair amount of outreach to do despite the strong demand for bank services observed in the SME segment, according to 81% of the banks. See Figure 10. Although SME demand does not make use of all the available credit offered by the banking system, banks point out that demand is indeed growing strongly. However, as mentioned above, SMEs that seek credit are not always creditworthy. Many banks believe that there are "high-quality" SMEs that could benefit from accessing bank financing but that do not approach banks for unknown reasons. Therefore, banks feel the need to reach out to these SMEs. High competition over the best SMEs that are already in the market also explains the need to make efforts to attract new SME clients. Banks rely on the pro-active role of relationship managers, and some banks even carry out special campaigns to attract SMEs. One bank states that since SMEs do not react to advertisements as promptly as consumers, efforts to attract them are greater.

The market is highly competitive, but unsaturated. High competition in the SME segment could also explain the need to reach out to SMEs. As indicated in Figure 11, all the banks interviewed believe that the SME segment is competitive. However, there is no consensus on the degree of saturation of the market. 80% of the banks believe there is still room for new competitors, while the rest believes the SME market is saturated.

The structure of the SME loan market differs between Argentina and Chile, and there is no full agreement within the countries. Among Argentine banks, 62% of the banks perceive that the market is atomized, 23% believe a small number of banks dominate the market, and only 15% deem it to be segmented. In Chile, the answers are not as dispersed: 75% of the Chilean banks consider that the SME loan market is dominated by a small number of banks and 13% see it as a segmented market. To summarize, in Argentina most of the banks perceive the market to be atomized, while in Chile the prevailing belief is that a small number of banks dominate the market. See Figure 12.A.

The main players in the SME market are large private banks, according to the majority of the banks in Argentina and Chile. They are followed in importance by public banks and niche banks. Other financial intermediaries and small banks also play a relevant role in the SME loan market, although a minority of the banks interviewed consider these to be main players. See Figure 12.B.

There have been significant changes over time in SME lending in terms of competition, consolidation, and entry, according to 70% of the banks. In both countries many banks have participated in the segment for years, but others are entering with very aggressive policies. Another significant finding is that almost 62% of the banks in both countries believe that banks lend to SMEs after seeing other banks do so. Almost 60% of the banks believe that there is a first mover's advantage: client's loyalty, brand identification, and know-how of the market are the most frequently mentioned advantages. Although more than half of the banks answer that there is a first movers' advantage, the difference in perceptions is significant across bank types. Most private domestic banks consider that a first movers' advantage does exist while public banks deny it. Most foreign banks answer affirmatively in Argentina. In Chile the process of capturing SME clients appears to be more advanced than in Argentina: while in Argentina SMEs usually have five or six banks serving them in different aspects of their business, the Chilean market has evolved to the point that an SME is only served by one or two banks, which offer an ample variety of products and services to fulfill the needs of SMEs. In Chile the importance of the relationship manager appears to be crucial for SMEs when choosing banks.

3.4. Government programs

The Argentine and Chilean governments have implemented several programs to promote the involvement of banks in the SME segment. Even though only half of the banks interviewed claim that they use these programs, 80% believes their overall effect is positive. However, these programs are not an important determinant of banks' involvement with the segment. Indeed, banks do not base their relation with SMEs on these programs. Banks might use them, but they are not the key driver of their involvement. Although all types of banks view these programs favorably, in terms of additionality generated there seems to be some disagreement.

In Argentina, all banks are familiar with government programs, but none consider them essential. The most frequently mentioned programs are the interest rate subsidies offered by the SME Secretary (SEPyME), and the Argentine National Guarantee System (that includes Reciprocal Guarantee Societies, SGRs). FONTAR (Argentine Technological Fund), and the credit lines offered by the IADB are also mentioned but banks do not believe they have a significant impact. See Appendix Table 1 for a detailed, but brief description of these programs. Most Argentine banks believe that the additionality generated by these programs is very low. Although 90% of the banks use the interest rate subsidy, they claim that they do not make use of it to attract new clients, but rather to lower the rate or increase credit to existing clients. Only a few private domestic and public banks state that the SEPyME interest rate subsidy generates additionality. The SGRs are employed by almost 20% of the banks interviewed and they are mostly used to increase the credit line to existing clients. Only private domestic banks claim that these guarantee societies allow them to attract new clients.

Most Chilean banks make use of government programs and believe these programs do generate additionality. In Chile the programs FECU-PyME (Uniform Codified Reporting Scheme for SMEs), CORFO (Corporation for Production Promotion), and FOGAPE (Small Enterprise Guarantee Fund) are considered most relevant by banks. See Appendix Table 1 for a detailed, but brief description of these programs. Most Chilean banks indicate that the programs FOGAPE and CORFO do generate additionality, mainly by attracting new clients. Foreign banks seem to be among the ones that benefit the most from these programs. FECU-PyME is mostly used by private banks, but they do not see it as a program that generates additionality, while Chile Compite is only used by one private domestic bank interviewed.

4. How do banks engage in lending to SMEs?

This section describes the mechanisms banks have developed to deal with SMEs and increase their lending activity. First, we explain in detail the business model banks are using, discussing the business structure and the products offered to SMEs. Second, we examine the risk management practices by describing the risk analysis, the monitoring and credit exposure analysis, and the management of the non-performing loans portfolio.

4.1. Business model

4.1.1. Structure

The conventional wisdom that SMEs lack proper financing (the U-shaped financing models mentioned above) is not supported by the evidence collected in the survey. Banks are now financing all the segments of the economy: consumers, small enterprises, medium enterprises, and the big corporate sector. Banks have developed SE and ME units to facilitate working with SMEs, and in some cases just SME units, separate from the consumer and corporate units. The relation with the segment occurs both through branches and headquarters, depending on the bank structure. However, some common patterns can be detected.

Banks perceive the SME segment as more profitable, riskier, and more costly than other segments. For this reason, banks are focusing on reducing the costs and risks of lending to SMEs. To reduce costs banks are increasing the efficiency of processes, reducing information technology (IT) costs, and standardizing the products offered. To control risk, banks are trying to increase diversification (atomized loans), get to know the client, capacitate sales personnel, review risk management models, and develop standardized risk procedures, such as scoring.

Banks present two main types of organizations to serve the SME segment. The first combines the work of a commercial and credit risk team established at headquarters with relationship managers (RMs) distributed throughout the branches. The second creates business centers or regional centers that operate as mediators between headquarters and branches, with a team leader or regional manager that controls and trains the RMs of the corresponding branches. These business centers are generally established using regional criteria (such as peripheral and metropolitan centers). In Chile, the first type of organization is more common. However, in both countries the role of the relationship manager is crucial: RMs look for new clients and prepare the information of each SME that is presented at the regional centers or at headquarters. They develop a relation with the client and, in some cases, they are allowed to express their opinion, make recommendations, or even present the case at the credit committee. Banks in Chile, and to a lesser extent in Argentina, are training RMs in risk management to improve their capacity to identify the credit quality of new clients and to reduce the number of inadequate cases presented to the credit committee.

Banks serve SMEs at almost all of their branches. See Figure 13. On the one hand, some banks consider branches to be small banks within the bank, performing the same duties as the bank headquarters. On the other hand, some banks consider branches to be only delivery and client-servicing channels, while half of the banks have branches that also execute some back-office functions. In Chile, there is a high degree of agreement over the fact that, in general, branches perform back-office functions. In Argentina, the disparity of opinions is higher across different bank types: public banks consider branches small banks within the bank, foreign banks state that they perform back-office functions, and private domestic banks show diverse structures of organization.

In most cases, branches and headquarters complement each other and undertake different functions. The initial stages of granting a loan to SMEs are decentralized in most banks, while later stages, such as risk analysis or loan recovery, are usually centralized. As indicated in Figure 14, in half of the banks, branches are in charge of pre-screening loans and selling non-lending products, while headquarters retains control over loan approval, risk management, and non-performing loan recovery. Approximately one-third of the banks interviewed point out that branches and headquarters share control over loan approval and non-performing loan recovery. In many banks the branches have a determined autonomy to grant loans up to a certain amount, above which loans are approved by headquarters.

Bank exposure to SMEs appears to be indiscriminate across sectors and regions. Most banks interviewed do not have a specific sector or geographic focus for targeting their SME clients. See Figure 15. Commercial and agro sectors are mentioned by some Argentine banks as main sector-specific targets, while one bank claims to revise its targets annually based on sector and geographic performance. A geographic focus based on branch location is also mentioned by a few banks. In Argentina, some banks cite a special focus on the Great Buenos Aires area and several other regions of the country; banks tend to focus on the SMEs that are near its branches in the capital city and/or in the main provinces.

Half of the banks acknowledge not having standardized processes to determine the SMEs they target. However, there seem to be some basic factors that banks take into account when selecting potential SME clients. In Argentina, almost 70% of the banks consider credit quality as a decisive factor when choosing SMEs; in Argentina and Chile, around one-third of the banks take into account the industry sector to which the enterprise belongs. For almost half of the Argentine banks, company size and expected profitability are the main measures considered when targeting SMEs; however these factors are not mentioned at all by Chilean banks. Other factors stated are the geographic area in which the company operates, exposure size, and product needs. Only 30% of the banks deny considering any type of criteria at all for selecting SMEs. See Figure 16.A. Only foreign banks claim to have a well-defined process to select SMEs, while private domestic and public banks say that they generally do not.

Most banks contend that the principal way to discover potential SME clients is through existing clients. SMEs that are clients or suppliers of existing clients appear to be natural candidates. In this way, banks exploit the synergies of working with different types of clients. Using information from existing firm databases, such as credit bureaus, relying on existing deposit clients, and attracting clients with bank credit are also main approaches that banks use to identify prospective SMEs. With a lower degree of importance, another practice observed is the incorporation of relationship managers from other banks, who bring their own client's portfolio. A very small percentage of the banks also reveal that they target SMEs that are located close to their branches. See Figure 16.B. The wide variety of methods that banks use to detect potential SME clients suggests the pro-active attitude of banks in reaching out to SMEs despite the strong demand. The approach to new SMEs does not seem to be standardized. Almost half of the banks reveal that they follow no particular sequencing in offering deposit or loan products to new clients. Almost 20% of the banks say that they first offer deposit and cash management products while another 20% say that they first offer credit.

The incentives that banks give to sales personnel are mostly based on the evaluation of the volume of loans that are granted, according to almost 90% of the banks. Approximately 60% of the banks evaluate sales personnel in terms of the number of clients they serve and the successful cross-sale of other banking products. Profitability and the volume of non-performing loans are also relevant, especially in Chile.

4.1.2. Products

The main products banks offer to SMEs are short-term loans (especially to finance working capital), overdrafts, leasing, investment loans, and document and check discounting, although this last product is not mentioned by banks in Chile. The macroeconomic uncertainty (related to the history of aggregate volatility) seems to deter the development of a long-term credit market for SMEs, in particular in Argentina, and also appears to be responsible for the small number of unsecured loans offered. In both countries, a high percentage of the banks' portfolios are collateralized.

Based on the data received from banks in Argentina, working capital loans represent approximately 60% of the SME loans, while investment loans account for almost 20% of the SME loans. In Chile, the distribution appears to be different since short-term and long-term products represent a similar proportion of total financing to SMEs; working capital and investment loans each represent around 40% of the SME portfolio. As for the term of investment loans, in Argentina the average term is 1,000 days while in Chile it is 3,700 days. See Appendix Figure 4. These stylized facts suggest that the SME lending market is more developed in Chile than in Argentina.

In both countries, SMEs are mostly offered standardized products, although the pricing of products is rarely standardized. In Chile more than 60% of the banks primarily offer standardized products, and this percentage falls to 31% in Argentina. Tailored products are mainly offered to SMEs in only 8% of the banks interviewed in Argentina and by none of the Chilean banks. See Figure 17. Similar ratios of standardized and tailored products are offered by only one-fourth of the banks in both countries. In most cases, sales personnel have the flexibility to modify the pricing strategy, but this flexibility is very limited. It is worth noting that banks might package standardized products in a way that seems more "tailor made" for SMEs, because they are adapted and customized to the needs of particular types of SMEs. For example, the maturity of short-term loans might vary by economic sector to match their production cycles and cash-flow streams, but in the end they are the same products. Other more sophisticated examples arise as banks are familiarized with their clients' needs.

Banks consider that regulatory requirements are either appropriate and beneficial or inconsequential. Many banks acknowledge that in absence of these regulations they would ask SMEs for the same information, although at the present they initially demand the documentation needed to classify the client and later complete additional Central Bank requirements. In some banks, the approval of document and check discounting is automatic and no specific documentation is required. Most banks require the same basic documentation regardless of the type of loan. Without pre-approved client limits, products are ready for disbursement within 11 to 20 days, while requests are processed more quickly under pre-approved limits, from less than a day up to nine working days on average. Document and check discounting receive the fastest approval in terms of requests without pre-approved limits, followed by short-term loans and overdrafts, leasing, and investment loans.

4.2 Risk management

4.2.1. Risk Analysis

In general, risk management is not largely automated; it is separate from sales and centralized at headquarters. It differs significantly among the micro, SE, and ME segments. Scoring models used for consumer lending are applied to small standardized loans, while rating models are down-scaled from the corporate sector and applied to MEs and tailored loans. For big loans, scoring is less useful. The complexity of the data requires the participation of credit risk analysts and a comprehensive qualitative and quantitative analysis. See Figures 18.A and 18.B.

Risk and sales departments have separate managers and in general both of them have to grant their authorization to approve a loan, according to 76% of the banks interviewed. See Figures 18.C. and 18.D. However, at many banks risk and sales are not separate for small loans, and in such cases sales personnel at branches have a higher degree of autonomy because the approval process is mostly standardized. Given that the level of sophistication increases for larger loans, risk assessments are required, and headquarters gains more control over the decision-making process (risk management is centralized at 75% of the banks). In some cases, sales personnel are encouraged to participate in the risk assessment because banks wish to train them to improve the filtering of loan requests at initial stages, and also because they tend to know the client better. Private banks have centralized risk management in both countries, while public banks have it decentralized in Argentina and centralized in Chile.

Banks consider the risk assessment of the SME segment to be an "art."[19] Scoring methods are not always applicable given that SMEs "are not that small" or homogenous. For MEs, the level of sophistication required is higher and loan approval cannot be automated. A majority of the banks alleged that risk management is not automated (81%) and that risk management is carried out by a credit risk analyst (57%). In Argentina banks adhere to the Central Bank regulations that require the incorporation of credit risk analysts for the assessment of loans of over AR$500,000 (US$166,667). The use of credit risk analysts to carry out risk management activities is not generalized across bank types in either country. In Chile, all foreign banks have credit risk analysts, while a majority of private domestic banks do not (i.e. 67%), because they do not separate risk from sales. In Argentina at a majority of private banks risk management is done mostly by credit risk analysts, while this is not the case at the public banks interviewed.

Scoring is only being used or developed for small loans and micro-enterprises

[19] As stated by one of the banks interviewed.

by approximately half of the banks. Banks that do not use scoring models state that this is due exclusively to a bank decision and is not affected by regulations. On the one hand, no companies are in charge of scoring and no good databases are available with long-term track-record of SMEs. On the other hand, the high levels of informality might invalidate the existing information available. When scoring results in a “grey” area, analysts generally intervene. There seems to be substantial room for improvement in the organization of risk management in the SME segment, as half of the banks have not incorporated standardized or automated risk analysis and analysts must assess SME clients case by case.[20]

Banks strongly rely on both qualitative and quantitative risk assessments that are not automated and that demand the participation of credit risk analysts. The quality rating of SME management and SWOT (Strengths, Weaknesses, Opportunities, and Threats) analysis are the main components of qualitative assessments, while the financial analysis and projections of the SME and its owner are the main quantitative assessments made. Qualitative assessments usually include an analysis of the SMEs’ products, their demand and market structure, the quality of the owners and managers (including the degree of separation between management and owners), the degree of informality, the years of activity in the sector, and the vulnerability to foreign exchange rate. Quantitative assessments entail profitability, cash flow generation capacity, solvency, quality of assets, structure of the balance sheets, and global guarantees. See Figures 19.A and 19.B.

Scoring models used for consumer lending are applied to small standardized loans in around 40% of the Chilean banks and almost 50% of the Argentine banks.[21] See Figures 20.A and 20.B. Only 5% of the banks use both country and sector-specific scoring models. Most banks that use country-specific scoring models do not have a sector-specific model. The application of scoring models differs across bank types: in both countries, private domestic banks apply scoring models, while public banks do not. Most foreign banks use them in Argentina, but none use them in Chile. In their scoring models, banks generally give equal importance to information on the owner and on the SME. However, the weight given to the information on the owner increases for smaller companies since their performance is more closely tied to the practices of the owner. See Figure 20.C. The high levels of informality, especially in Argentina, also explain the importance given to information about the owner in scoring models.

Banks obtain their information mostly from internal sources and credit bureaus, and the main variables taken into account are credit track records, sales performance, and the level of indebtedness in the system. Other variables considered are liquidity, solvency, loan type and amount, state of the commercial chain, credit bureau information (“Veraz” in Argentina), the management experience, cash flows, economic sector, guarantees, and marital status of the owner.[22] The main complaint

[20] According to FELABAN (2007), 70 banks out of the 111 they surveyed say that they evaluate SMEs’ financial risk on a case-by-case basis.

[21] These figures differ from the findings in a recent report by the Central Bank of Argentina (2006). According to it, 13 of the 17 banks interviewed that participate in the retail segment (a total of 20 banks was interviewed) use scoring methods in their loan granting process.

[22] “Veraz” is an Argentine private company that contributes to the transparency of the credit market by collecting, processing, and providing adequate and efficient information, reflecting the credit track

from banks in Argentina is that after the crisis it became harder to distinguish between good and bad SMEs due to the generalized cessation of payments that occurred. Since no long-term history of SMEs is available, credit risk analysis becomes difficult. Banks take into account the informal side of a company when doing risk assessment. However, banks determine the amount of an SME loan based on official information presented, because when SMEs are in trouble they are only accountable for what is stated on their balance sheets. Banks would like to increase the amount of loans, and request SMEs to reduce the level of informality in order to do so.

Following the corresponding risk assessments, loan approval is subject to the compliance of mandatory collateral requirements, according to most banks interviewed. See Figure 21.A. However, these collateral requirements usually depend on the loan type and characteristics of the company. Approximately 70% of the loans require collateral, and the collateral requirement represents, on average, 96% of the loan amount. Banks usually require some basic collateral based on the product. Additional collateral varies with the characteristics of the company and the particular request made. Some banks mention that their collateral requirements are more flexible the larger the size of the company and others stress that the requirements are stricter for long-term loans. Some banks always require SMEs to present a personal guarantee from the owners and additional collateral depends on the loan type, while some banks offer signature loans for loans up to 180 days. Private banks require collateral for SME loans as a general rule, while public banks state that it depends on the case. Both movable and immovable collateral are generally accepted by banks with few exceptions. Industrial plants, fields, and properties are the most-frequently mentioned immovable collateral accepted, while schools, clinics, and owners' houses are not usually accepted. In general, banks prefer collateral that is easiest to execute in case of default; nonetheless, banks do not assume that they will be able to execute the collateral for its full value. In fact, many banks specifically state that they do not grant a loan with the expectation of executing the collateral. The judicial process is very slow and costly, and banks only maintain these strong collateral requirements as an incentive for debtors to repay as agreed.

Collateral requirements are higher for SME loans relative to large corporate and consumer loans, according to almost 40% of the banks. Some banks believe that SMEs are not necessarily intrinsically riskier than other segments but that they demand different products that require more collateral. SME loans have higher collateral requirements than consumer loans because the probability of an SME defaulting is harder to evaluate, according to 24% of the banks. SME loans are larger and their risk is less diversifiable. The fact that scoring cannot be applied to evaluate SMEs and also that consumers "cannot disappear" the way SMEs might are other reasons why collateral requirements are higher for SMEs than for consumers. See Figure 21.B. Relative to the corporate sector, SMEs have higher collateral requirements because they are more unstable and harder to evaluate than large corporations, according to 29% and 24% of the banks, respectively. Also, SMEs are more informal and tend to have worse management than large corporations, according to 19% of the banks. SMEs' weak solvency and the fact that they usually have one owner are other reasons stated for having higher collateral requirements. See Figure 21.C.

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records of individuals or enterprises.

4.2.2. Monitoring and credit exposure analysis

All the banks interviewed have an annual approval cycle for credit limits. These limits are usually established per SME or per lending product as a sub-limit of the total enterprise limit, as indicated in Figure 22. Limits by sector of economic activity are less important but many banks are trying to incorporate them. In most cases credit limits cannot be exceeded because automatic controls in the bank system reject the processing of operations that surpass the limits imposed, according to a third of the banks.

Credit risk analysts must adhere to the credit limits at most banks. They can override limits when considered necessary at only 10% of the banks. At one-third of the banks only top-level management is allowed to override limits, while at one-fourth of the banks limits can be overridden by low-level management, depending on the situation. For example, some banks mention that temporary excesses can be authorized by low-level management while permanent excesses have to be approved by top-level management. Also, the amount of excess determines whether low- or top-level management can authorize it. The level of approval can also depend on the rating of the company: the higher the rating the greater the approval power at lower levels. However, in most cases the person or group that establishes the limit is frequently the only one authorized to change or review these limits. In Chile, there is no policy addressing who is authorized to change credit limits at 50% of the banks (it depends on the case), while in Argentina mostly top-level management is authorized.

Credit risk outlook is standardized at the majority of the banks. Some monitoring mechanisms used widespread are preventive triggers and alerts automatically generated to signal the deterioration of the SMEs' payment capacity. However, credit risk monitoring still depends on the diligence of the relationship manager or the credit risk analyst in almost 40% of the banks. See Figure 23. Some banks use a system that allows different individuals to provide input on each enterprise (such as auditors, back-office area, commercial area, and risk analysts). Branch managers are in charge of the daily monitoring of limits while top-level managers or committees at headquarters review monthly, quarterly, or annually the compliance with limits according to the importance of the enterprise. In Argentina, SME compliance with credit limits is monitored daily at almost 70% of the banks interviewed.

Half of the banks interviewed do not manage their exposure to SMEs using a portfolio approach. In Chile, 50% of the banks use this approach, while in Argentina this percentage is only 38%. See Figure 24.A. Banks that do have a portfolio approach tend to diversify through sector allocation and, to a lesser extent, through geographic allocation and scale (especially in Argentina). In Chile, the portfolio exposure is monitored per economic sector by 50% of the banks and per geographic allocation by almost 40%. This information is not available to most of the Argentine banks. See Figure 24.B. The use of a portfolio approach seems to be a new trend among the banks interviewed. Banks in Chile are more developed in this area; around 30 percent of the banks interviewed carry out stress tests for their portfolios, analyzing the effects of shocks of the currency, GDP, commodity prices, and slow-downs in any of the sectors in which SMEs participate. The use of a portfolio approach is not as common in Argentina, even though some banks do carry out stress tests for commodity prices or interest rate shocks. However, in both countries stress tests appear to have a limited or null impact on the banks' involvement with SMEs. One possible reason is that banks are experiencing a learning process, working to improve the portfolio approach to make it more influential in the future. The difference between Argentina and Chile regarding the use of portfolio approach could be due to country differences in terms of the geographic location and organization of the productive sector. Banks in Chile appear more capable of identifying economic sectors and groups of SMEs as targets.

4.2.3. Management of the non-performing loans (NPLs) portfolio

The management of the non-performing loans portfolio (NPLs) is one aspect of the banking relation with SMEs that will likely face substantial changes. Banks do not appear to be keeping accurate performance data of loans after they are classified as non-performing. Although most banks interviewed have an SME loan recovery unit, they do not track the amounts recovered, the length of time, or the costs it takes to recover an SME loan, and past default experiences do not feed into any risk or commercial model in most cases. See Figure 25. One possible explanation for this is that the amount of NPLs as a ratio of total private sector loans is historically low both in Argentina (around 4%) and Chile (almost 1%). The banks' increased focus on SMEs has taken place in conjunction with a strong reduction in the NPLs portfolio, so banks do not have an opportunity to analyze these data. Even though banks do not currently have the information to carry out this type of analysis (given that they have not experienced many defaults in the recent years), they could be developing the mechanisms to store the data for future use in their risk models.

Banks carry out similar actions once a loan is classified as overdue, although the definition of an overdue loan changes across banks and countries. See Figure 26.A. A loan is considered to be overdue between day 1 and day 30 of being non-serviced in 33% of the Chilean banks and in 43% of the Argentine banks. Only 14% of the Argentine banks consider a non-serviced SME loan overdue if it is non-serviced for more than 30 days. Once a loan is classified as overdue, banks initiate several recovery procedures. Some of the most-frequently mentioned actions are: calling the client from the commercial or credit risk department (depending on the bank), initiating the process to obtain repayment, assessing the situation to understand why the client has difficulties repaying, suspending the client's credit lines, and visiting the client. If none of these actions yields positive results, the loan is transferred to the recovery unit or to the legal department. Most banks try to settle the loan repayment through negotiations with the client instead of initiating payment intimations. See Table 3.

In both countries, the banks' practices (in some cases stricter than regulations), determine that a non-serviced SME loan is re-classified as non-accrual after 60 to 90 days. See Figure 26.B. Only a minority of the banks waits more than 90 days to do so. Once this happens, most banks initiate judiciary action, which might be a reorganization proceeding or bankruptcy.[23] Some banks claim that in most cases they do not file for bankruptcy because it is too costly, but rather they resolve the situation with a repayment plan or judiciary action to third parties involved, trying to reach a favorable agreement.

[23] Reorganization proceeding stands for "concurso preventivo" in Spanish.

Most of the banks interviewed do not apply a standardized restructuring policy for non-performing loans. Banks are generally unwilling to do partial loan forgiveness and try to tailor the restructuring of the loan as long as the client has the capacity (and willingness) to repay the debt. Banks tend to prefer an interest rate reduction or a term extension for the loan, but in most cases the restructuring depends on the particular loan and client.

Most of the interviewed banks have a dedicated SME recovery unit. In Chile, all the banks interviewed have an SME recovery unit. However, recovery operations are outsourced in 80% of the banks; this could be due to the fact that currently not many default cases have been reported, so having a unit within the bank prepared to take care of all the default cases may be costly and unjustified.

Very few banks keep track of some basic information regarding past default experiences or the behavior of the NPL portfolio. Even though in Argentina and Chile approximately 70% of the banks keep track of the loss after default, only 43% keep track of amounts recovered versus amounts under default; 38% do not keep track of the costs to recover an NPL for SMEs, and in almost 50% of the banks past losses do not feed into an estimate of the minimum interest rate spread to cover expected loss or of capital requirements. In Chile, 88% of the banks claim that they keep track of the length of time it takes to recover a loan, while in Argentina only 48% answer affirmatively. See Figure 26.C.

We believe the current management of NPLs might change when the number of NPLs in the banking system increases as a percentage of total private sector loans. The average number of years it takes to recover an SME, the average percentage share of SME loans recovered, or the average costs to recover an SME loan are not reported by more than 80% of the banks, who acknowledge that they do not keep track of these variables. Many managers are not aware of the evolution of these variables because they have not dealt with these issues in recent years; even if banks do keep track of this information, the data are usually stored by the legal department or recovery unit, and the commercial and risk managers are not aware of their status.

5. Conclusions

In this study we explore the perceptions of banks in Argentina and Chile regarding lending to SMEs. To this end, we interviewed and collected new and unique data from a significant number of banks in both countries, which shed new light on the relation between banks and SMEs. We were able to complete questionnaires for all the banks interviewed, although in many cases banks did not answer all the questions. Areas that are not discussed in detail due to lack of sufficient responses are mainly those related to provisioning and capital charges; the contribution of SMEs to the bank's revenues, costs, and risks; the growth projections of the segment; and information related to the non-performing loans portfolio. As for data collection, in Argentina we were able to obtain hard data from 12 banks, and in Chile from seven banks, although the data received are incomplete. With the information obtained we conducted the analysis in this study. The main findings are summarized below.

First, SMEs have become a strategic sector for banks. This signals a gap in perceptions since it contradicts the common belief that banks are not interested in serving SMEs. We offer two possible explanations for this new strategy of focusing on the SME segment. First, this change might be explained by the decreasing profits in other segments, which encourages banks to look for new markets when the chances to grow based on the consumer and corporate sectors decline. Banks focus on SMEs because they perceive that the segment's elevated profits will more than compensate for the higher implied costs and risks. The SME lending market is perceived to be large and prospects are optimistic. Second, banks are attracted by the increasing participation of SMEs in the productive chains of the economy. This occurs in a context of apparently significant changes in industrial organization, in which large corporations outsource processes and actively support their SME clients and suppliers in order to foster their own growth. The importance of the SME segment has grown to the point that most banks have created separate units to serve it. This relation has become integral since banks offer SMEs a great variety of services and lending products. Although the SME universe is not clearly identified in Argentina or Chile, banks are aware of the large number of high-quality, untapped SMEs that could benefit from accessing bank financing and consequently banks are actively reaching out to them.

Second, banks have developed coping mechanisms to overcome the obstacles in SME financing that discourage them from entering the segment. Interestingly, the institutional and regulatory environment is not considered a binding obstacle to SME financing by most banks. Indeed, banks have developed the mechanisms to deal with informality, regulation requirements, documentation and paperwork burden, and the costly constitution of guarantees. As part of these mechanisms, banks have limited the range of products they offer to SMEs to cope with macro-level obstacles.[24] They offer mostly short-term, secured products, making an intense use of immovable guarantees and always demanding the owners' guarantee. In addition, the favorable macroeconomic conjuncture mitigates the institutional deficiencies since the banking system shows high levels of liquidity and non-performing loans are historically low (as a percentage of total private sector loans).

Third, risk management is separate from sales but is not largely automated at most banks. Knowing the client is still crucial because banks have not yet developed adequate models to reflect the complexity of SMEs. Scoring models are still being developed and are primarily applied to small loans. At the moment, banks base their lending decisions on quantitative and qualitative risk models, and on subjective assessments.

Fourth, banks are developing the structure and the mechanisms to work with SMEs. Although banks appear to be more involved than expected, they are still not able to measure their exposure to the segment in terms of income, costs, or risk. Thus, we believe we are witnessing a learning process in which banks are developing the structure to deal with SMEs: they are adapting their business and risk models to reduce the costs and risks of the segment.

A lingering question remains, how much of the above-mentioned

[24] The ability to cope with risk is observed in emerging economies in general; see de la Torre and Schmukler (2004).

developments in SME financing are a trend, and how much are due to the current macro stability and low interest rates observed in Argentina and Chile? There is evidence of flight to quality when rates rise, and SMEs could be more vulnerable to GDP volatility than large corporates. Hence, part of the move towards SME lending could be explained by the overall stability and low rates. Nevertheless, the evidence presented in this study seems to point to a new, profound trend developing: Argentina and Chile appear to be facing an embryonic “bancarization” of the SME segment. Banks have discovered a key, untapped segment and are making substantial investments to develop the relation with SMEs. We expect that lending practices and risk management will significantly change in the years to come, as the involvement with SMEs matures.

Our analysis points to some possible explanations for the gap between the common perceptions of what banks are doing and how banks perceive the financing opportunities presented by the SME segment. The first explanation is that the gap was caused by the rapid changes the banking system has been experiencing in recent years. In this respect, the message is: be patient, out-dated perceptions will likely catch up soon. The second explanation relies on the fact that, on the one hand, the common perceptions and SMEs are focusing on what is not happening (the lack of long-term, fixed-rate loans) and, on the other hand, banks are focusing on what is happening (increasing involvement in the SME segment). Third, the common perception might be rooted in the possibility that the SMEs that complain about the lack of financing are those that are two risky and should not be financed at a low cost of capital. Fourth, although there might be an embryonic bancarization, there is a large universe of worthy but untapped SMEs that do not have access to finance.

Despite the aforementioned findings, there is still substantial room for improvement in SME financing that requires action on behalf of banks, SMEs, and policymakers. SMEs would benefit from an expanded offer of long-term credit and they would likely gain more access to finance if they reduced their levels of informality. Authorities could facilitate this process of formalizing the SMEs’ economic activity. Improving information availability is another key aspect that could enhance financing to SMEs. The lack of adequate information regarding the SME universe is an important problem to be tackled and governments could help substantially in this area. It would be especially useful to identify the universe of SMEs and to quantify the share of SMEs that actually has access to finance. Moreover, further understanding of the demand side is needed to quantify the needs for SME financing. On the supply side, additional information could be useful, such as the percentage of SMEs that are rejected when applying for a loan and the contribution of the segment to banks’ income, costs, and risks. Central banks could also help to reduce the existing information gap by increasing the flow of information regarding the evolution of the SME market, for example, by making SMEs’ balance sheets public.

This study is merely the beginning of a series of studies that the World Bank Group is conducting in several countries. We believe that these surveys will help to enrich and expand the current thought on financial development, in particular on SME financing. For future work, it would be interesting, among many other things, to compare these findings with what banks in upper income economies (and other emerging economies) are doing in terms of SME financing and with the financing of larger corporations in Argentina and Chile. Furthering our analysis in other countries will allow us to improve regional and cross-regional comparison to better understand the complexities of SME financing and to identify the new trends that are emerging.

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Table 1
Definition of SMEs

This table shows the criteria banks use to define SEs and MEs. All banks indicate that they use the average sales criteria (as opposed to total assets, total employees, or other possible definitions). The values in the top panel are expressed in US dollars and the ranges are calculated as the average lower bound and average upper bound of average annual sales that define SEs and MEs. The bottom panel presents the same information with a greater level of detail, showing the maximum and minimum values of the lower bound and upper bound of the average range of sales presented in the top panel. Banks are asked: "Specifically provide your bank's definition criteria for SEs (MEs)."

	Average range of sales to define SEs *US Dollars*		**Average range of sales to define MEs** *US Dollars*	
	From	To	From	To
Argentina	288,889	4,647,704	4,647,704	30,000,000
Chile	90,000	1,595,143	1,595,143	23,800,000
Total	201,875	3,312,208	3,312,208	26,900,000

	Lower bound of sales to define SEs *US Dollars*			**Upper bound of sales to define SEs** *US Dollars*		
	Minimum	Maximum	St. Deviation	Minimum	Maximum	Std. Deviation
Argentina	0	1,300,000	503,598	833,333	12,000,000	4,165,762
Chile	0	180,000	53,229	866,000	2,300,000	609,452
Total	0	1,300,000	383,114	833,333	12,000,000	3,442,356

	Lower bound of sales to define MEs *US Dollars*			**Upper bound of sales to define MEs** *US Dollars*		
	Minimum	Maximum	St. Deviation	Minimum	Maximum	Std. Deviation
Argentina	833,333	12,000,000	4,165,762	10,000,000	75,000,000	22,200,000
Chile	866,000	2,300,000	582,116	2,000,000	50,000,000	22,900,000
Total	833,333	12,000,000	3,348,207	2,000,000	75,000,000	21,800,000

Table 2
Obstacles to bank involvement with SMEs

Banks are asked to list up to three important factors that create obstacles in terms of their involvement with SMEs. This table lists the most frequently mentioned factors and repeats the information illustrated in Figure 6 by presenting the percentage of banks that consider each type of obstacle significant, very significant, or extremely significant. The percentage of banks that consider these factors marginally significant or not significant is not presented in the table. For Table 2 banks are asked to "Indicate to what degree the following factors are important obstacles to your exposure to SMEs. Rate them and specify up to the three most important aspects within these categories."

Type of obstacle	Percentage of banks that consider the obstacle at least significant		Frequently mentioned factors
	Argentina	Chile	
SME-specific factors	46%	50%	Scoring is inadequate Informality Lack of quality information Cannot evaluate SMEs based on behavior Costs to improve information are high Family management Lack of adequate guarantees
Competition	69%	13%	Difficult to continue growing Narrow margins Private banks in high quality segments Public banks distort the market Unfair competitors (strong private and public banks)
Macroeconomic	46%	13%	Long term instability Ceiling prices Exchange rate or interest rate risk Ban on exports
Regulations	23%	50%	Too much documentation required Ceiling rates Inflexibility Financial transaction taxes / Stamp tax Obstacles in foreign exchange transactions Regulation forces banks to act as tax authorities
Legal and contractual environment	31%	38%	Judicial inefficiency Judicial insecurity / dependent on politics Bankruptcy process very costly Lack of contract enforcement
Nature of SME lending technology	23%	38%	Costly Difficult to standardize risk management (scoring and rating) Need to adapt commercial model Difficult to standardize products and procedures High entry costs
Lack of adequate demand	46%	0%	Supply exceeds demand SMEs only demand low fixed rates in pesos SMEs prefer self-financing SMEs think banks are tough
Bank-specific factors	23%	13%	Some banks are new to the segment Inefficiency Lack of technology and qualified personnel Lack of expert analyst in commercial and risk sectors Limited geographic presence

Table 3
Actions taken once an SME loan is overdue

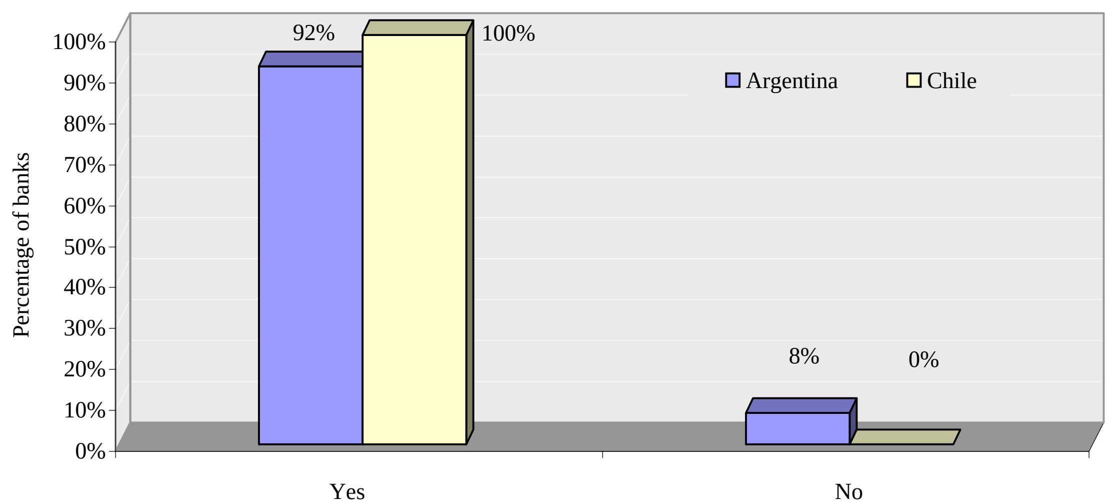
Banks are asked to list up to three important actions taken once an SME loan is overdue. This table lists the most frequently mentioned actions and it also shows the percentage of banks that implement each action. For Table 3 banks are asked: "What are the top three actions typically taken once an SME debtor is declared bankrupt?"

Frequently mentioned actions taken	Percentage of banks
First action	
Call the client (commercial or credit risk department)	38%
Initiate process to obtain a repayment agreement	19%
Assess the situation - stays in commercial area or goes to loan recovery unit	10%
Second action	
Negotiate repayment	19%
Recovery unit	14%
Send letter	10%
Third action	
Legal department - Commence legal action	43%
Refinancing - Recovery unit	10%

Figure 1
Bank involvement with SMEs (I)

This figure shows that almost all the banks in the sample have SMEs among their clients and that the relation established with them is integral. For Figure 1.A banks are asked: "Does the bank currently have SMEs among its clients?" For Figure 1.B banks are asked: "What type of involvement do you have with SMEs?"

A. Does the bank have SMEs among its clients?



B. What type of involvement do you have with SMEs?

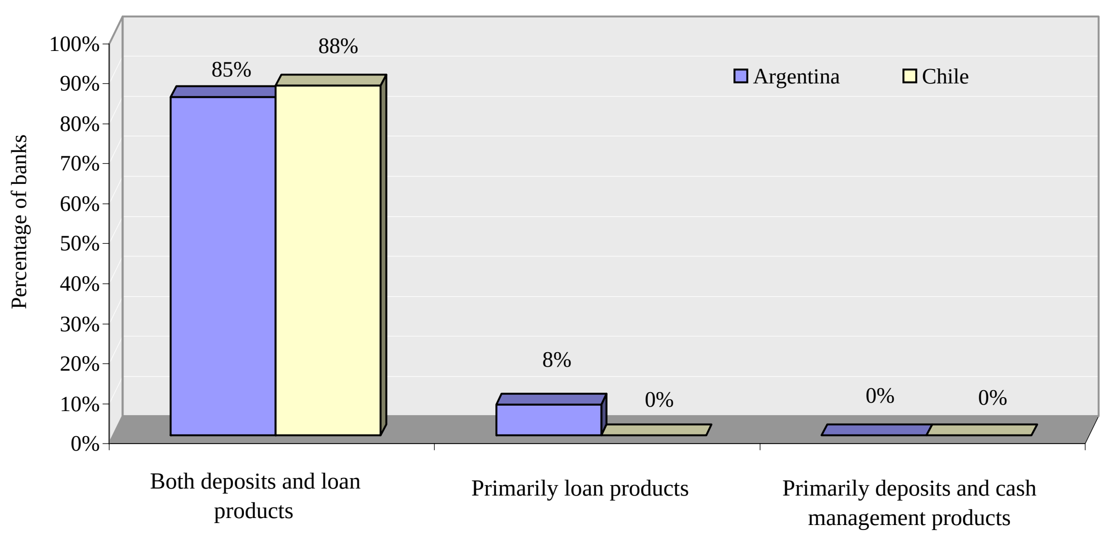


Figure 2
Bank involvement with SMEs (II)

This figure shows the range of products that banks offer to SMEs and the percentage of banks that mention each product. "Other" includes insurance products, mortgages, credit cards, advances, and promissory notes. Banks are asked: "List the main lending products you offer to SMEs."

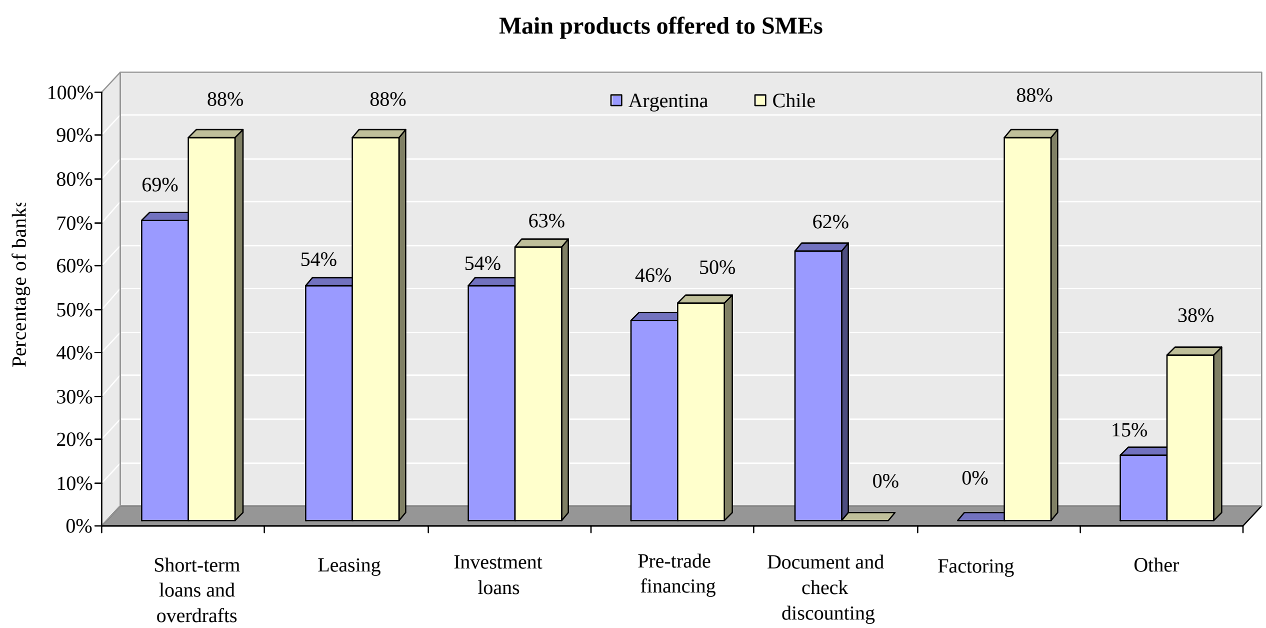
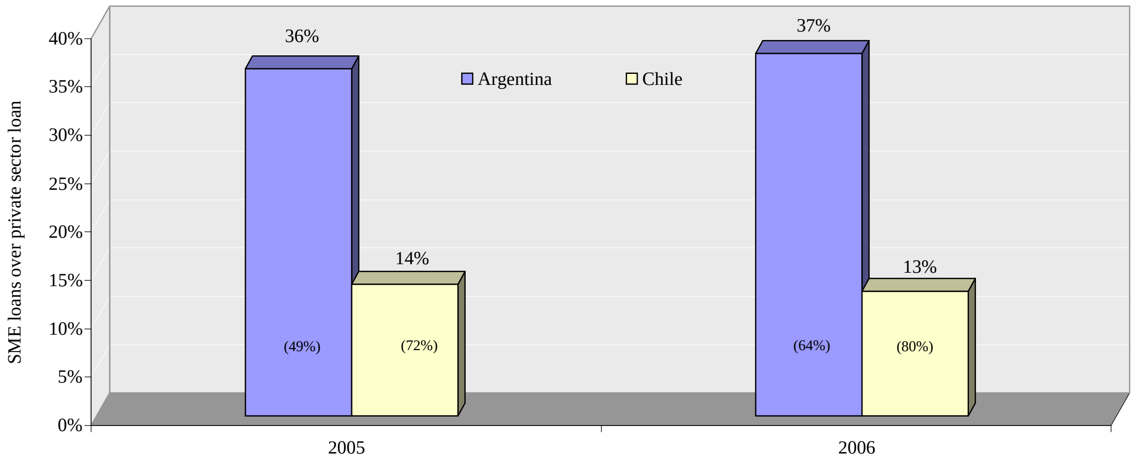


Figure 3
Bank exposure to SMEs (I)

The information shown in this figure is derived from the data we collected from banks. The source of the panels is the same but the information is displayed differently in each case. Banks provide information regarding both the amount of loans offered to SMEs and the amount of loans offered to the private sector as a whole. The ratios presented in Figure 3.A are calculated as the sum of loans offered to SMEs according to the data provided by the banks over the sum of loans offered to the private sector according to these same banks. Therefore, Figure 3.A presents financing to SMEs as a share of total financing to the private sector for 2005 and 2006, for Chile and Argentina separately. In parentheses we present the share of total private sector loans that correspond to the banks that answered. Figure 3.B presents a scatter of this information as provided by each bank, by showing the amount of loans to SMEs over the amount of loans to the private sector for each one of the 19 banks that provided this information in Argentina and Chile for 2006.

A. Financing to SMEs as a share of financing to the private sector



B. Financing to SMEs as a share of financing to the private sector

Per bank

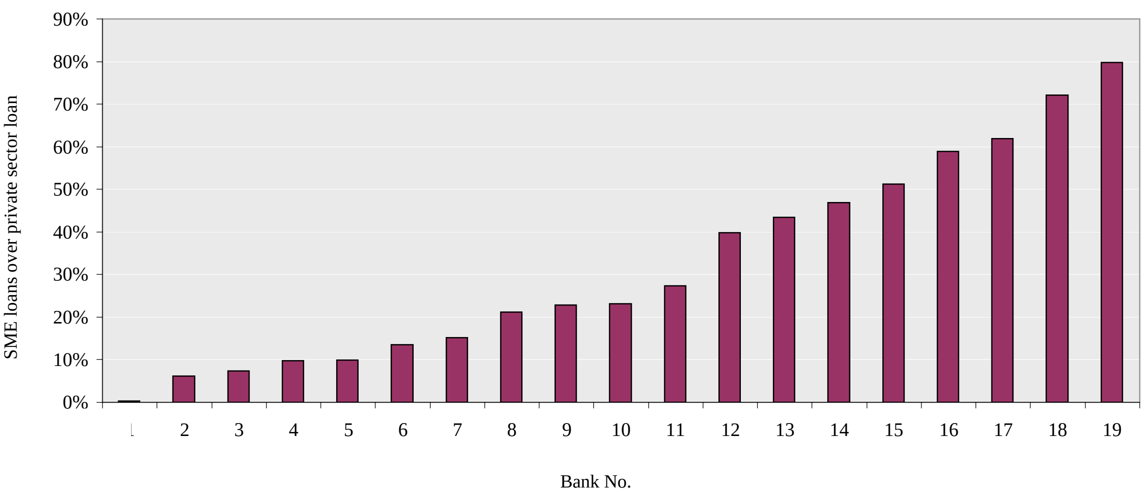
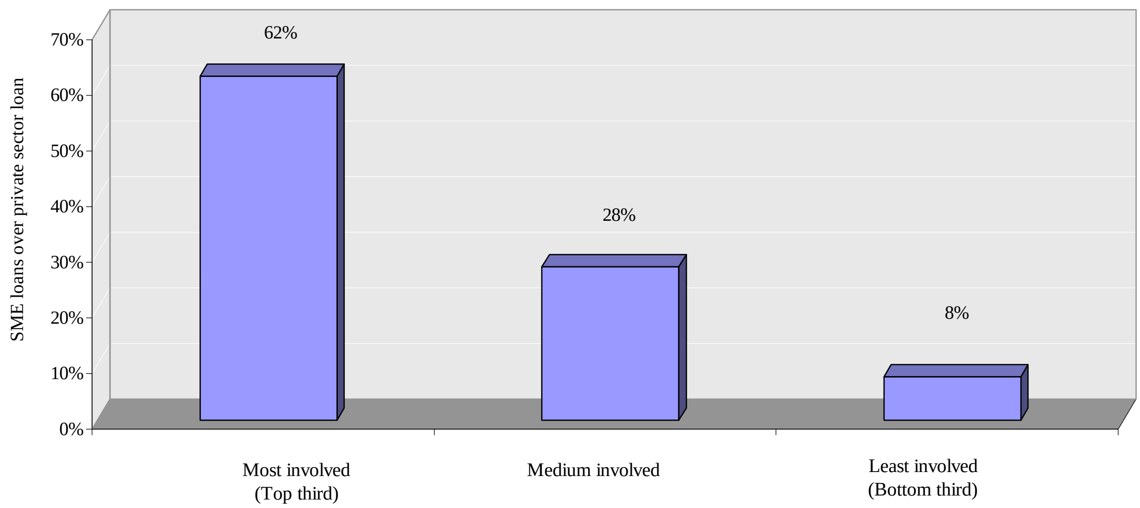


Figure 4
Bank exposure to SMEs (II)

The information shown in this figure is derived from the data we collected from banks. The source of the panels is the same but the information is displayed differently in each case. Figure 4.A shows the average financing to SMEs as a percentage of total bank financing to the private sector in the most involved, medium involved, and least involved banks of the aggregated sample of Argentina and Chile for 2006. The most involved banks are the top third of banks with the highest share of SME loans as a percentage of total bank loans to the private sector. The least involved banks are the bottom third of banks with the lowest share of SME loans as a percentage of total bank loans to the private sector. The medium involved banks are the ones that do not fall in either category. Figure 4.B illustrates financing to SMEs by type of bank for 2006. The banks that answered the information presented in both panels represent 64% of total private sector loans in Argentina and 80% in Chile.

A. Financing to SMEs as a share of financing to the private sector
By level of involvement



B. Financing to SMEs as a share of financing to the private sector
By type of bank

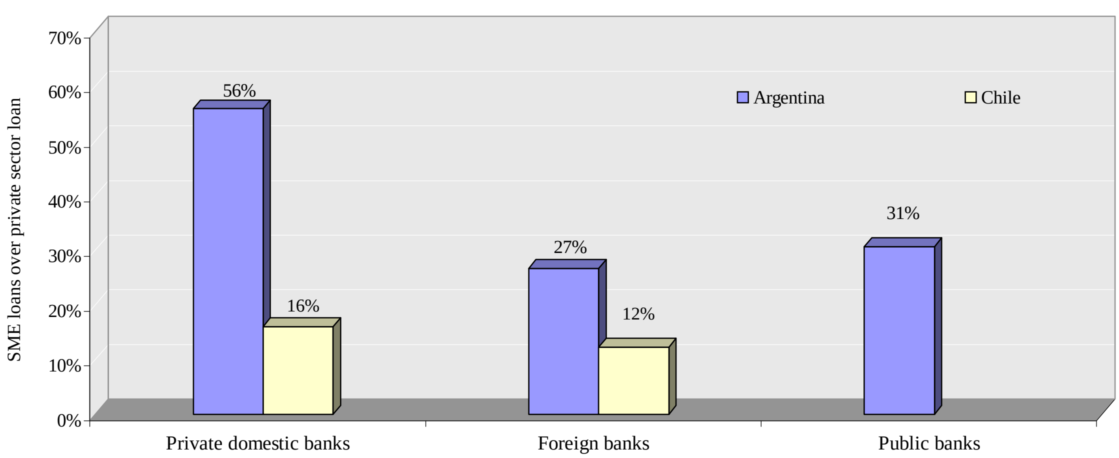
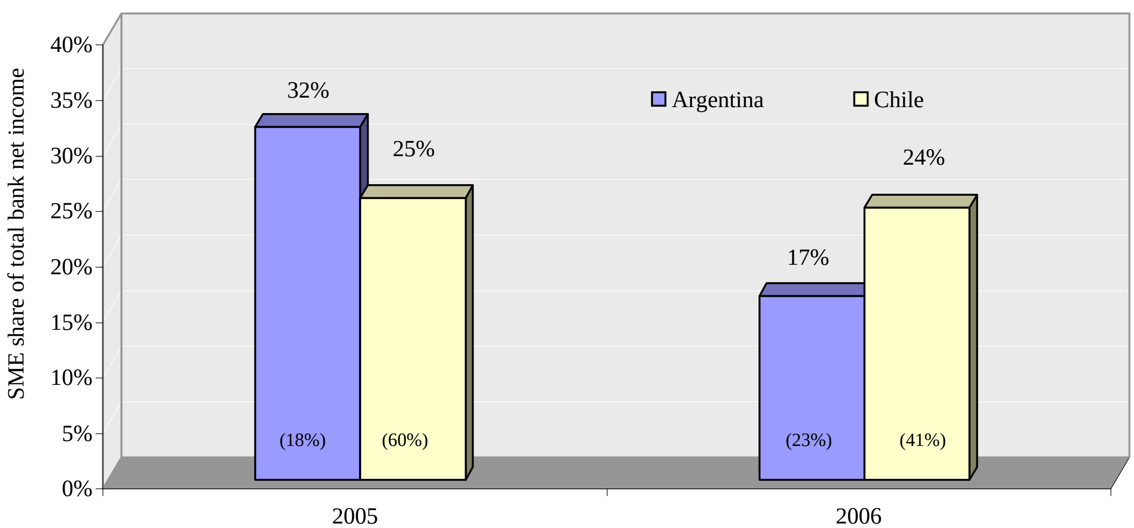


Figure 5
SME contribution to banks' net income

This figure is constructed with hard data collected from banks. Both panels display the same information, but presented in different ways. Figure 5.A shows the weighted average of SME contributions to total net income. In Figure 5.B banks are grouped according to the share of their total net income generated by SMEs; the percentage of banks that belongs to each category is shown. Three intervals are constructed: *more than 50%*, *between 25-50%,* and *less than 25%* of total net income generated by SMEs. In Figure 5.A we present in paretheses the share of total private sector loans that corresponds to the banks that provided this information.

A. Average SME contribution to total net income

Weighted according to bank loans to the private sector



B. SME contribution to total net income

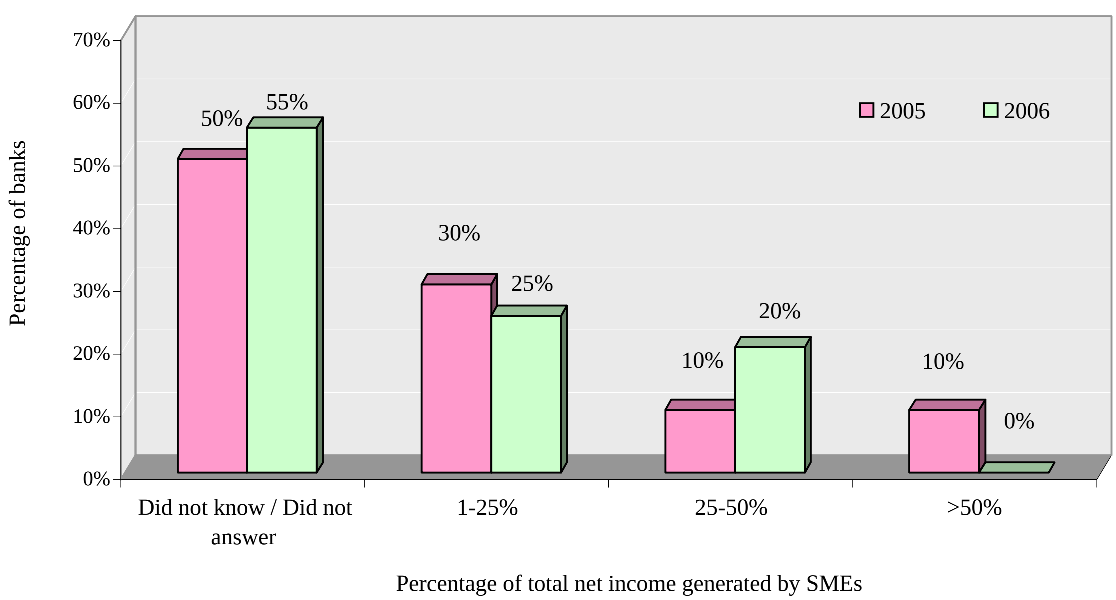


Figure 6
Drivers of bank involvement with SMEs

Banks are asked to indicate to what degree their involvement with SMEs is driven by the factors presented in Figure 6. The options available to qualify the importance of these factors vary from not significant to extremely significant/crucial. This figure shows the percentage of banks that consider these factors significant, very significant, or extremely significant/crucial drivers. The percentage of banks that consider these factors marginally significant or not significant is not presented. It should be noted that "Social objective" and "Strategic sector" are not factors given by the questionnaire, but they are mentioned as a relevant factor by some banks. “Other segments” refers to the corporate and/or retail segments. For Figure 6 banks are asked “To what degree is your involvement with SMEs driven by the following?: i) Perceived profitability in the SME segment, ii) Intense competition for large corporations, iii) Intense competition for retail customers, iv) Excessive exposure to large corporations, v) Excessive exposure to retail customer service, vi) Possibility to seek out SMEs through existing relations with large clients (e.g. reverse factoring), and vii) Othe

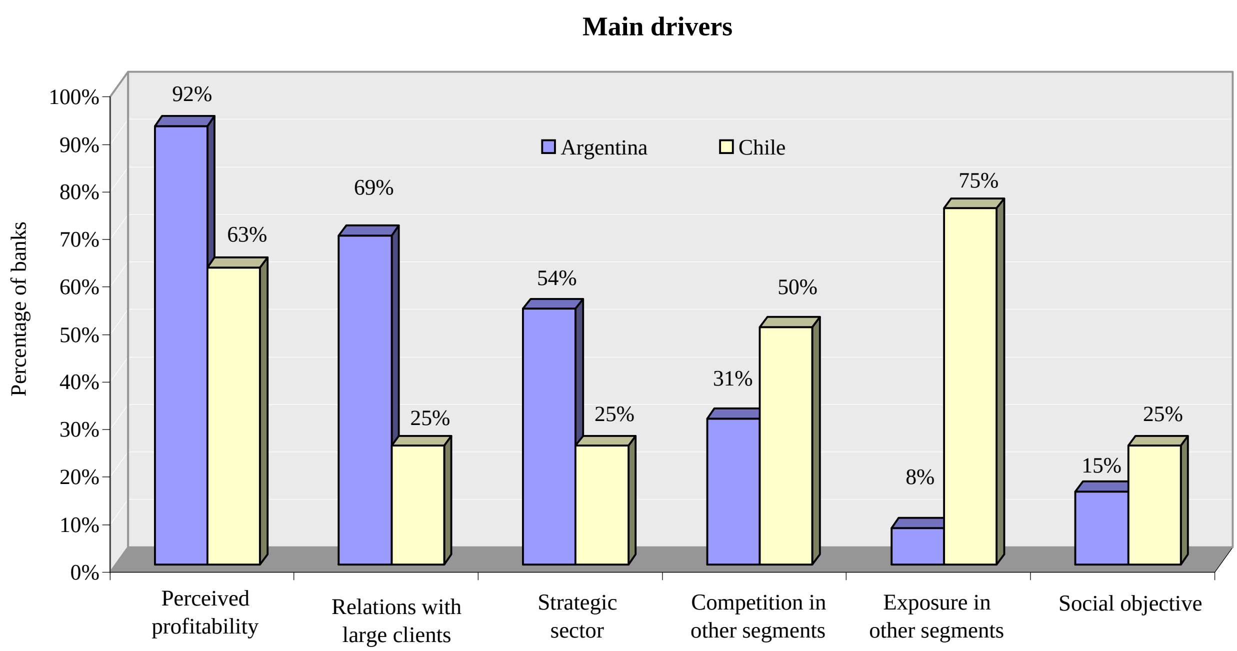


Figure 7
Obstacles to bank involvement with SMEs

Banks are asked to indicate to what degree the factors observed in the figure are important obstacles to their exposure to SMEs. This figure shows the percentage of banks that consider each factor significant, very significant, or extremely significant/crucial. The percentage of banks that consider these factors marginally significant or not significant is not presented in the figure. For Figure 7 banks are asked to "Indicate to what degree the following factors are important obstacles to their exposure to SMEs. Rate them and specify up to the three most important aspects within these categories."

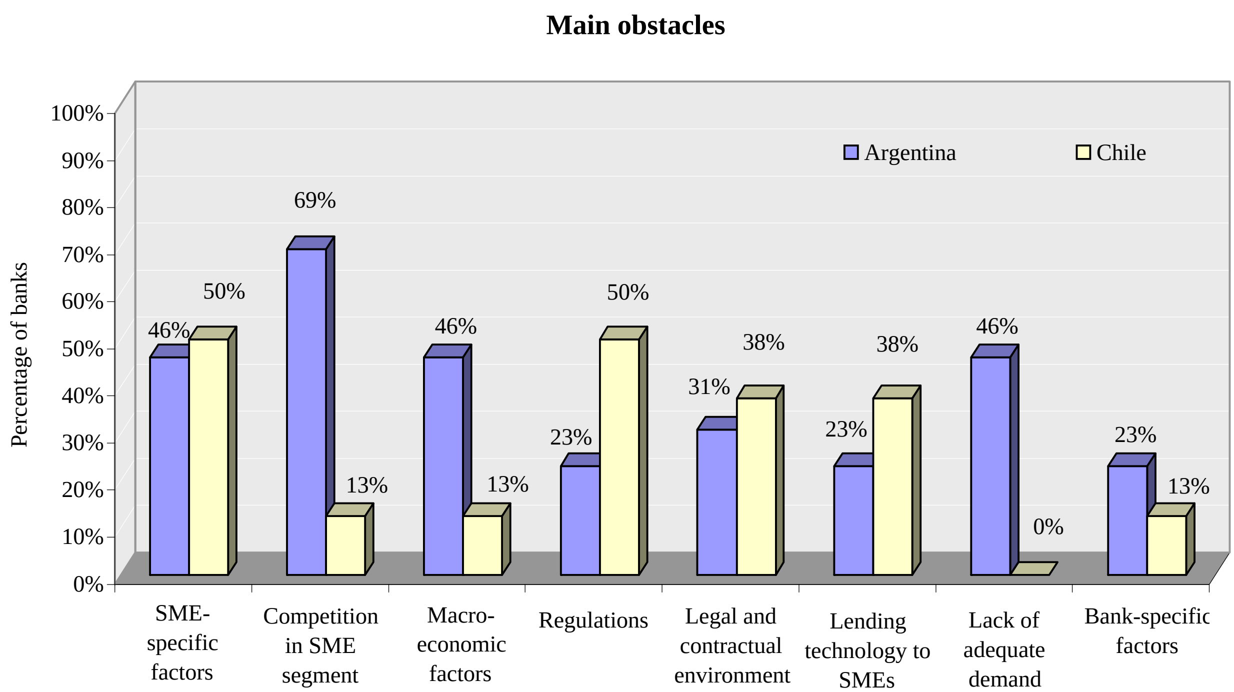
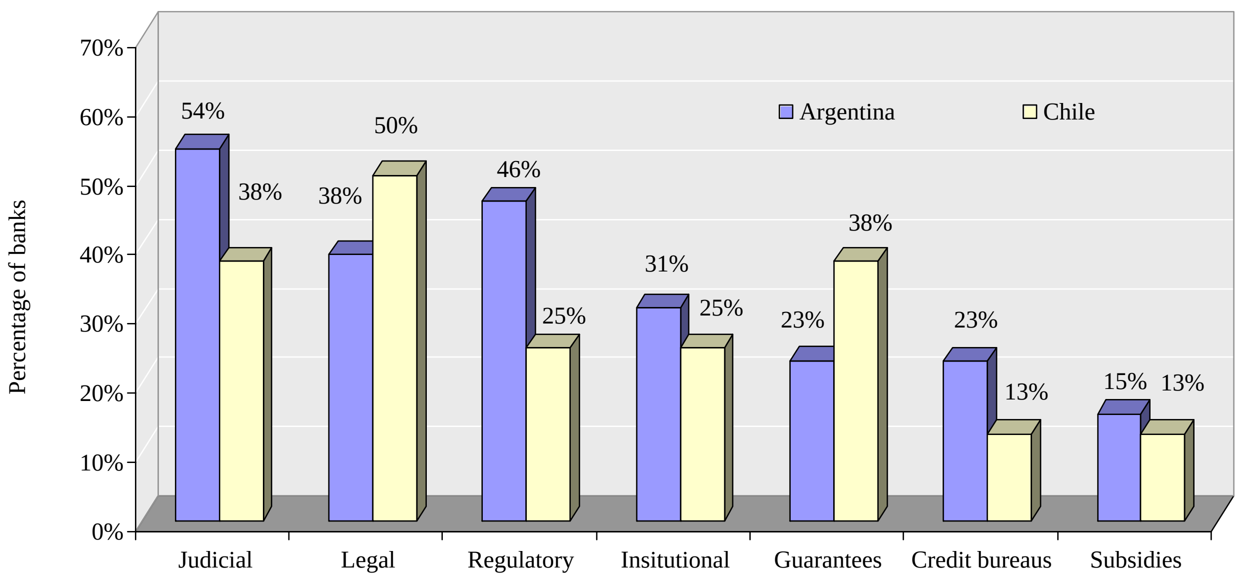


Figure 8
Role of the government

Figure 8.A displays the percentage of banks that answer affirmatively that government actions could increase the appeal of SME lending in each area and Figure 8.B shows, in particular, the perceived importance of credit bureaus for SME lending. For Figure 8.A banks are asked: "Do you think the government could increase the appeal of SME lending through actions in the following areas?" and for Figure 8.B: "Does the existence of a public credit bureau facilitate SME lending?"

A. Areas in which government action could promote SME lending



B. Does the existence of a public credit bureau facilitate SME lending?

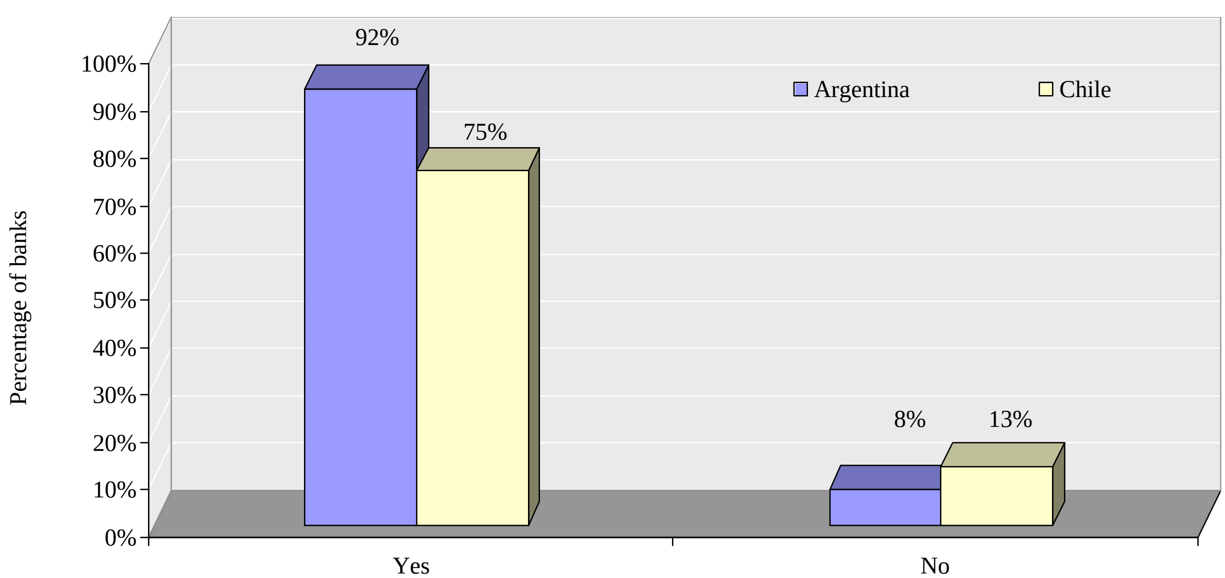


Figure 9
Market environment (I)

This figure shows the percentage of banks that answer each question regarding their view on the size and prospects for the SME market in general. For Figure 9 banks are asked: "What is your view on the size and prospects for the SME market in general, not just for your bank?”

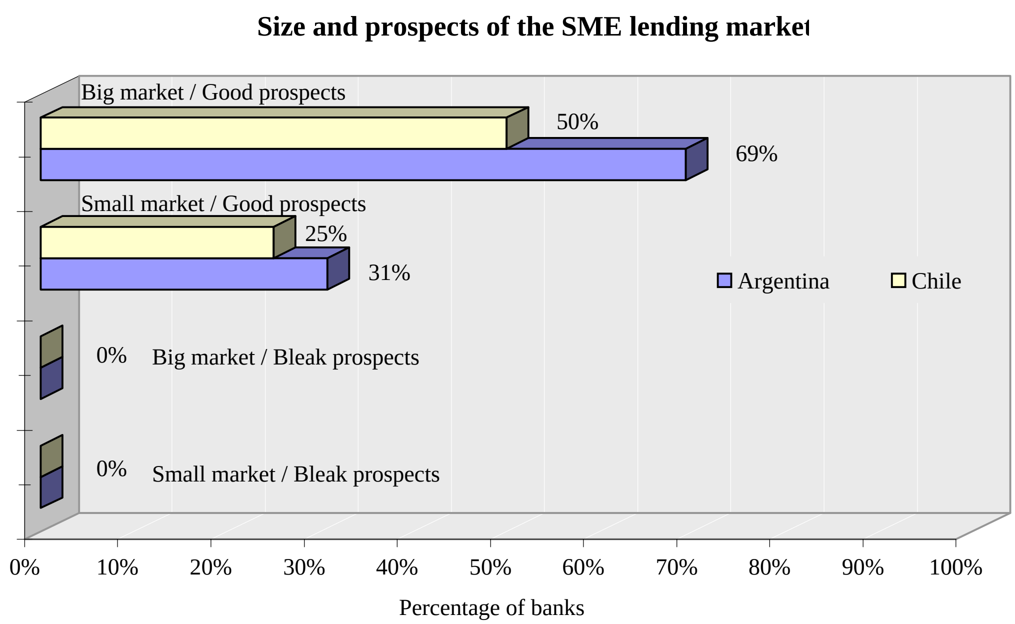


Figure 10
Market environment (II)

Banks are asked about their perceptions of the demand of the SME lending market and the degree of reaching out they have to do. The figure shows the percentage of banks that answer each question affirmatively. For Figure 10 banks are asked: "How much reaching out does the bank have to do?: i) The bank has a strong demand so no reaching out is required to SMEs, ii) Despite strong demand for our SME products we still do a fair amount of reaching out, and iii) Demand is weak so we have to actively seek clients by reaching out to them." The first option is not represented in the chart because no banks chose that answer.

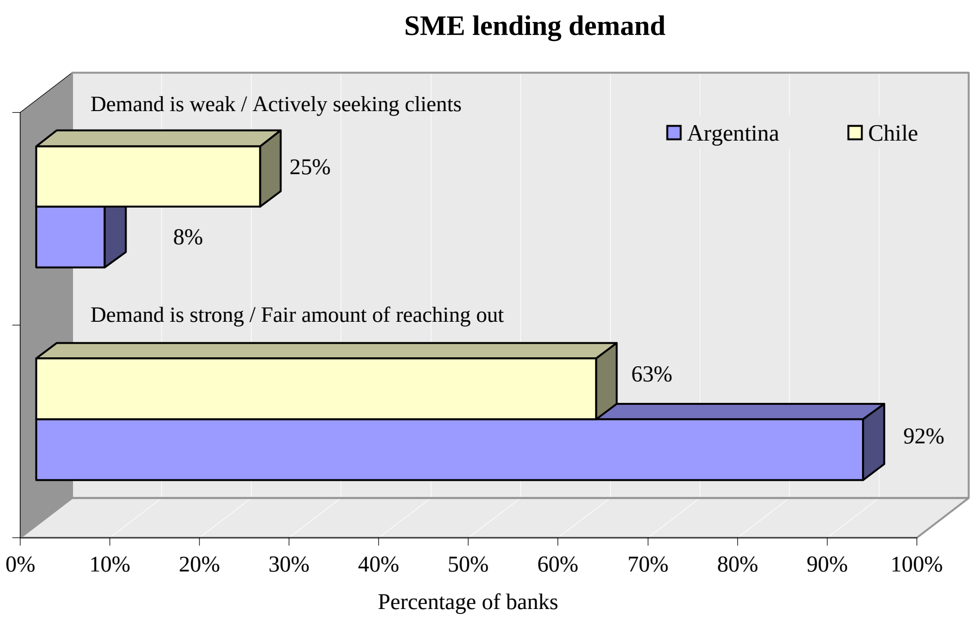


Figure 11
Market environment (III)

Banks are asked to express their view on how competitive the market for SME lending is. The figure shows the percentage of banks that indicate each option given. The percentages for the aggregated sample of Argentina and Chile are shown because the answers are very similar for both countries. For Figure 11 banks are asked: "How competitive is the market for SME lending?”

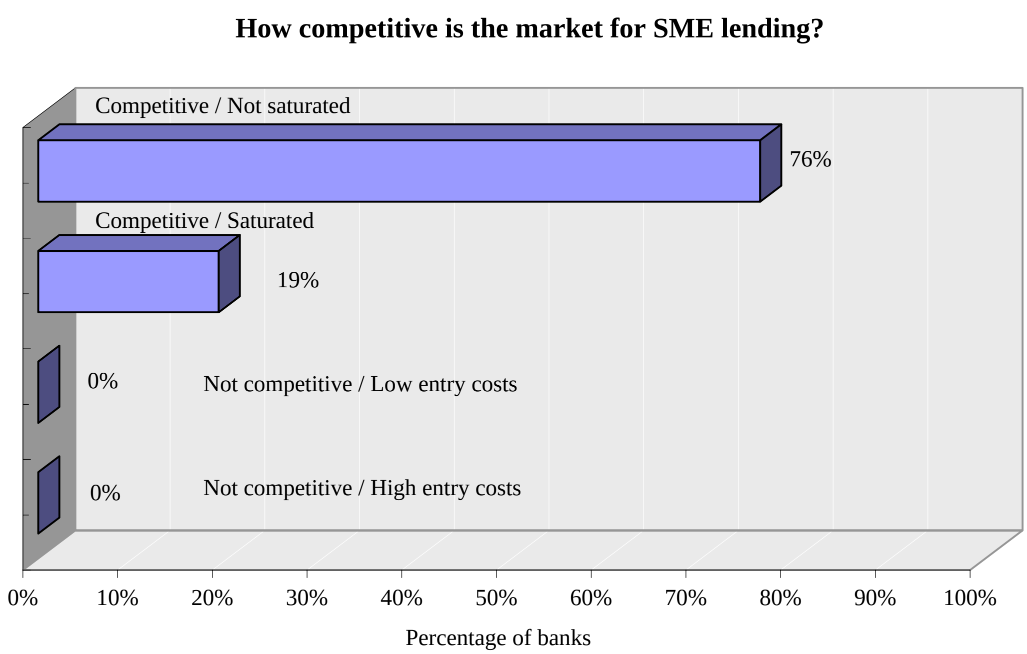
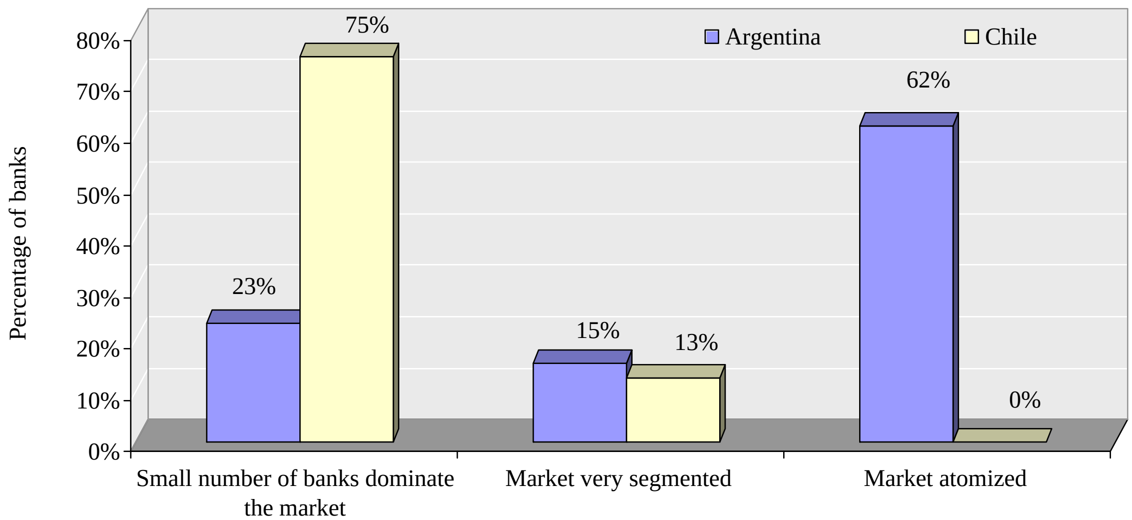


Figure 12
Market structure

This figure analyzes the SME lending market structure and the main players in the market as perceived by banks. For Figure 12.A banks are asked: "What is the market structure of the SME loan market?" For Figure 12.B: "Who are the main players in SME financing?"

A. What is the market structure of the SME loan market?



B. Who are the main players in SME financing?

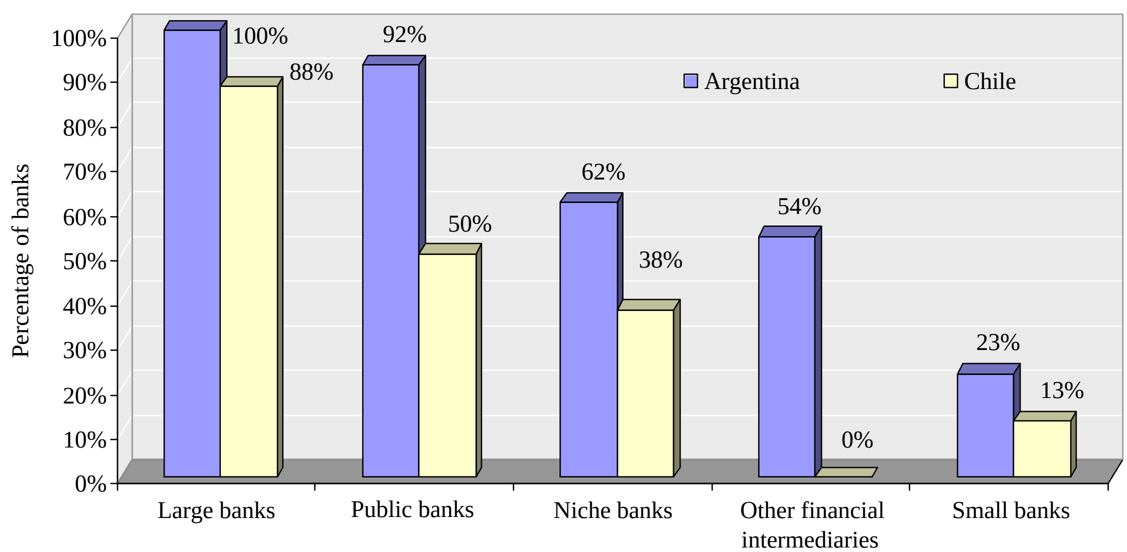


Figure 13
Level of centralization of the SME business model (I)

This figure shows the average percentage of total branches that serve SMEs, which was calculated as a simple average of the data. The information exposed in Figure 13 comes from the data we collected from banks. We present in paretheses the share of total private sector loans that correspond to the banks that provided this information.

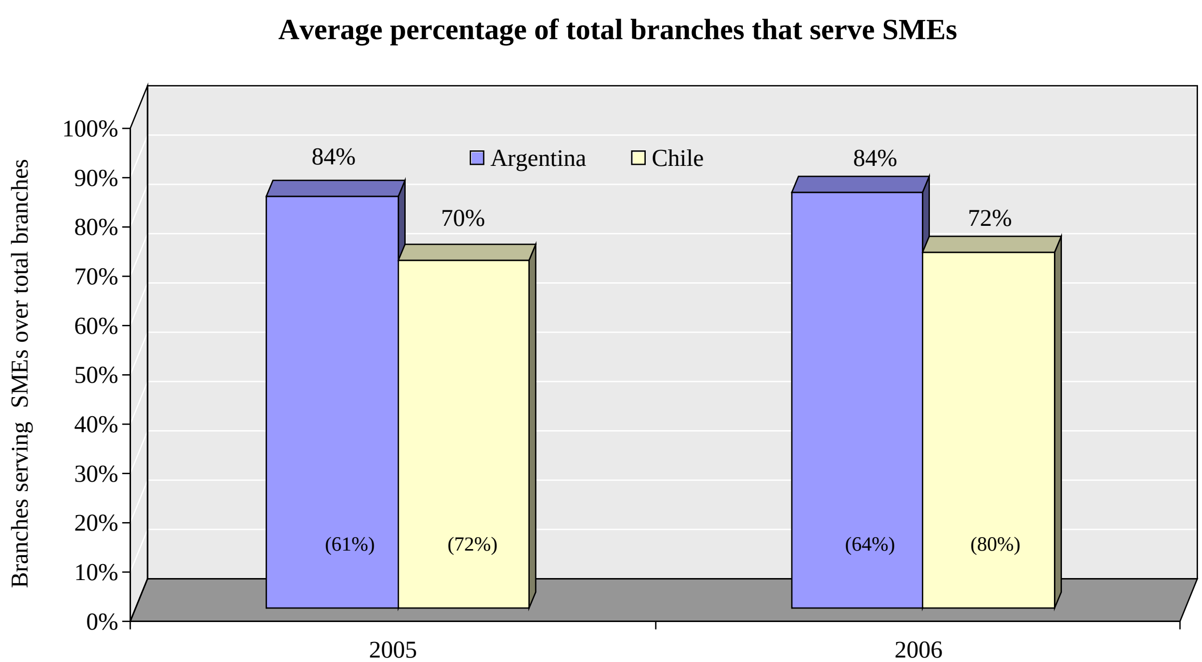
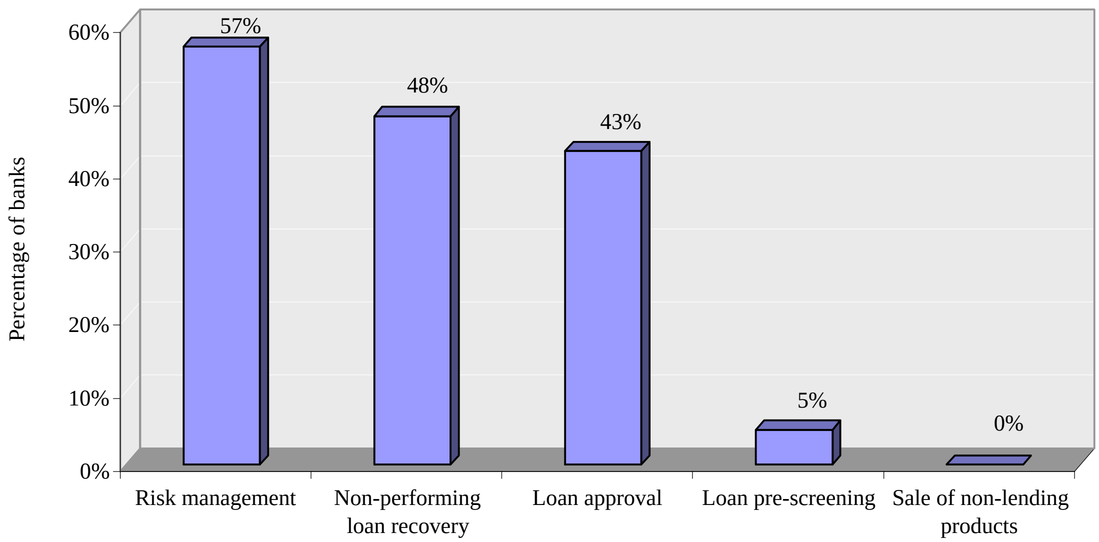


Figure 14
Level of centralization of the SME business model (II)

This figure presents the percentage of banks that have specific aspects of SME lending centralized (Figure 14.A.) or decentralized (Figure 14.B.). The activity is considered to be centralized when it is done only or primarily at headquarters, while it is considered to be decentralized when it is conducted only or primarily at branches. Some banks conduct these activities both at headquarters or branches, but these results are not presented. The percentages shown are from the aggregated sample of Argentina and Chile because there are no significant differences across countries. For Figure 14 banks are asked: "What aspects of the SME banking business are centralized and at what level?"

A. What aspects of SME lending are centralized?



B. What aspects of SME lending are decentralized?

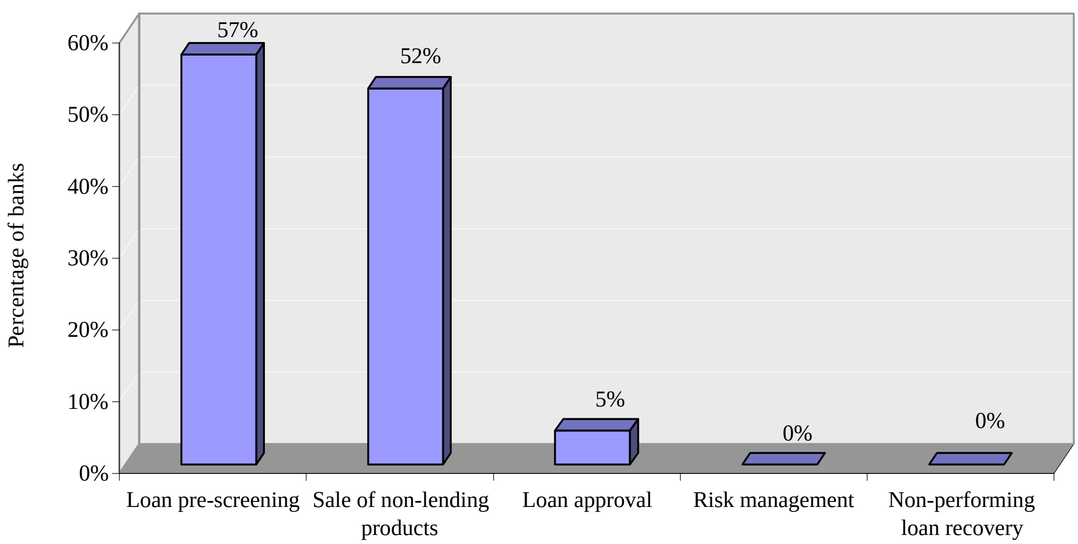
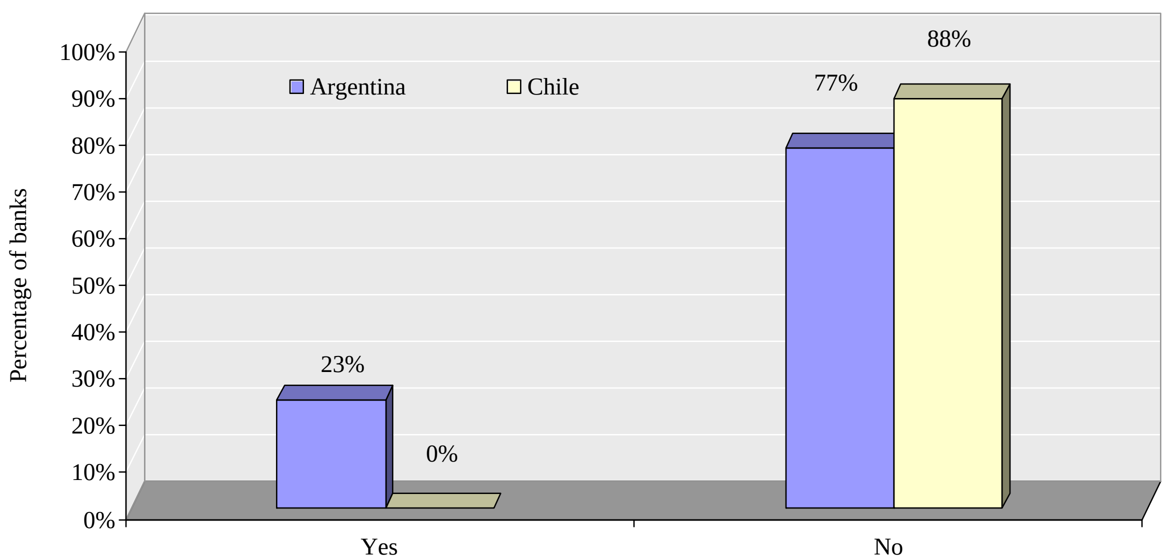


Figure 15
Determining SME clients (I)

This figure indicates that most banks interviewed do not have either a sector-specific or a geographic focus in their relation with SMEs. For Figure 15.A banks are asked: "Does the bank have a sector-specific focus in dealing with SMEs?" For Figure 15.B: "Does the bank have a specific geographic focus in dealing with SMEs?"

A. Does the bank have a sector-specific focus in dealing with SMEs?



B. Does the bank have a specific geographic focus in dealing with SMEs?

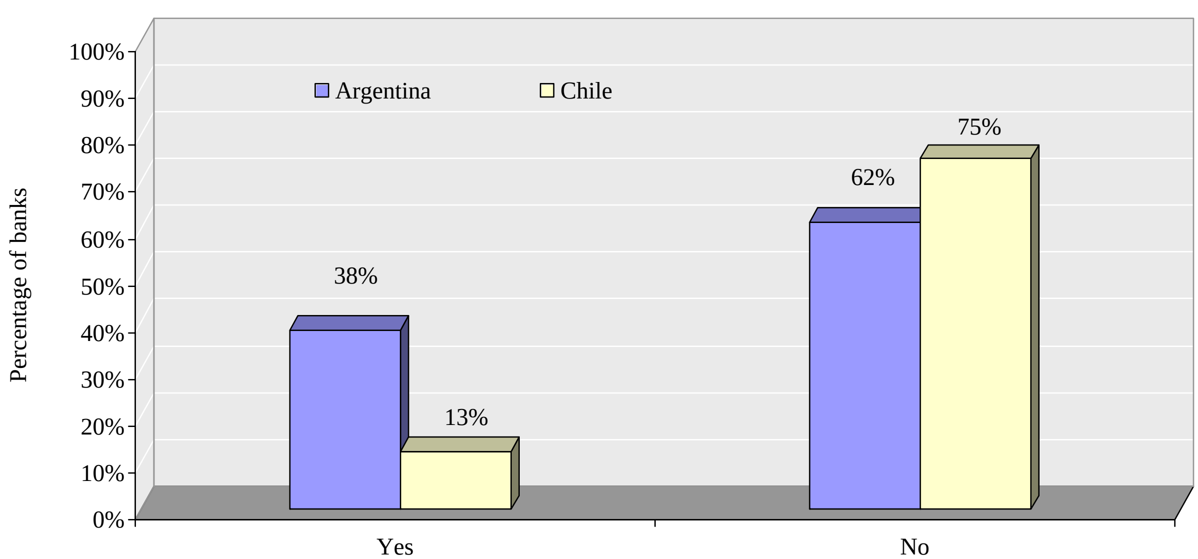
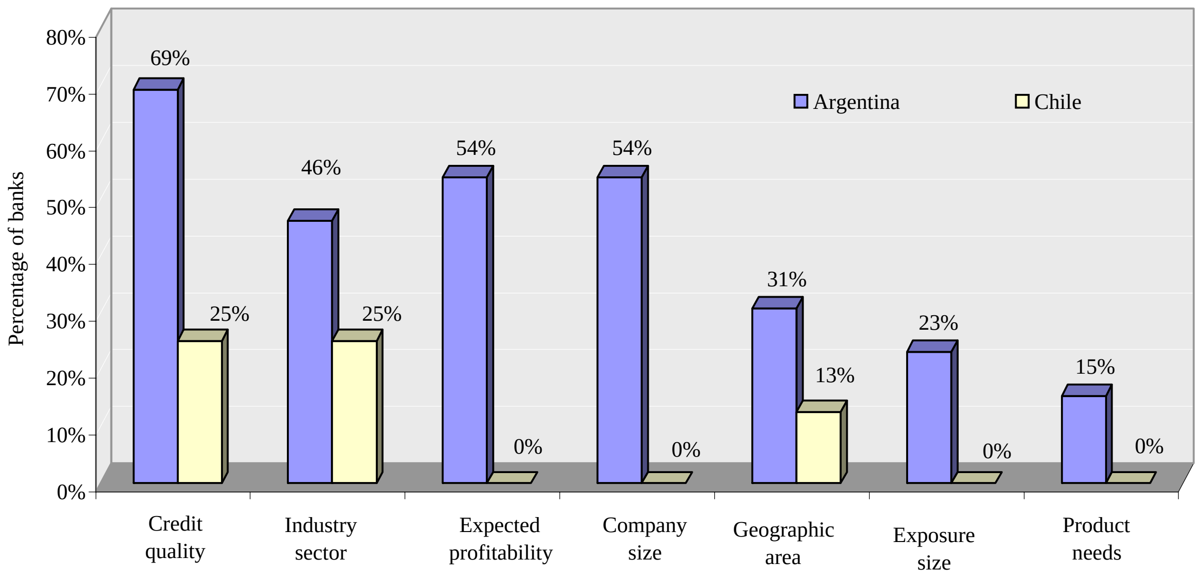


Figure 16
Determining SME clients (II)

This figure illustrates the mechanisms and the criteria that banks use to determine their SME target market and potential SME clients. Banks select the criteria they use from a list of options to determine the SMEs they target and the mechanisms they use to identify potential SME clients. Figure 16.A shows the percentage of banks that use each criterion to target SMEs and Figure 16.B shows the percentage of banks that use each source to identify potential SME clients. For Figure 16.A banks are asked: "Which particular criteria does the bank use to determine the SEs and MEs it will target?" For Figure 16.B: "How do you identify potential SME clients?"

A. Criteria to determine the SMEs target market



B. Sources to identify potential SME clients

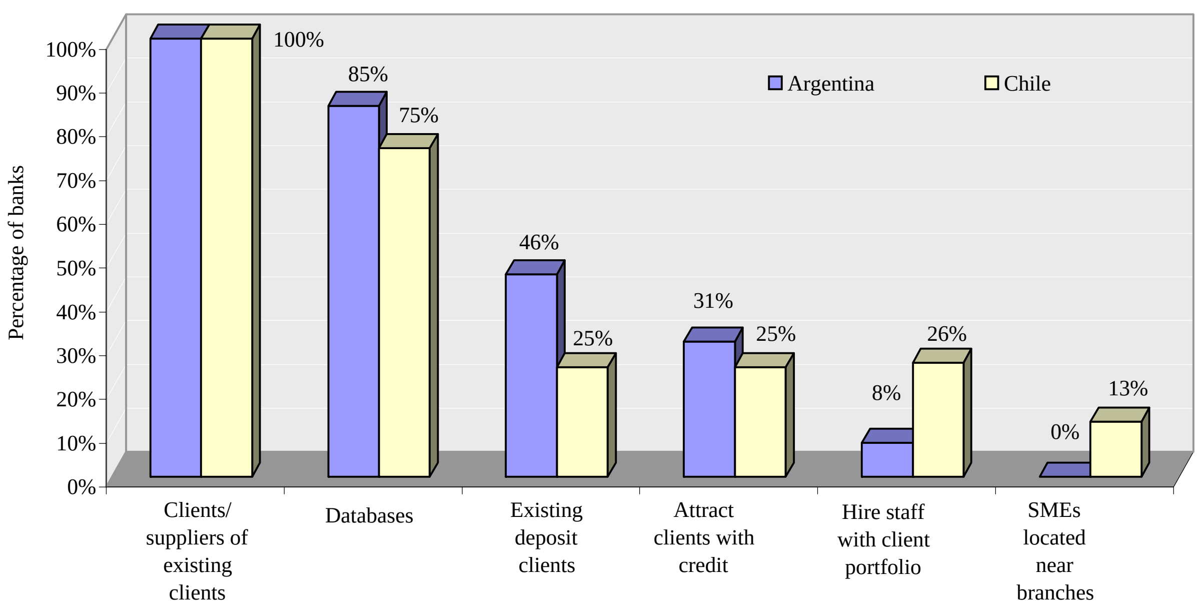


Figure 17
Characteristics of SME lending

Banks are asked to indicate the most relevant statement regarding the standardization of their SME products among the three options presented in the Figure 17.A. This figure shows the percentage of banks that select each of the statements we propose. For Figure 17 banks are requested to: “Indicate the most relevant statement regarding the standardization of your SME products.”

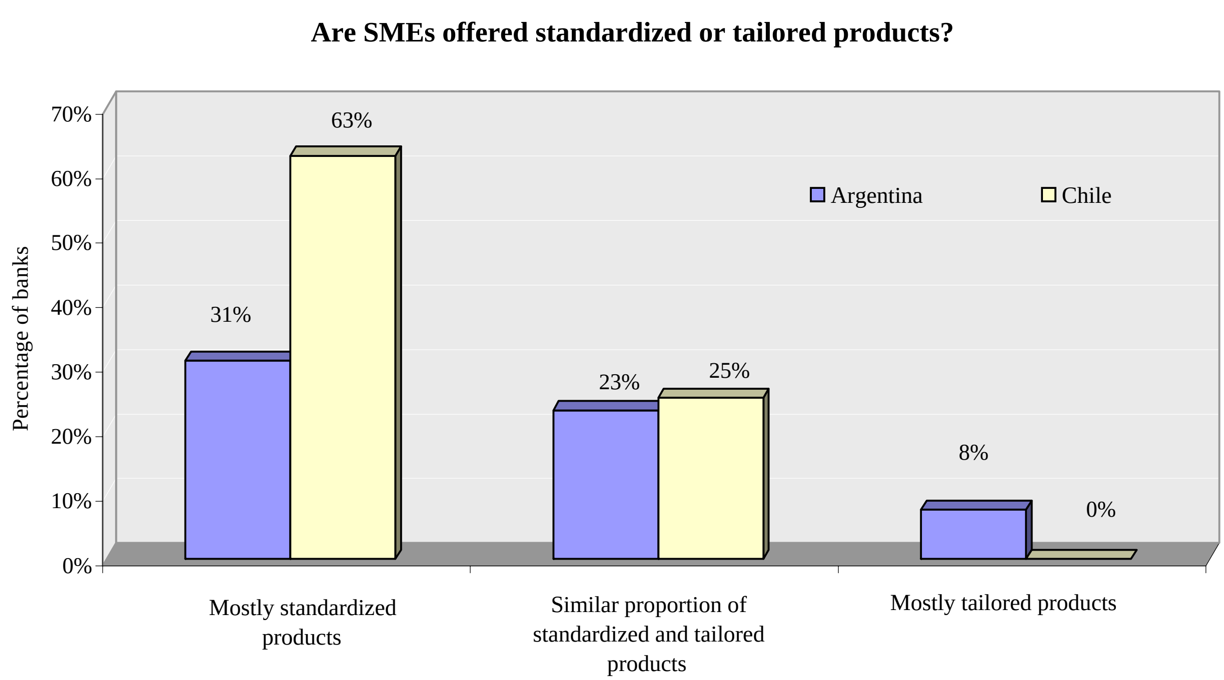
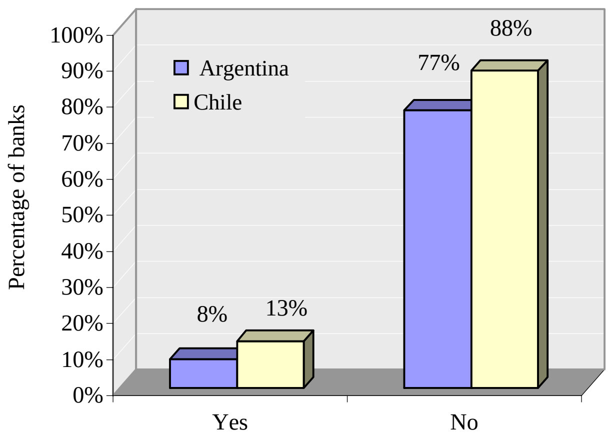


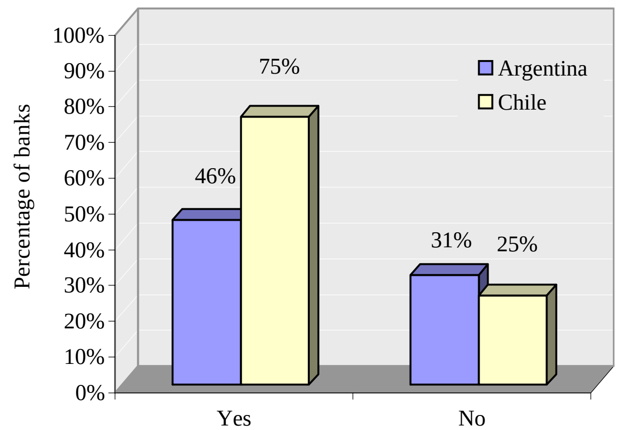
Figure 18
Risk management

Banks are asked to describe the organization of credit risk management. This figure shows the percentage of banks that answer affirmatively or negatively to different options available regarding the structure of their risk management for the SME segment. For Figure 18 banks are asked: "How is the credit risk management function organized in your bank?"

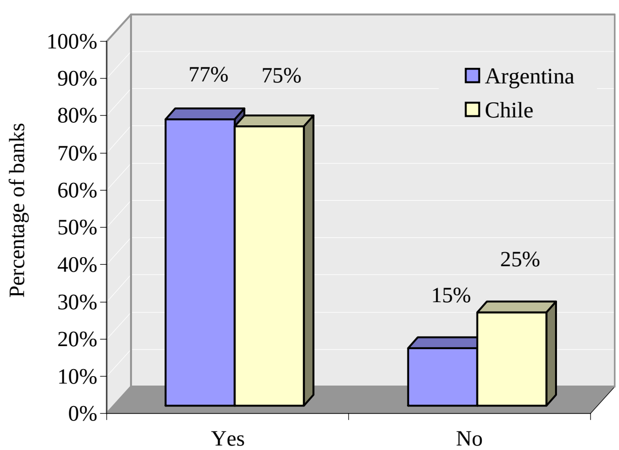
A. Is it largely automated?



B. Is it done by a credit risk analyst?



C. Is it separate from sales?



D. Is it done primarily at headquarters?

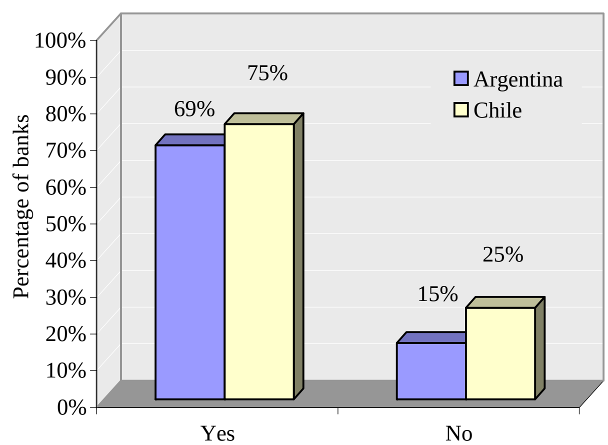
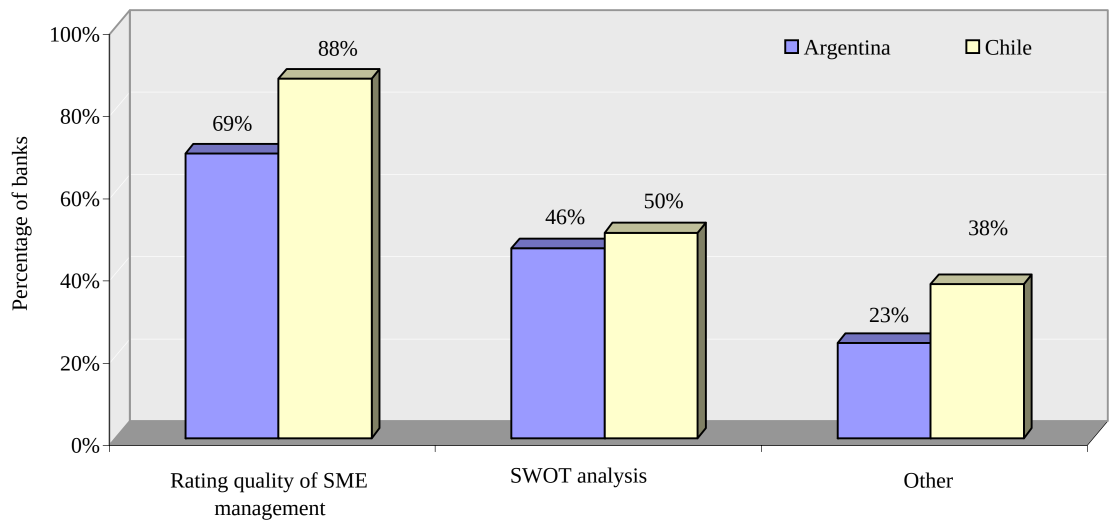


Figure 19
Qualitative and quantitative risk assessments

Among the options provided, banks select the statements that best describe their qualitative and quantitative assessments of SME risk. Banks also have the possibility to add other options. This figure shows the percentage of banks that chose each statement presented. For Figure 19.A banks are asked: “If your bank credit analysis relies on qualitative assessments, does the bank use one of the following?” For Figure 19.B: “If your bank credit analysis relies on quantitative assessments, does the bank use one of the following?” In Figure 19.A, SWOT stands for "Strengths, weaknesses, opportunities, and threats" and "Other" includes owners, infrastructure, product, target market, competition, commercial chain, and static model without projections reports. In Figure 19.B, "Other" includes financial analysis of sector, global guarantees, supplier and client concentration analysis, static model without projections, solvency, net worth, sector analysis, experience in the sector, and composition of commercial chain.

A. Mention the types of analysis that your qualitative risk assessments include



B. Mention the types of analysis that your quantitative assessments include

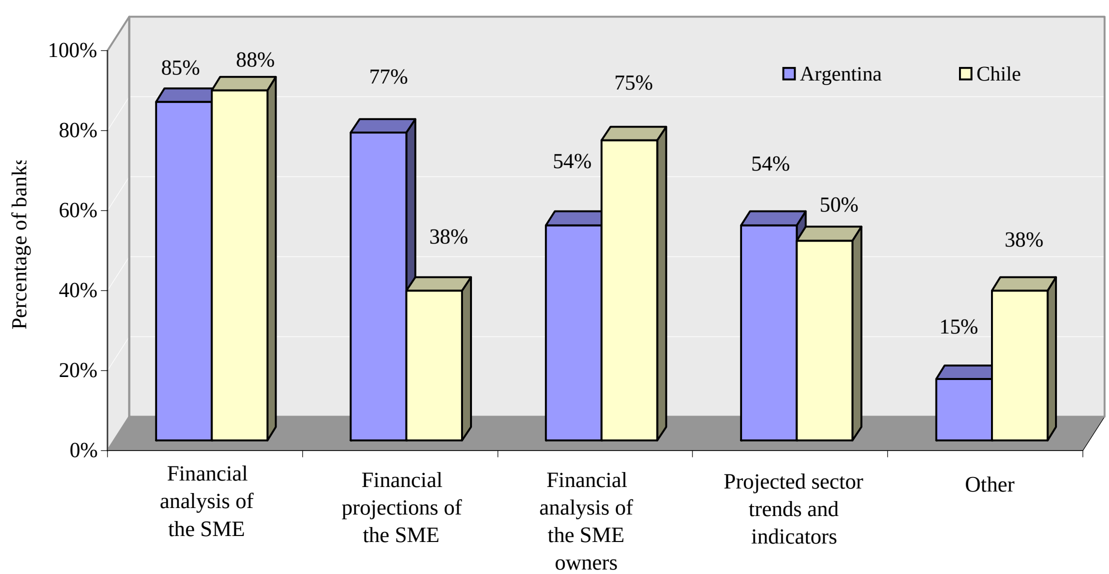
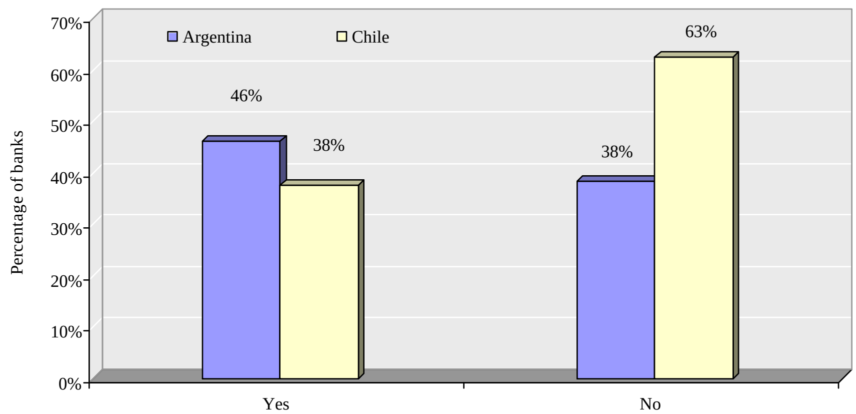


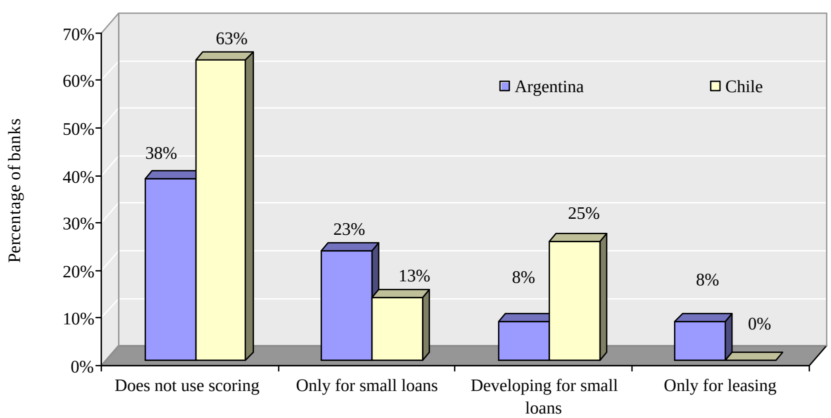
Figure 20
Scoring models

This figure analyzes the extent of the use of scoring models applied to the SME segment and the importance of owner and SME information in these scoring models. For Figure 20.A banks are asked: "Does your bank use scoring models to select SMEs?" For Figure 20.B:"What weight do you give to scoring in lending decisions?" For Figure 20.C:"If your bank uses scoring models, select the statements that best describe them: i) We score just the SME, ii) We score just the owner, and iii) We score both the owner and the SME."

A. Does your bank use scoring models to select SMEs?



B. What weight do you give to scoring in lending decisions?



C. In your scoring model, do you score the owner, the SME, or both?

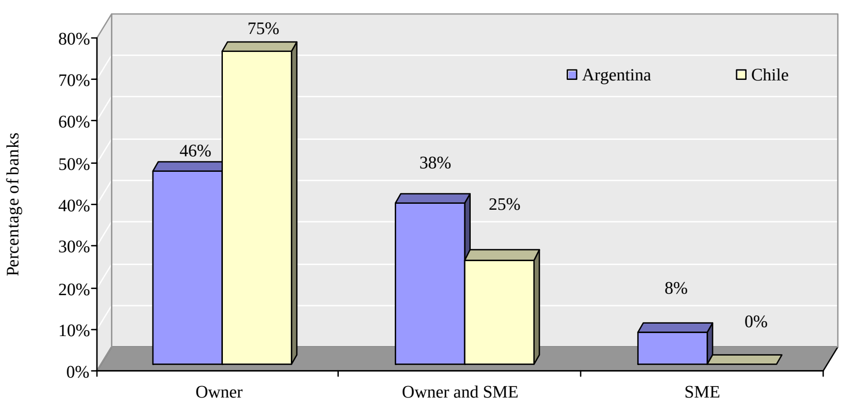
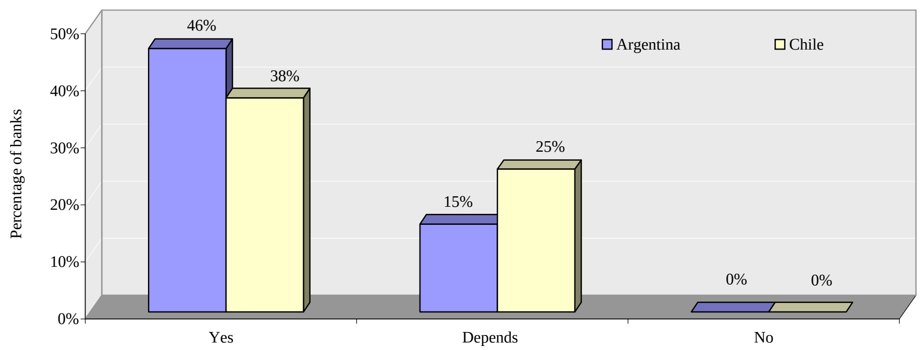


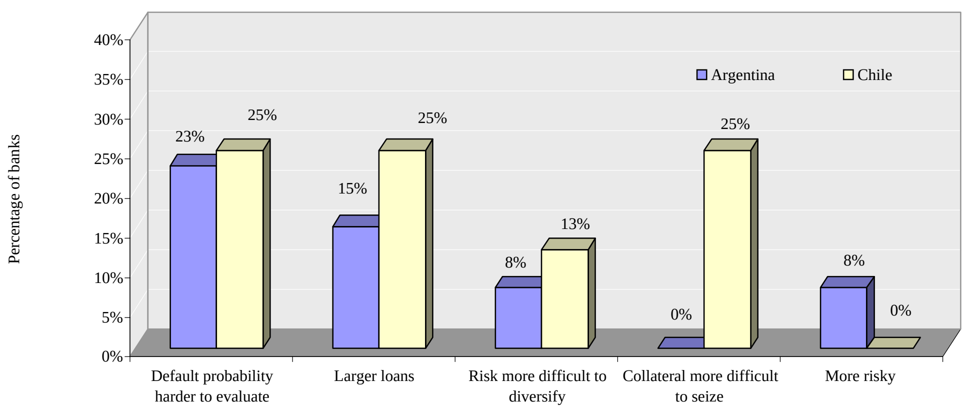
Figure 21
Collateral requirements for SMEs

This figure analyzes collateral requirements for SMEs. For Figure 21.A banks are asked: "Does the SME borrower need to pledge collateral?" For the middle and bottom panels, banks are offered a list of possible reasons for SME collateral requirement to be higher than those for consumer (Figure 21.B) and corporations (Figure 21.C) and they are asked to indicate which of the reasons proposed apply. They are also given the possibility to list up to three other factors they consider relevant. Each panel shows the percentage of banks that choose each of the options given in the questionnaire or added by banks. For Figure 21.B banks are asked: "To the extent that collateral requirements are higher for SMEs than for consumers (credit card or overdraft, non-collateralized), indicate which of the reasons below apply or list up to three other factors." For Figure 21.C: "To the extent that collateral requirements are higher for SMEs than for large corporations (credit card or overdraft, non-collateralized) indicate which of the reasons below apply or list up three other factors." Figure 21.B includes only one option added by banks: "Risk more difficult to diversify." Figure 21.C does not include any option added by banks.

A. Does the SME borrower need to pledge collateral



B. What characteristics of SMEs make collateral requirements relative to consumers?



C. What characteristics of SMEs make collateral requirements higher relative to large corporations?

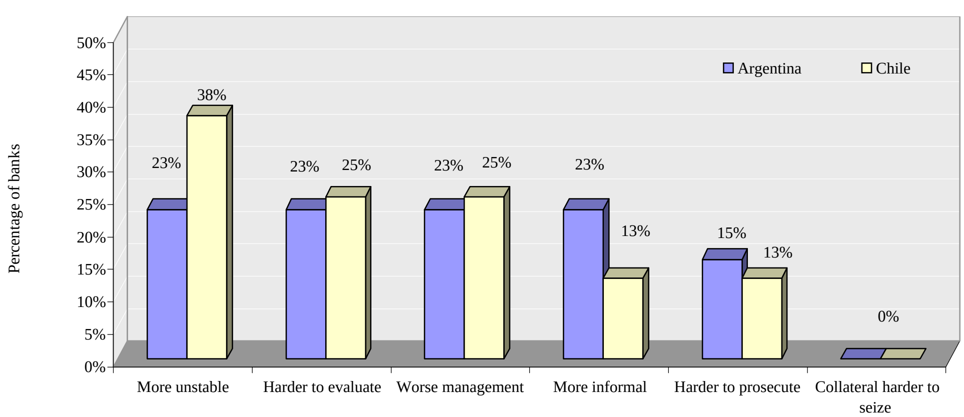


Figure 22
Credit limits

Banks are asked if they have an annual approval cycle for credit limits for the criteria stated in the figure. The figure presents the percentage of banks that determine their credit limits according to each criterion. The option "No set limits exist" is not presented in the chart since it is not chosen by any bank. For Figure 22 banks are asked: "Does the bank have an annual approval cycle for credit limits? i) Yes, limits exist for the overall bank SME portfolio, ii) Yes, limits exist per sector of activity of SMEs, iii) Yes, limits exist per SME, iv) Yes, limits exist per SME, v) Yes, limits exist per individual loan per SME, vi) No set limits exist, vii) If no limits exist, please explain how the bank manages it's credit risk."

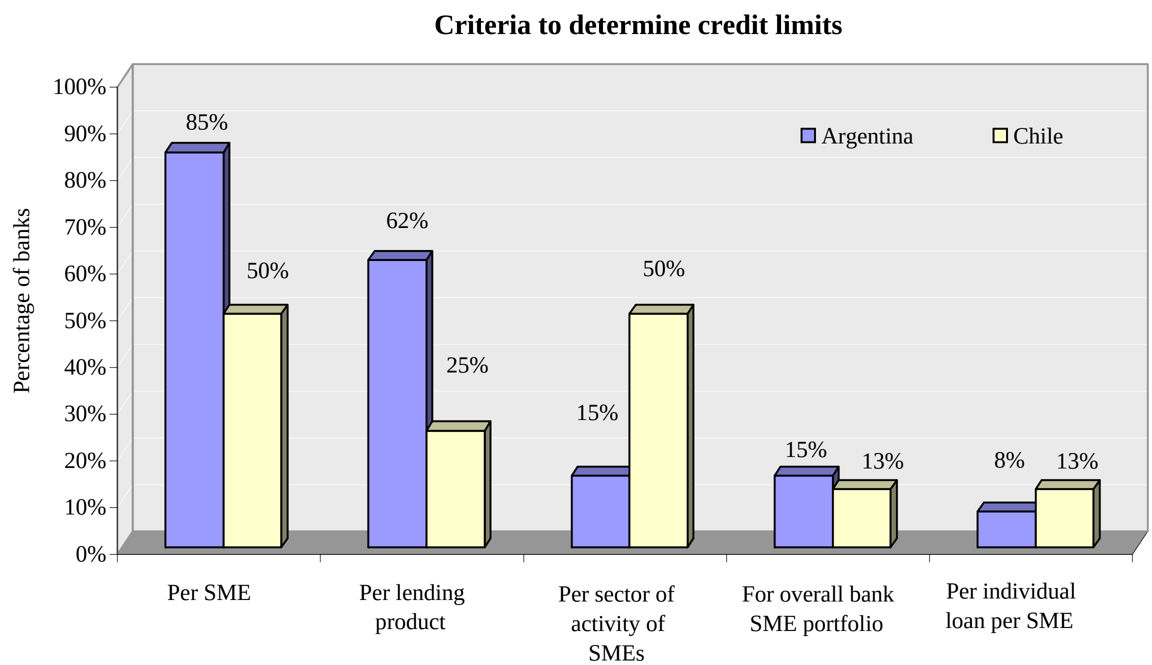
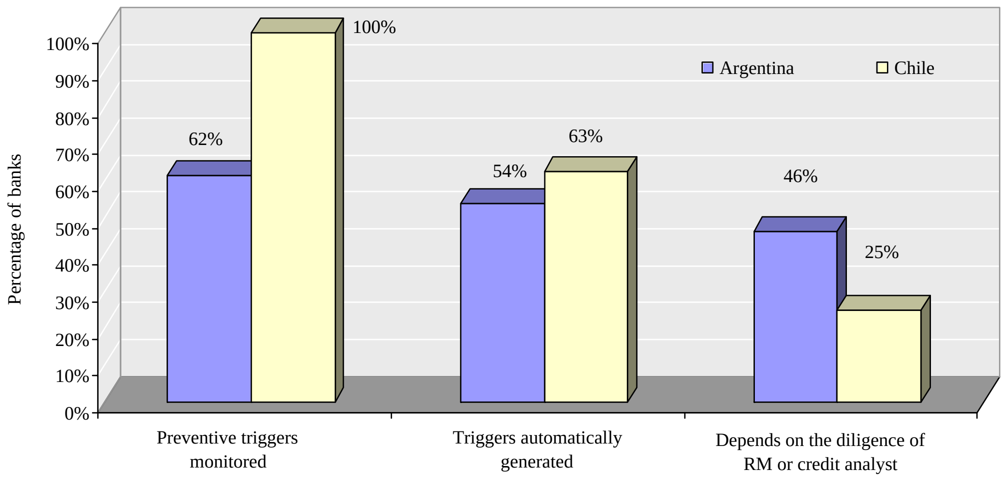


Figure 23
Monitoring credit risk exposure

This figure describes how banks monitor credit risk outlook and the main items on which they rely. For Figure 23.A banks are asked: "Which of the following characterize some of the ways the bank monitors credit risk outlook over time for a particular SME?" For Figure 23.B: "Which of the following items are monitored by the bank?" Banks are also given the opportunity to mention other options but these responses are included in the figure. In Figure 23.A, RM stands for relationship manager.

A. Describe how the bank monitors credit risk outlook for a particular SME



B. Which of the following items are monitored by the bank?

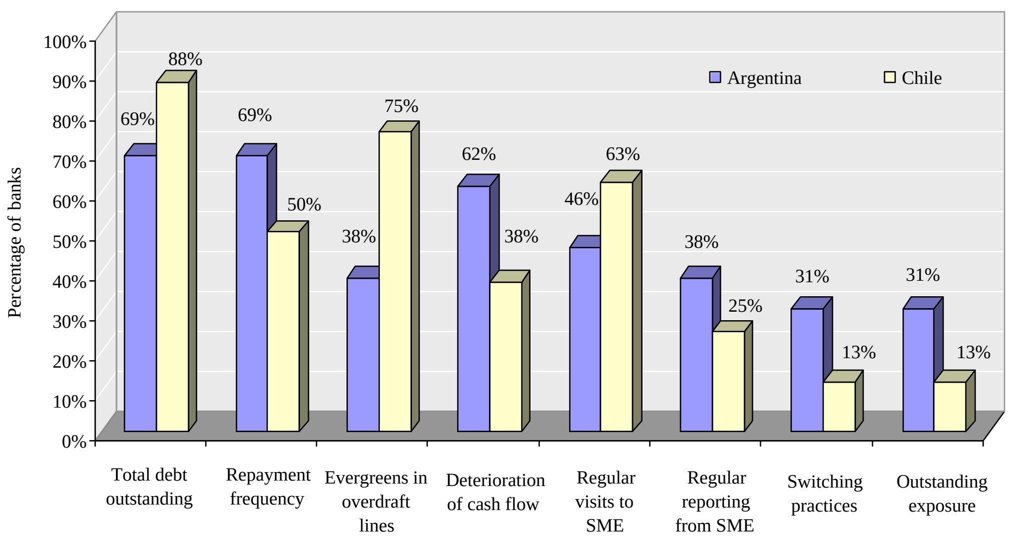
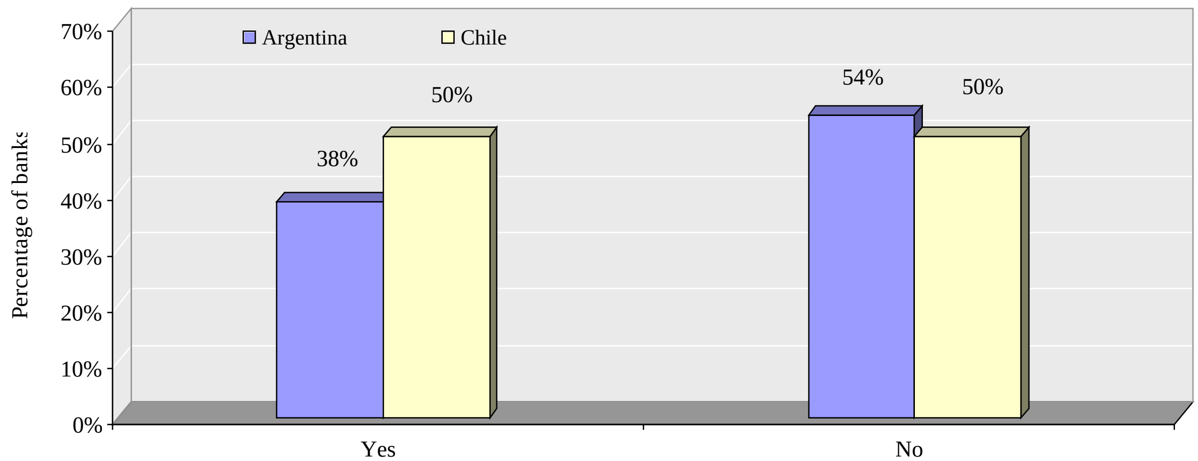


Figure 24
Portfolio approach to credit exposure monitoring

This figure examines the importance of the portfolio approach in credit exposure monitoring of the SME segment and describes the way portfolios are structured. For Figure 24.A banks are asked: "Does the bank manage the exposure to SMEs using a portfolio approach?" For Figure 24.B: "Describe the portfolio you use to monitor SME credit exposure."

A. Does the bank manage the exposure to SMEs using a portfolio approach



B. Describe the portfolio you use to monitor SME credit exposure

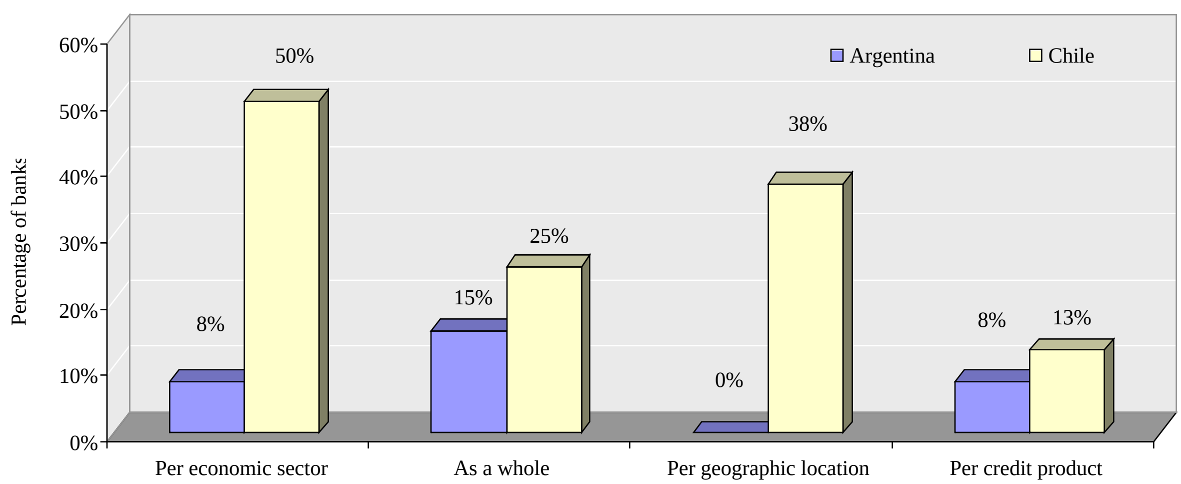
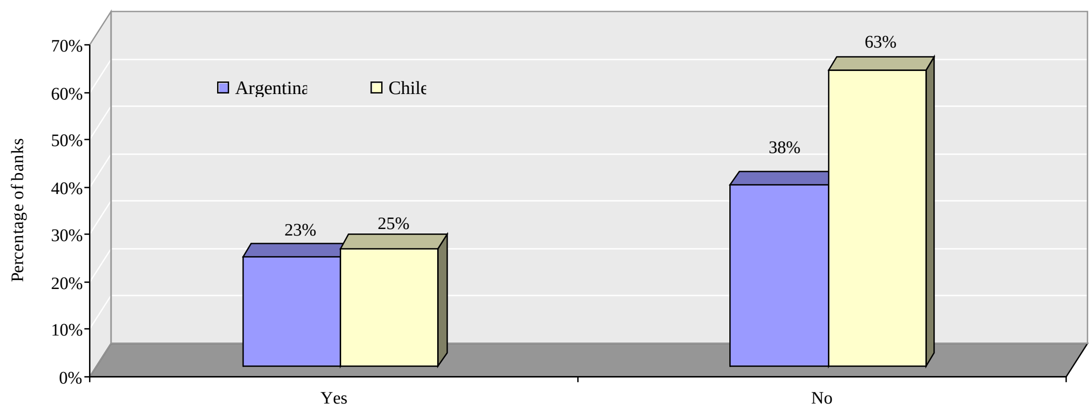


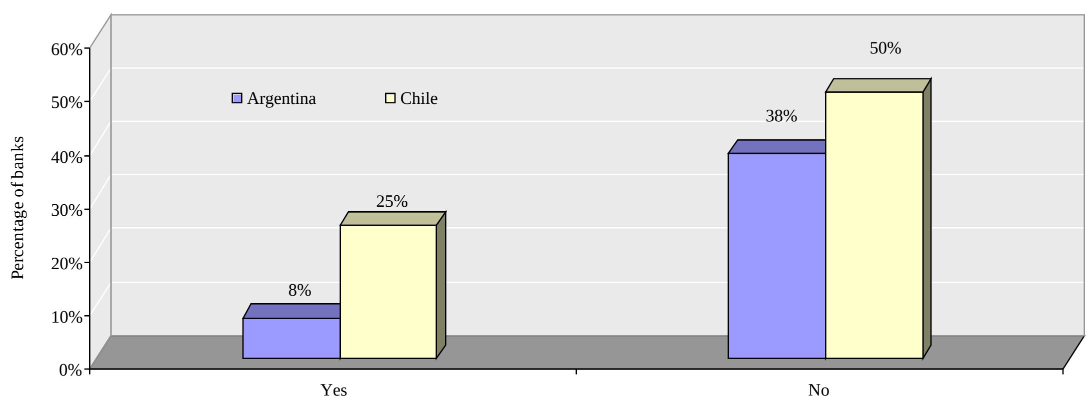
Figure 25
Management of non-performing loans (I)

This figure illustrates the fact that banks have not developed the mechanisms to incorporate information regarding SME losses in estimates of SME lending. For Figure 25.A banks are asked: "Do past losses feed into some model/estimate of minimum interest rate spread to cover expected losses?" For Figure 25.B: "Do past losses feed into some estimate of capital requirements?" For Figure 25.C: "What is the average percent share of SME loans recovery?"

A. Do past losses feed into interest rates to cover expected losses?



B. Do past losses feed into capital requirements?



C. What is the average share of SME loans recovered?

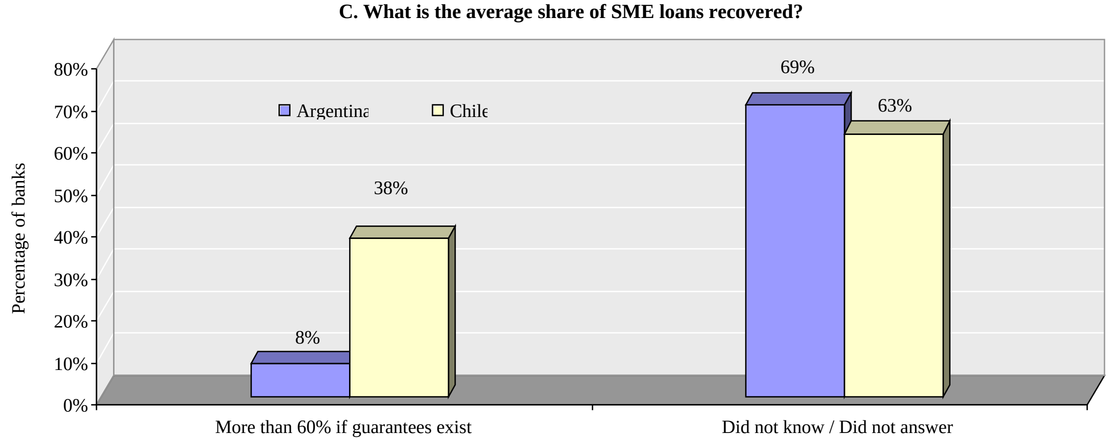
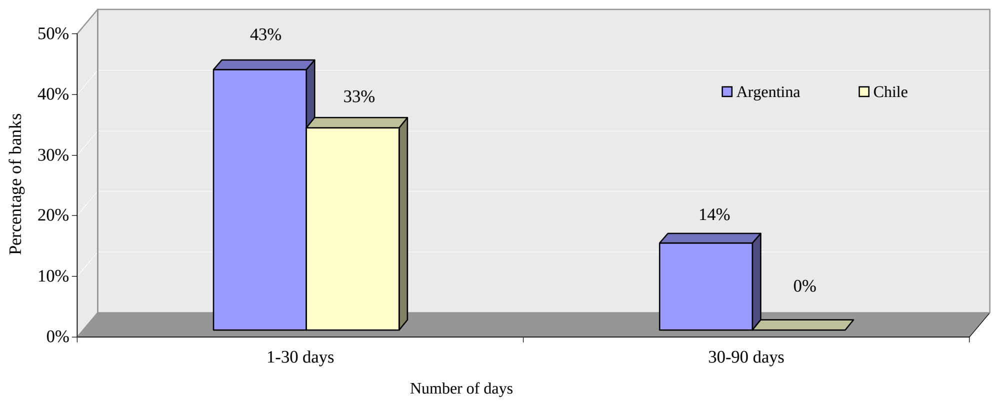


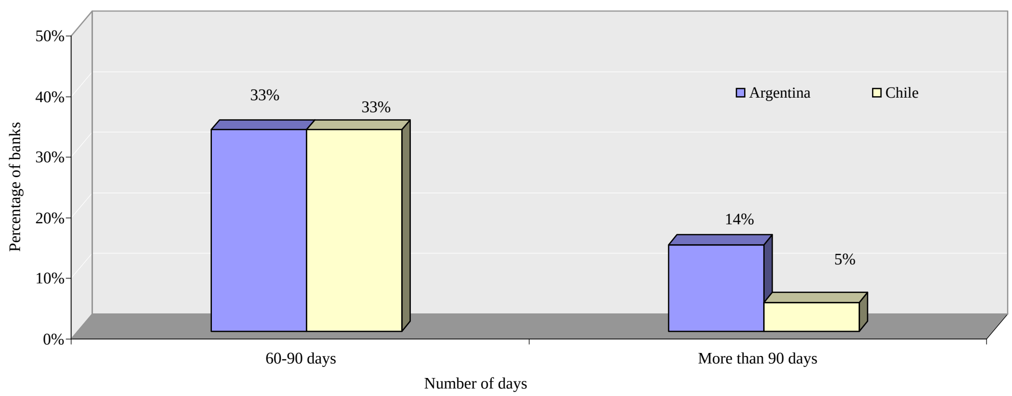
Figure 26
Management of non-performing loans (II)

Banks are asked after how many days a non-serviced SME loan is considered overdue and after how many days it is re-classified as non-accrual. Intervals are constructed to group these answers. Figures 26.A and 26.B show the percentage of banks that fall into each interval. Figure 26.C shows the percentage of banks that keep track of different items; the percentages shown in the bottom panel are calculated from the aggregate sample for Argentina and Chile. For Figure 26.A banks are asked: "After how many days is a non-serviced SME loan considered overdue?" For Figure 26.B: "After how many days is it re-classified as non-accrual?" For Figure 26.B: "Do you keep track of the loss given default on SMEs?" "Do you systematically keep track of the amounts recovered vs. amounts under default?" "Do you keep track of the length of time it takes to recover a non-performing loan?" and "Do you keep track of the costs to recover a non-performing loan?"

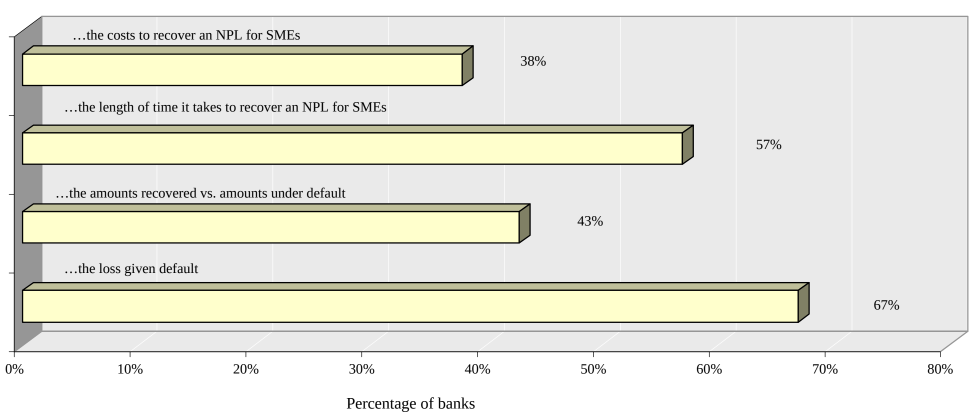
A. After how many days is a non-serviced SME loan considered overdue?



B. After how many days is a non-serviced SME loan classified as non-accrual?



C . Percentage of banks that keep track of…



Appendix Table 1
Government programs

Argentina

SEPyME - Interest rate subsidy

This is a program of the SME Secretary that links small entrepreneurs with financial institutions, subsidizing up to eight percentage points on loans to SMEs. The subsidies are granted through public bids to the banks that offer the lowest interest rates. Since this program was first applied in August 2003, more than 200,000 operations have been supported by this program and funds have totaled AR$1,300,000 for the financing of working capital and investment projects.

National Guarantee System

This system is composed of Reciprocal Guarantee Societies (Sociedades de Garantía Recíproca, SGR) and a provincial public guarantee fund called Guarantee Fund of the Buenos Aires Province (FOGABA). SGRs are private corporations whose objective is to increase SME access to financing by providing guarantees for their loans through a fund that fosters risk taking. This is a strategic association since SGRs are formed by participating shareholders (SMEs), and protecting shareholders (public or private, domestic or foreign entities). Protecting shareholders make the main contributions to the fund while participating shareholders make small contributions and are the beneficiaries of the guarantees backed by the fund. One of the advantages of SGRs is that contributions to the fund are exempted from income and value added tax as long as some conditions are met. In 2005 there were 20 SGRs with a US$112.4 million fund guaranteeing US$97.7 million in credit. FOGABA usually limits coverage to 75% of the loan value, has a fund of US$8.3 million and a stock of guarantees of US$12 million.

FONTAR (Fondo Tecnológico Argentino / Argentine Technological Fund)

FONTAR finances public and private projects that promote innovation and technological modernization through a wide variety of financial instruments. The funds are provided by domestic or foreign sources, from both public and private entities, who can demand these funds to be applied to general or specific uses in the promotion of technological innovation. FONTAR also provides technical assistance, personnel training programs, and a thorough monitoring of these projects.

Chile

FOGAPE (Fondo de Garantía para Pequeños Empresarios / Small Enterprise Guarantee Fund)

FOGAPE is a guarantee system that allows SMEs to overcome their lack of guarantees or insufficient guarantees to access lending from the financial system. It is a public fund managed by Banco Estado that provides partial credit guarantees to working capital loans or investment loans provided by commercial banks to SMEs. Its design includes several features to reduce moral hazard problems: partial credit guarantees that force banks to share part of the risk, a bidding process that determines how risks are shared among FOGAPE and financial intermediaries, the exclusion of banks with high default rates on guaranteed loans from future bidding processes, and limits on the guarantees that each bank can obtain from FOGAPE.

FECU-PyME (Ficha Unica Codificada Uniforme para PyMEs / Uniform Codificated Reporting Scheme for SMEs)

FECU-PyME is a joint private and public initiative undertaken by the Superintendence of Banks and Financial Institutions (SBIF) and the Chilean Association of Banks (ABIF) aimed at simplifying and standardizing the available SME financial information. The implementation of a unified reporting scheme for SMEs seeks to solve the lack of quality information, increase transparency, and improve the relation between SMEs and the financial system.

CORFO (Corporación de Fomento a la Producción / Corporation of Production Promotion)

CORFO is a public entity that offers a wide variety of programs to promote the development of technological innovation, investment projects, export-related activities, education scholarships, and regional integration. Its financial services include loans, guarantees, leasing, and factoring.

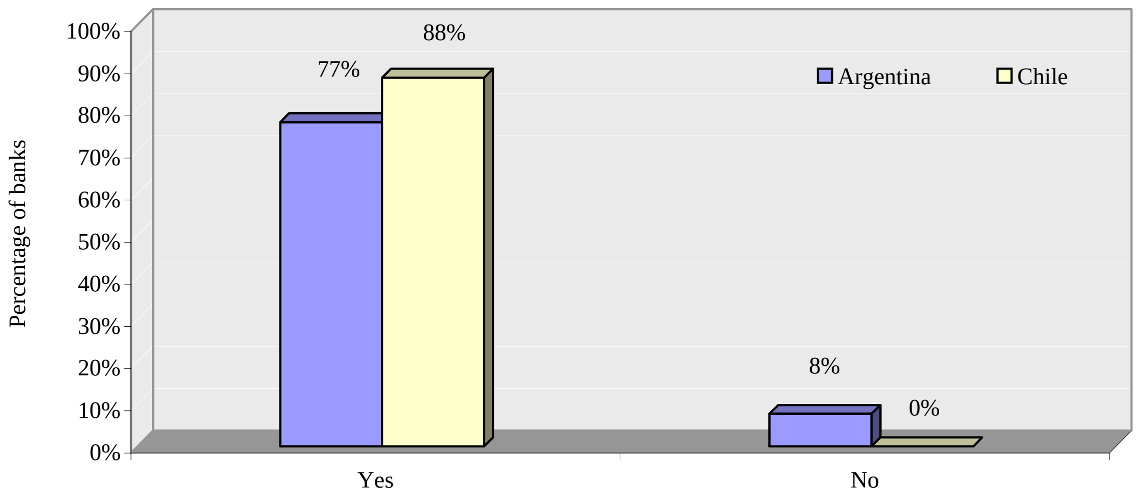
Chile Compite

Chile Compite is a government program that was launched in June 2006 and is aimed at promoting technological innovation and SME access to financing through a comprehensive package of 15 plans. This program includes regulatory simplifications, tax reductions for software imports, technical assistance, exemptions to the stamp tax for SMEs, subsidies of up to 35% for research and development programs, and the creation of a National Secretary for Innovation, among others.

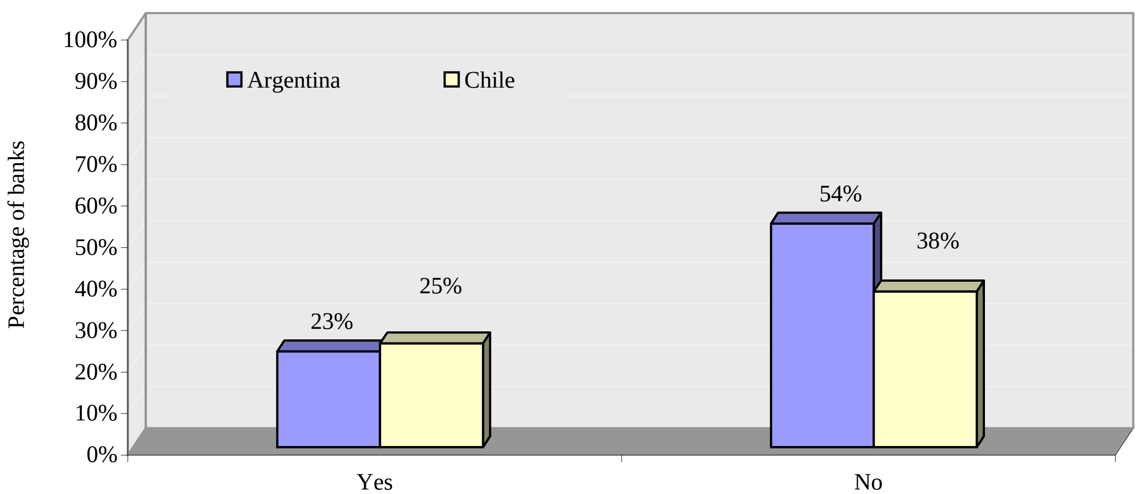
Appendix Figure 1
Bank involvement with SMEs (I)

The titles of these panels display the questions we ask banks as stated in the Questionnaire.

A. Does the bank currently have a separate unit managing the banking relation with SMEs?



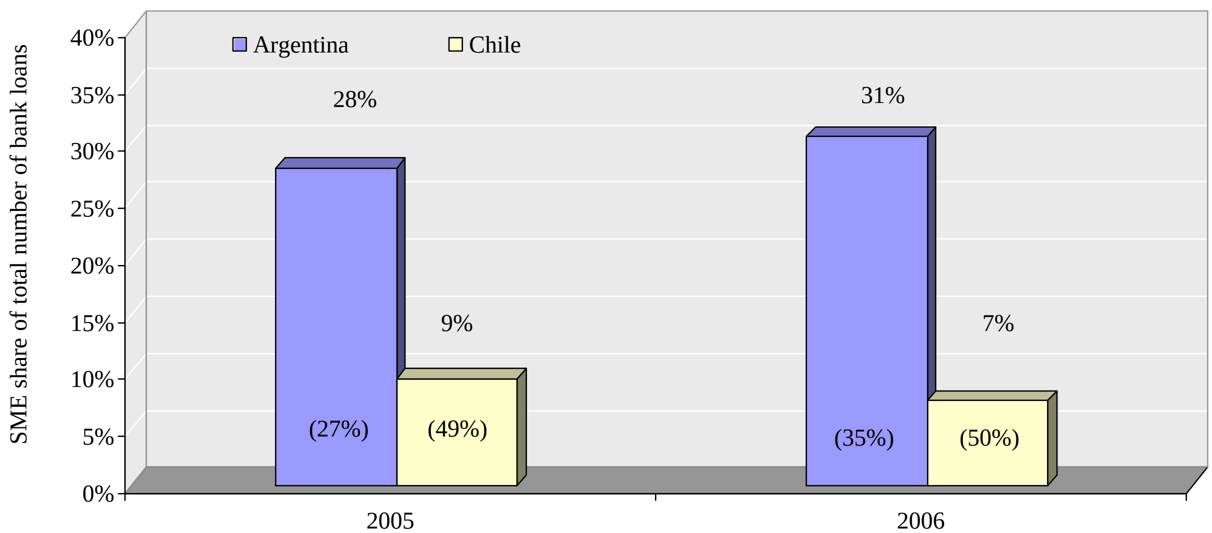
B. Does the bank have a well-defined process to determine the SME target market and sectors?



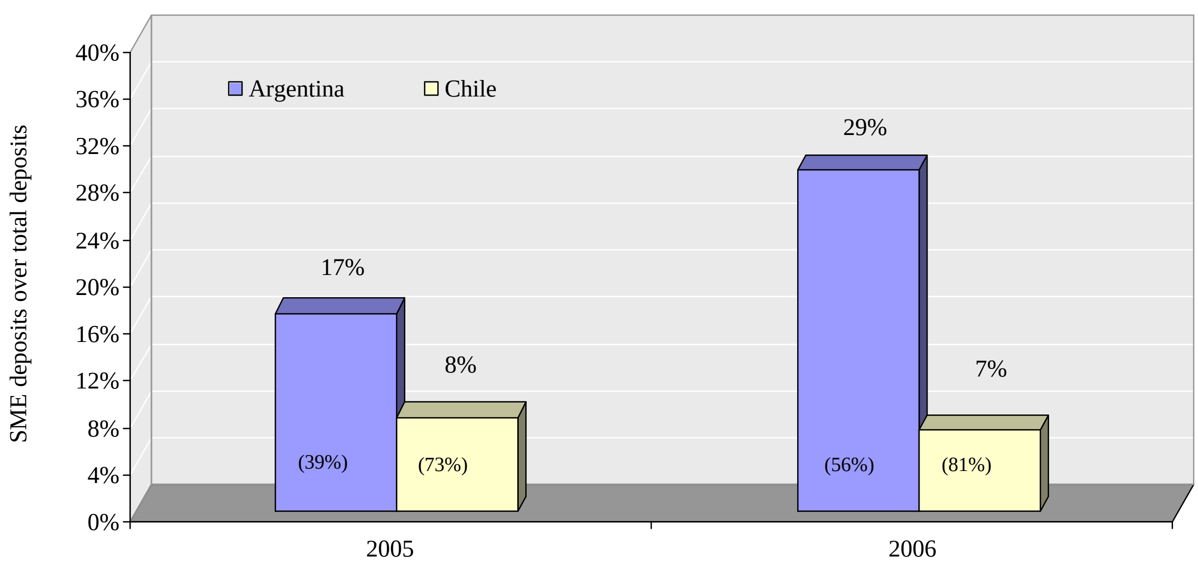
Appendix Figure 2
Bank involvement with SMEs (II)

The source of this figure is the data collected from banks. Appendix Figure 2.A displays the simple average of the number of SME loans as a percentage of the total number of bank loans in each bank. Appendix Figure 2.B displays total SME deposits as a percentage of total deposits from the private sector. Appendix Figure 2.A presents in parentheses the proportion of total loans to the private sector that corresponds to the banks that answered while Appendix Figure 2.B displays in parentheses the proportion of total deposits that corresponds to the banks that answered.

A. SME loans over total bank loans
By number of loans



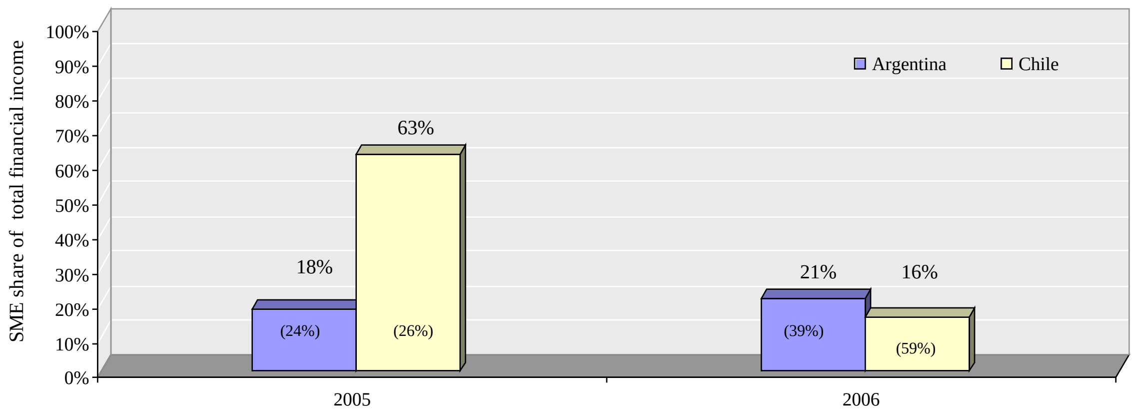
B. SME deposits over total bank deposits



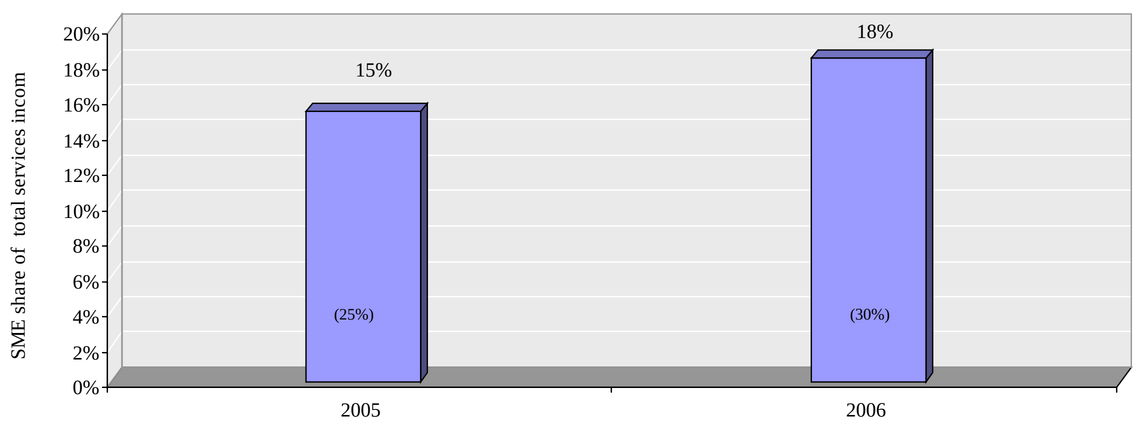
Appendix Figure 3
Bank involvement with SMEs (III)

The source of this figure is the data collected from banks. The panels report the average values of the information that banks provide, weighted according to bank loans to the private sector. Appendix Figure 3.B only displays the information for Argentina because few Chilean banks provided this information. Appendix Figures 3.A and 3.B present in parentheses the proportion of private sector loans that corresponds to the banks that answered.

A. SME financial income over total bank financial income
Weighted according to bank loans to the private sector



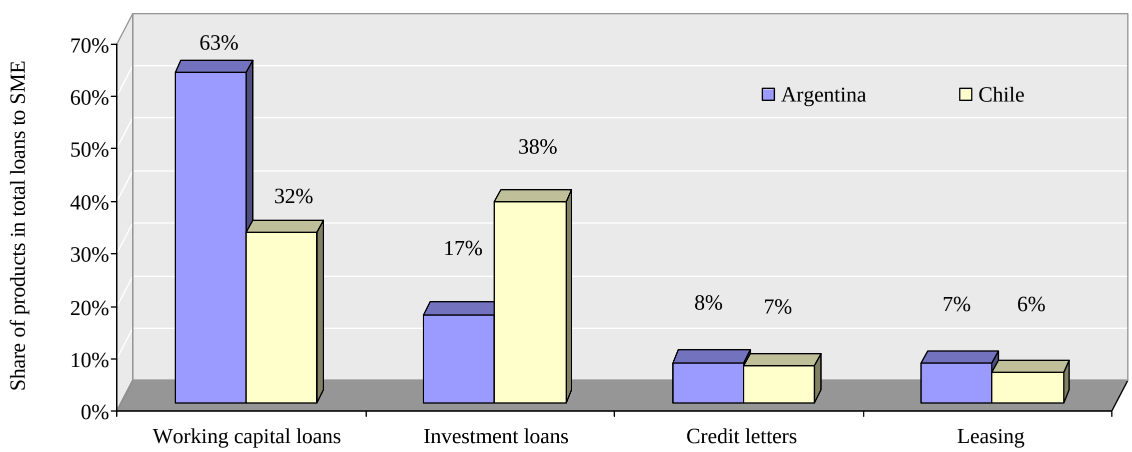
B. SME services income over total bank services income
Weighted according to bank loans to the private sector



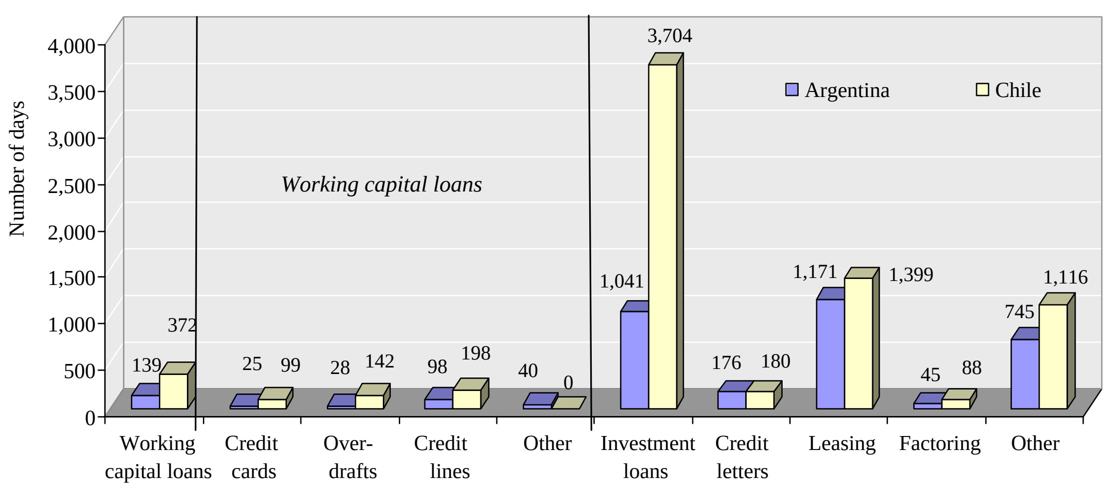
Appendix Figure 4
Bank involvement with SMEs (IV)

The source of this figure is the data collected from banks. The banks that answered the information displayed in Appendix Figure 4.A represent around 40% of the private sector loans in each country and the banks that answered the information displayed in Appendix Figure 4.B represent between 15% and 20% of the private sector loans in each country. Appendix Figure 4.A presents the share of each product in total bank lending to SMEs. Appendix Figure 4.B displays the weighted average of the terms of the main lending products to SMEs, weighted according to the amount each bank lends of each product.

A. Share of main products in total lending to SMEs



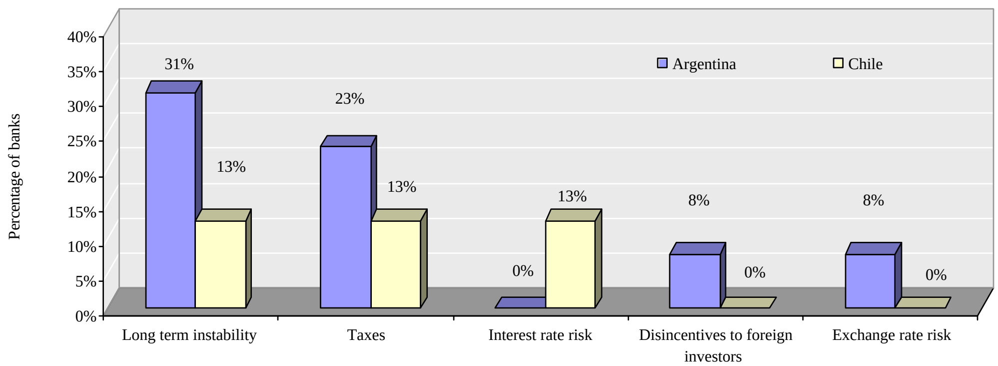
B. Average term of main lending products to SMEs
Weighted average according to bank lending of each product



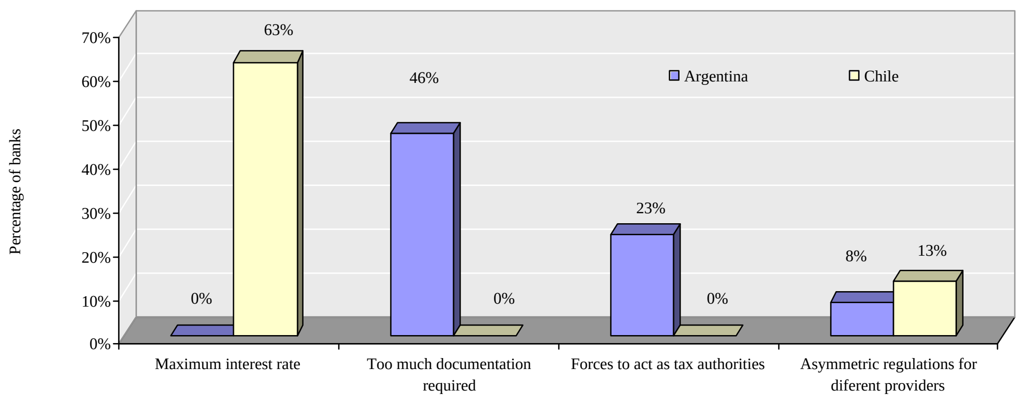
Appendix Figure 5
Obstacles to bank involvement with SMEs (I)

For Appendix Figure 5, Appendix Figure 6, and Appendix Figure 7 we ask banks: "Indicate to what degree the following factors are important obstacles to your exposure to SMEs. Rate under each heading and specify up to the three most important aspects within these categories." The categories are: macroeconomic factors, regulations, legal and contractual environment, bank-specific factors, SME-specific factors, nature of the lending technology to SMEs, competition in the SME segment, and lack of adequate demand. In Appendix Figure 5, Appendix Figure 6, and Appendix Figure 7 we present the most-frequently mentioned aspects for each category.

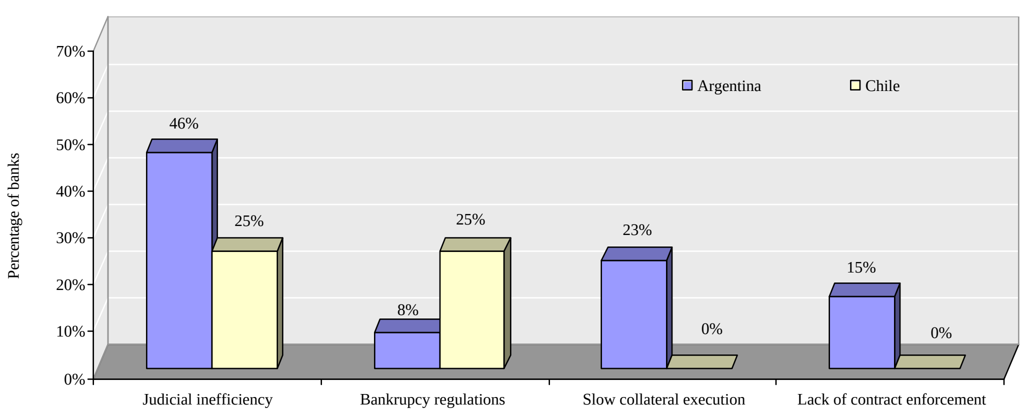
A. Macroeconomic aspects mentioned as obstacles to bank involvement with SMEs



B. Regulatory aspects mentioned as obstacles to bank involvement with SMEs



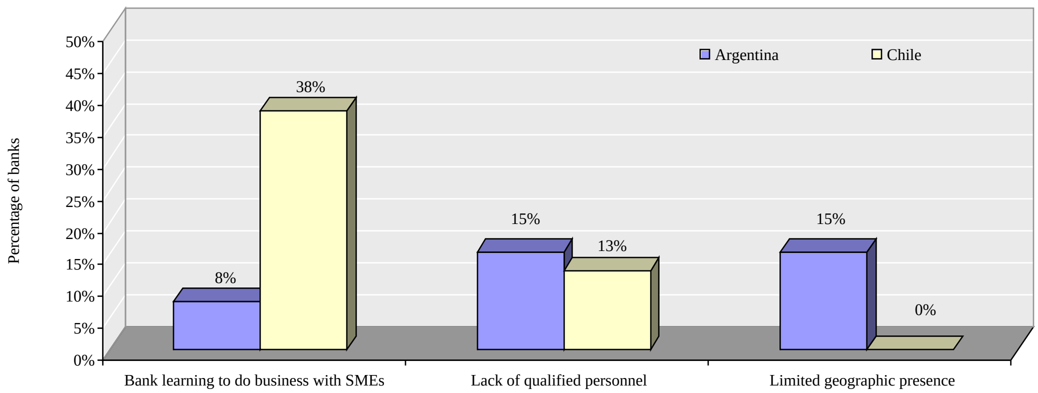
C. Aspects from the legal and contractual environment mentioned as obstacles to bank involvement with SMEs



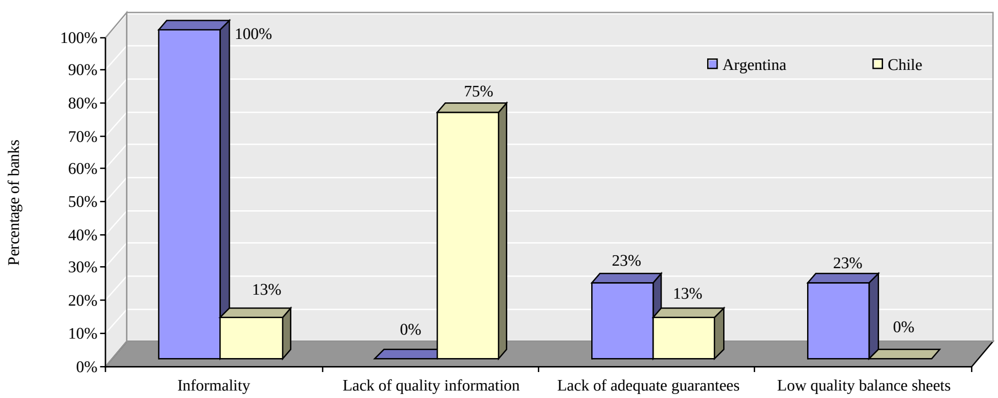
Appendix Figure 6
Obstacles to bank involvement with SMEs (II)

For Appendix Figure 5, Appendix Figure 6, and Appendix Figure 7 we ask banks: "Indicate to what degree the following factors are important obstacles to your exposure to SMEs. Rate under each heading and specify up to the three most important aspects within these categories." The categories are: macroeconomic factors, regulations, legal and contractual environment, bank-specific factors, SME-specific factors, nature of the lending technology to SMEs, competition in the SME segment, and lack of adequate demand. In Appendix Figure 5, Appendix Figure 6, and Appendix Figure 7 we present the most-frequently mentioned aspects for each category.

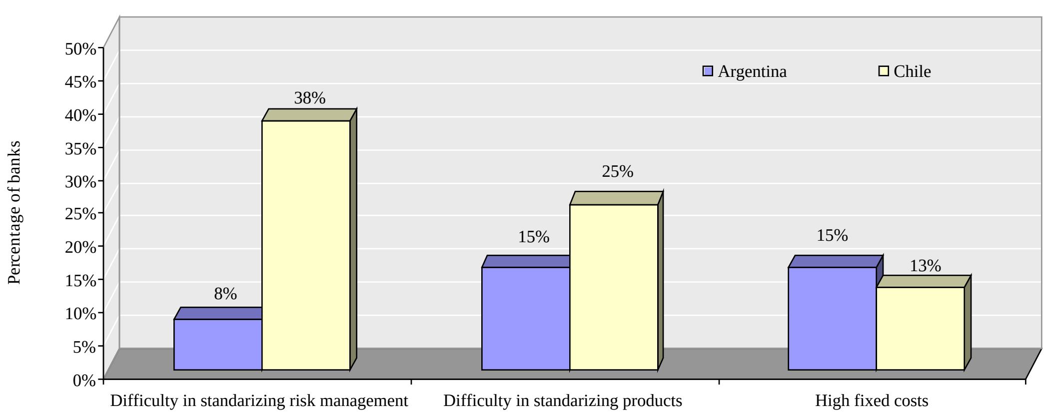
A. Bank-specific aspects mentioned as obstacles to bank involvement with SMEs



B. SME-specific aspects mentioned as obstacles to bank involvement with SMEs



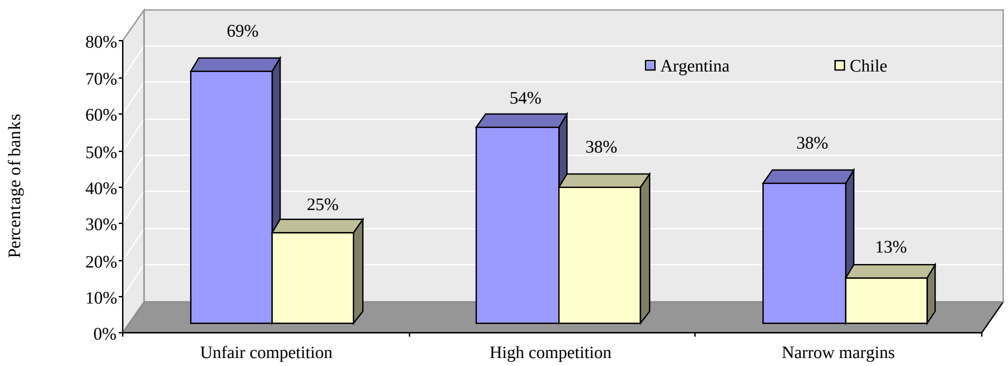
C. Aspects of the lending technology to SMEs mentioned as obstacles to bank involvement with SMEs



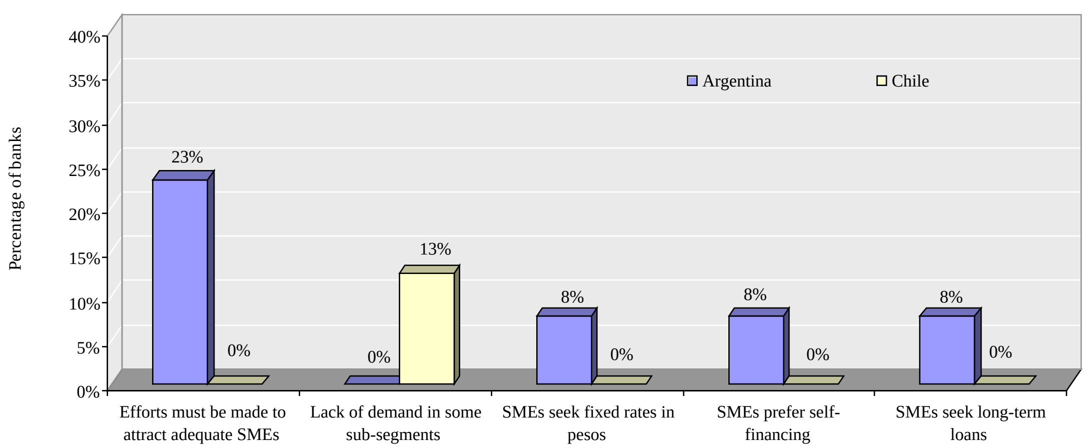
Appendix Figure 7
Obstacles to bank involvement with SMEs (III)

For Appendix Figure 5, Appendix Figure 6, and Appendix Figure 7 we ask banks: "Indicate to what degree the following factors are important obstacles to your exposure to SMEs. Rate under each heading and specify up to the three most important aspects within these categories." The categories are: macroeconomic factors, regulations, legal and contractual environment, bank-specific factors, SME-specific factors, nature of the lending technology to SMEs, competition in the SME segment, and lack of adequate demand. In Appendix Figure 5, Appendix Figure 6, and Appendix Figure 7 we present the most-frequently mentioned aspects for each category.

A. Aspects related to the competition mentioned as obstacles to bank involvement with SMEs



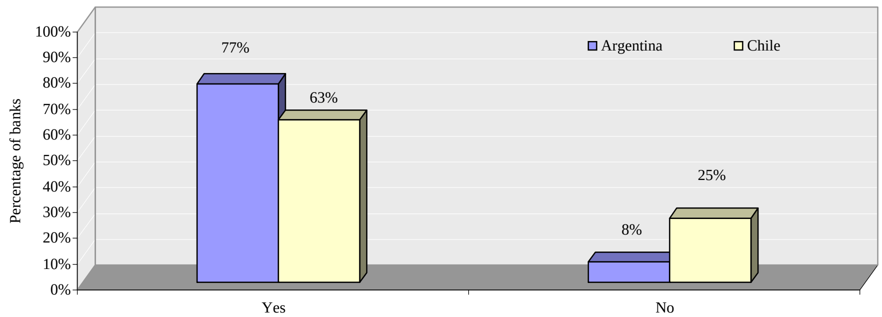
B. Aspects related to demand mentioned as obstacles to bank involvement with SMEs



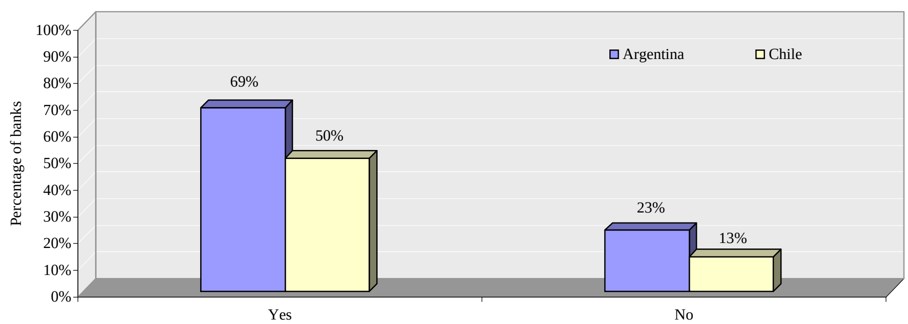
Appendix Figure 8
SME lending market environment

The titles of these panels display the questions we ask banks as stated in the Questionnaire. The question shown in the bottom panel is only asked to private banks.

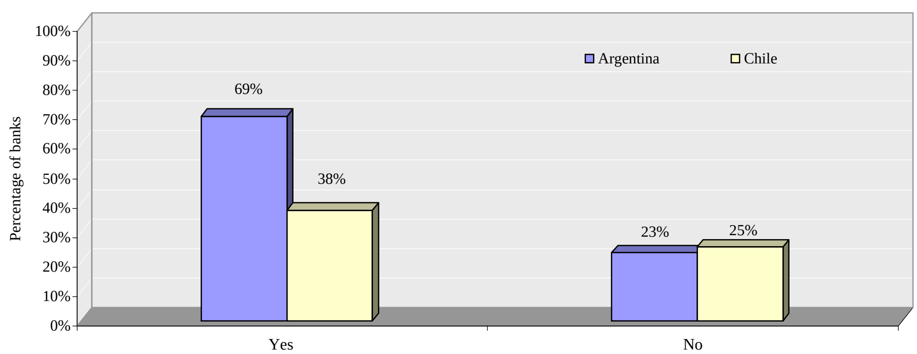
A. Have there been significant changes over time in bank SME lending in terms of competition, consolidation, and entry?



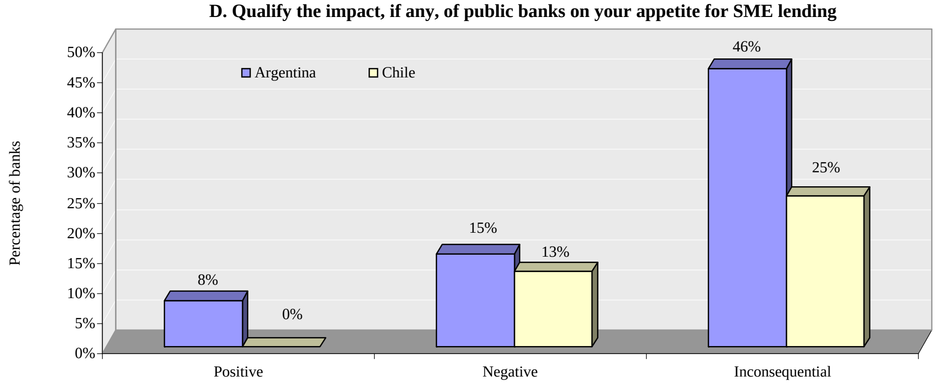
B. Do you lend to SMEs after seeing other banks do so?



C. Is there a first movers' advantage?



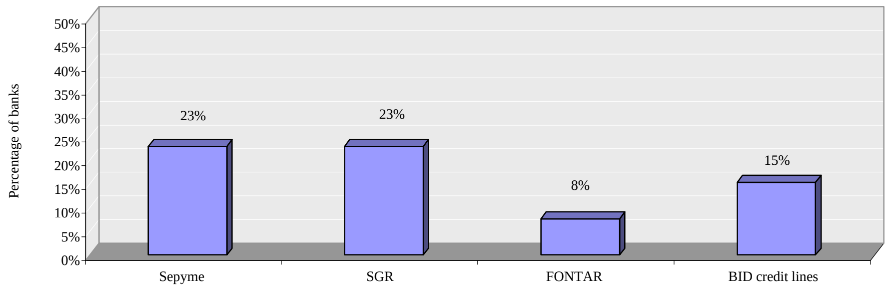
D. Qualify the impact, if any, of public banks on your appetite for SME lending



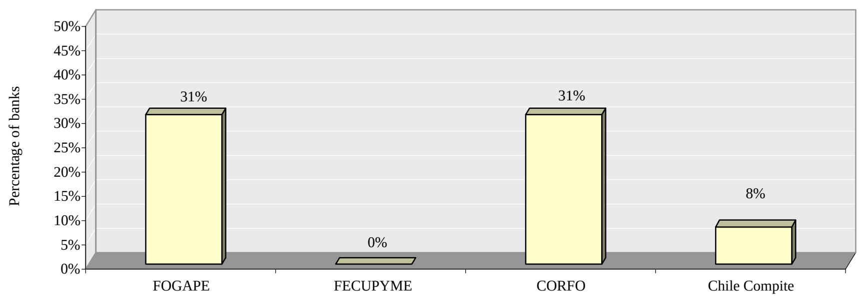
Appendix Figure 9
Government programs

For Appendix Figure 9.A and 9.B banks are ask to: "List the government programs that you are familiar with that directly or indirectly affect your involvement with SMEs and discuss (a) their additionality in terms of increased financing (new loans and low interest rates) and (b) the degree of risk sharing with the public sector." For Appendix Figure 9.C we ask banks: "If you think government programs affect your involvement with SMEs, qualify the effect: overall positive, overall negative, or inconsequential. Please list up to three programs and qualify their impact." For Appendix Figure 9.D we ask banks: "To what extent do you lend to SMEs based on local credit enhancement programs."

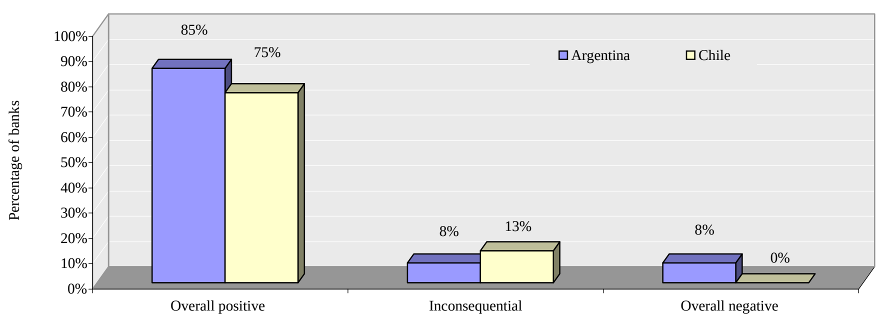
A. Government programs that generate additionality (Argentina)



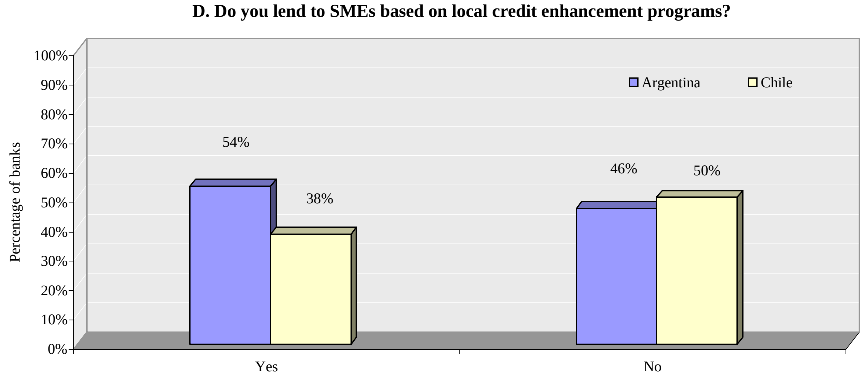
B. Government programs that generate additionality (Chile)



C. Qualify the effect of government programs on your involvement with SMEs



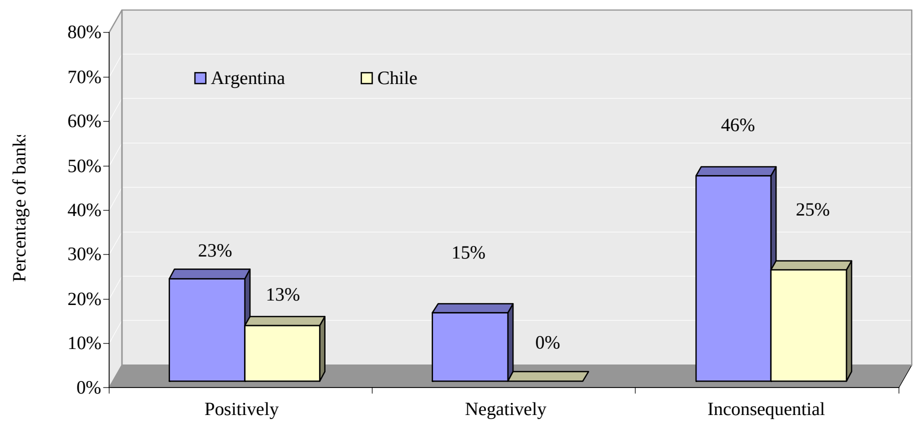
D. Do you lend to SMEs based on local credit enhancement programs?



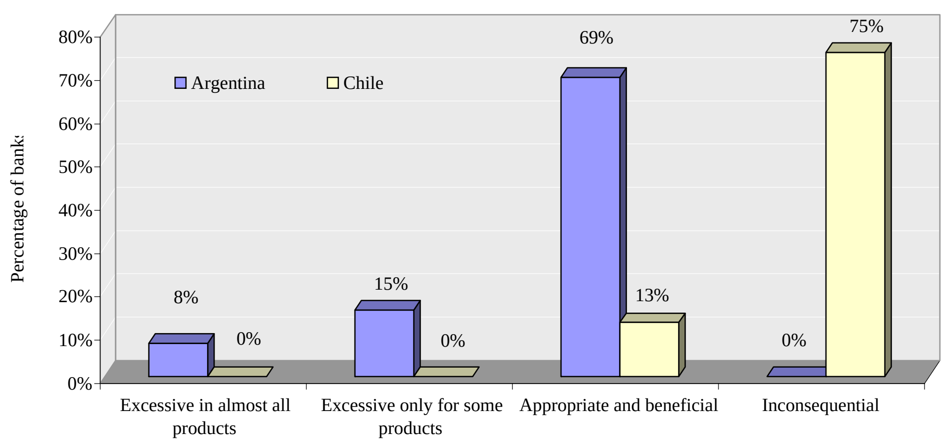
Appendix Figure 10
Regulations (I)

The titles of these panels display the questions we ask banks as stated in the Questionnaire.

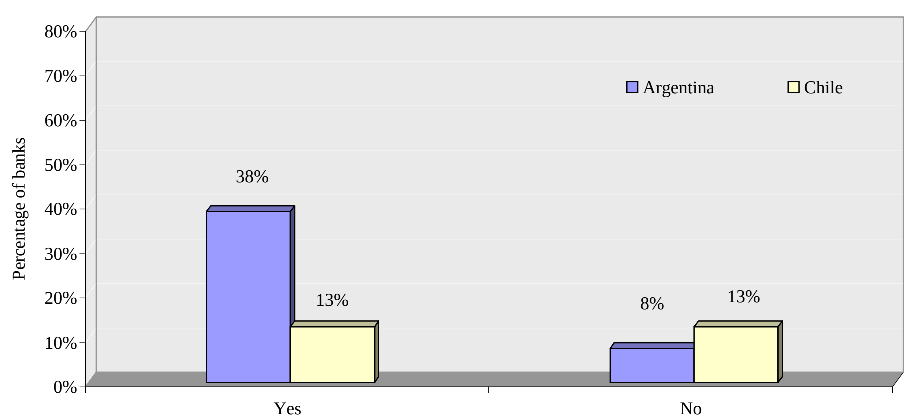
A. How does prudential regulation affect your involvement with SMEs?



B. Give your impression of the burden posed by regulatory requirements on commercial lending to SMEs



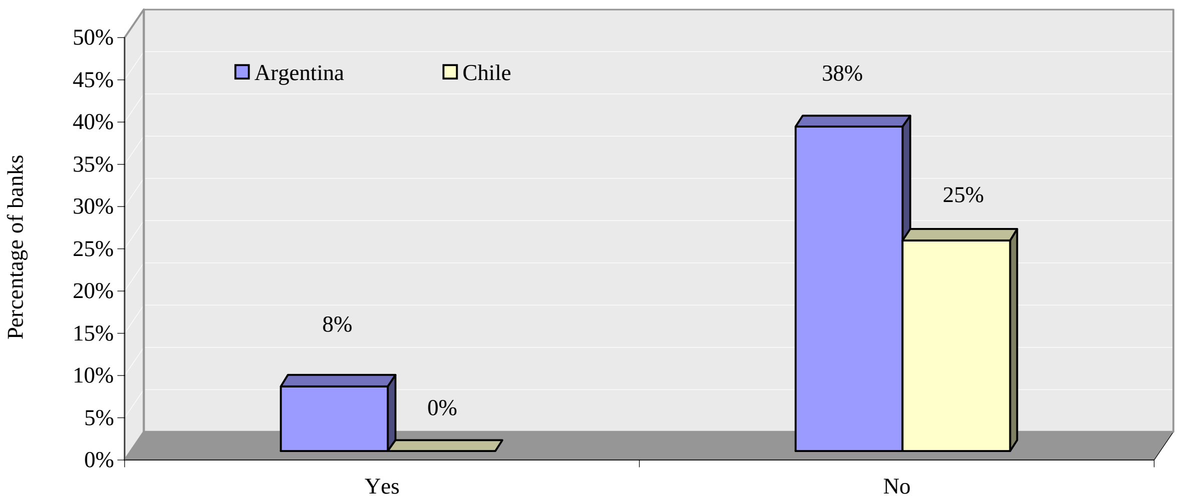
C. Are there differences in the required documentation for commercial lending based on the size of loan?



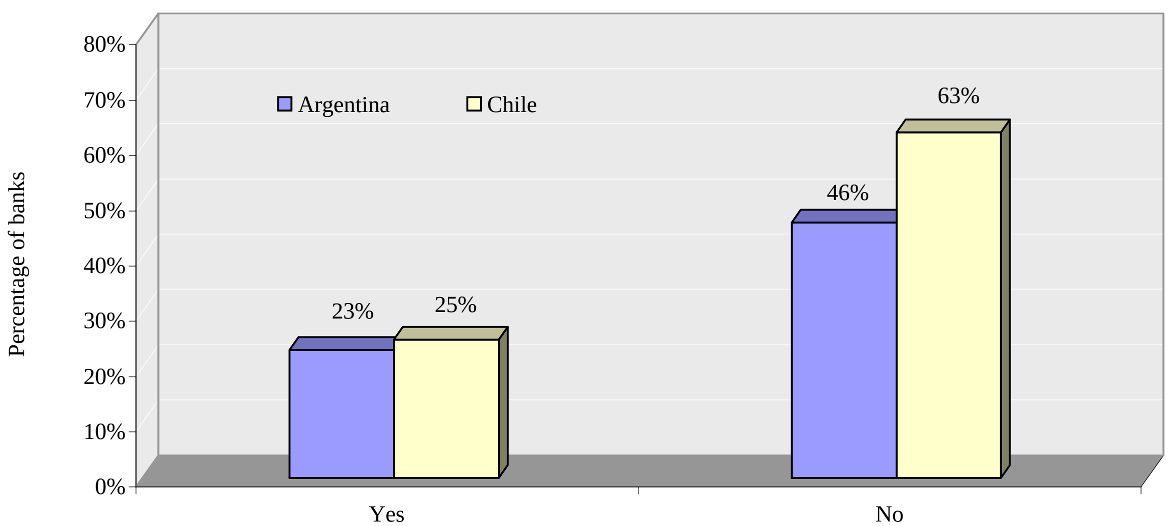
Appendix Figure 11
Regulations (II)

The titles of these panels display the questions we ask banks as stated in the Questionnaire.

A. Does the regulatory definition of secured loans (in terms of collateral) inhibit SME lending?



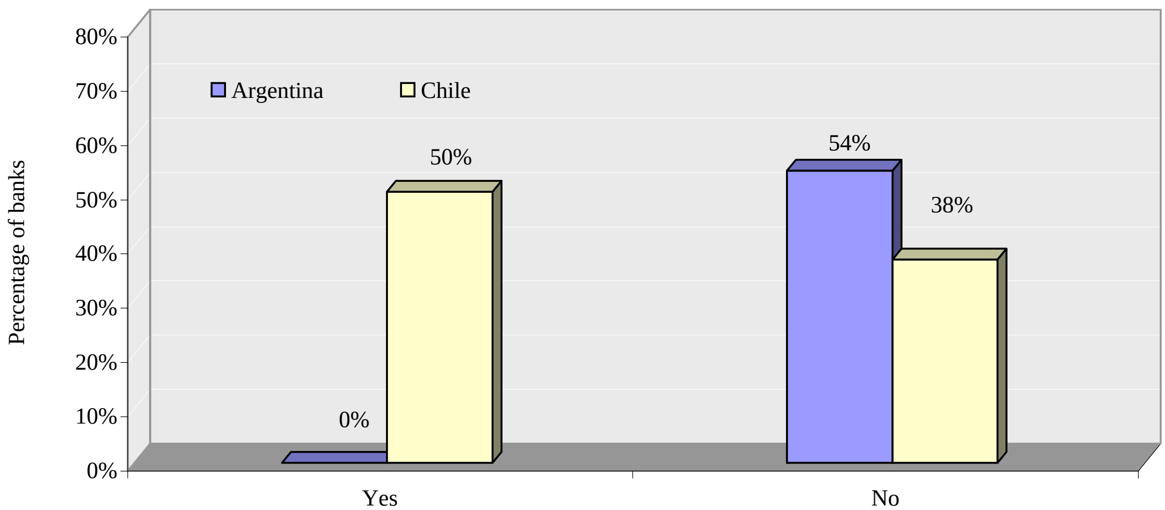
B. Are there regulatory issues in registering collateral that inhibit SME secured lending?



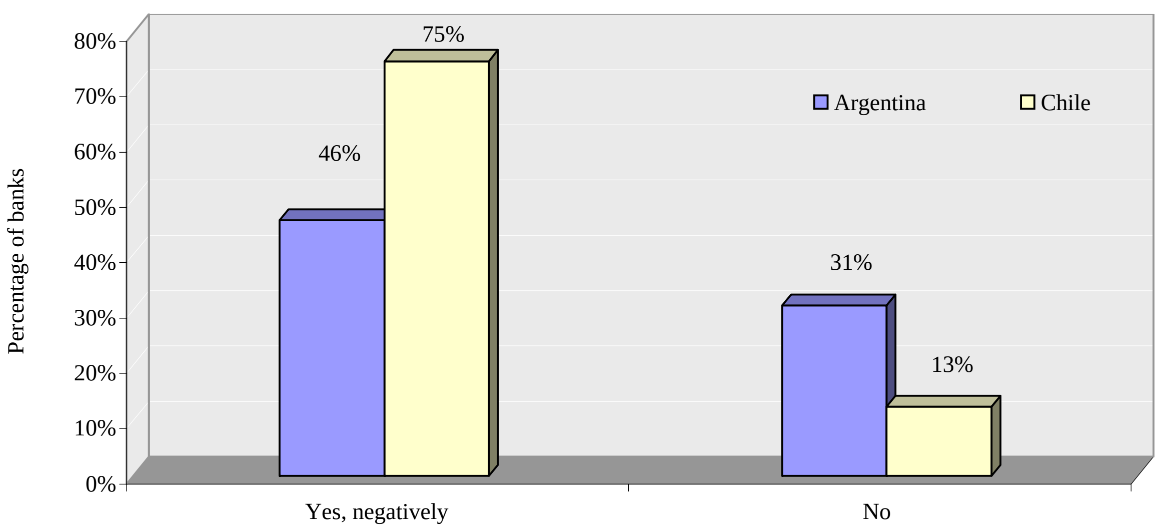
Appendix Figure 12
Regulations (III)

The titles of these panels display the questions we ask banks as stated in the Questionnaire.

A. Do maximum lending rates, if any, have an impact on your appetite for SME lending?



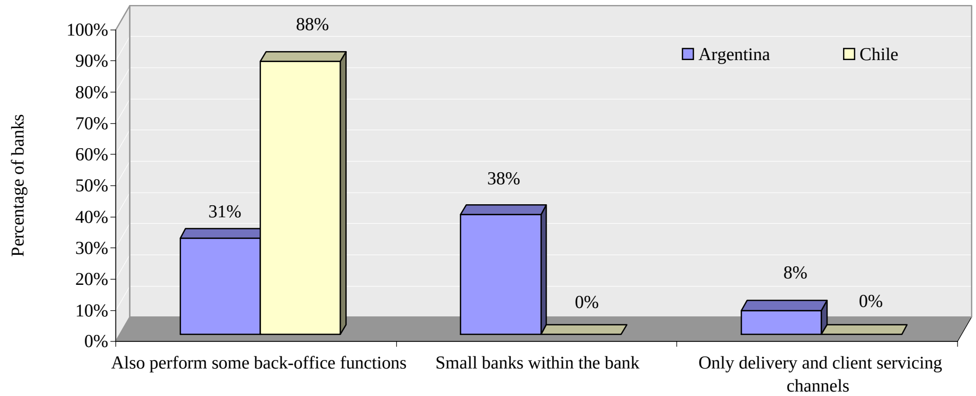
B. Do any tax related issues affect your appetite for SME lending?



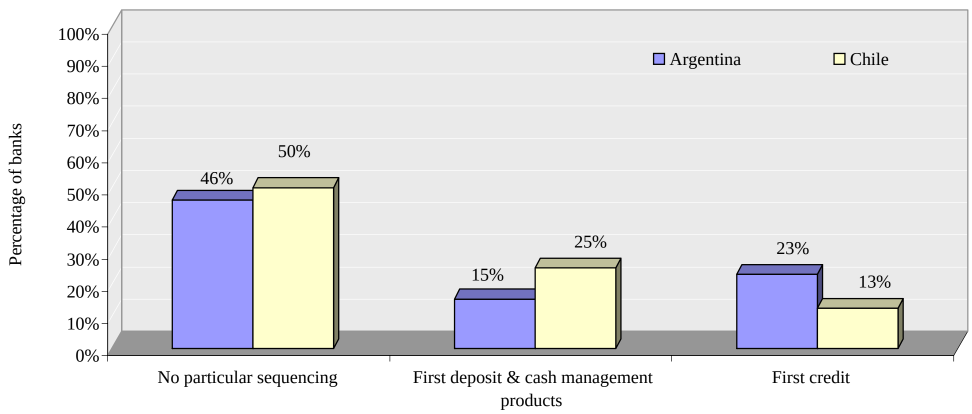
Appendix Figure 13
Business model (I)

The titles of Appendix Figures 13.A and 13.B display the questions we ask banks as stated in the Questionnaire. For Appendix Figure 13.C we ask banks: "Describe the incentives to sales personnel to lend to SMEs, in terms of how they are evaluated, by loan volume granted, by number of clients, by profitability, by market share target, by non-performing loans, by successful cross-sale of other banking products, and other, please specify."

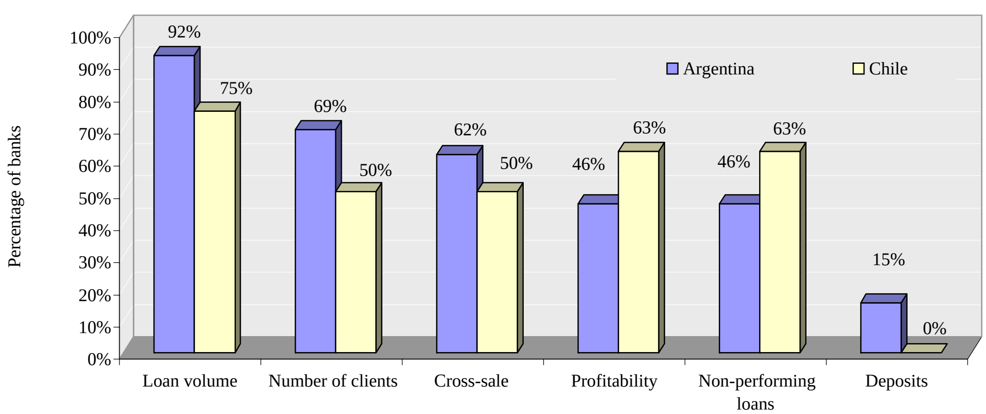
A. What is the role of branches?



B. In targeting new clients, is there a specific sequencing in how you offer products?



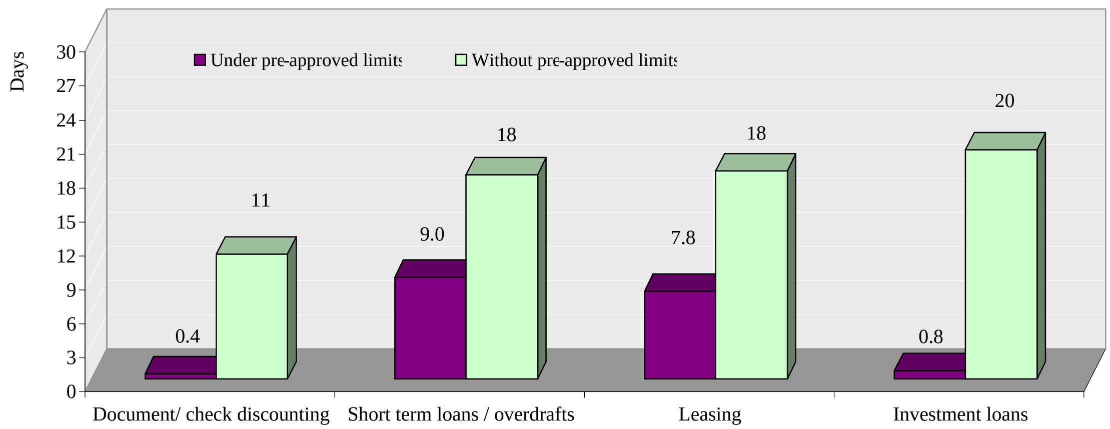
C. Criteria to grant incentives to SME sales personnel



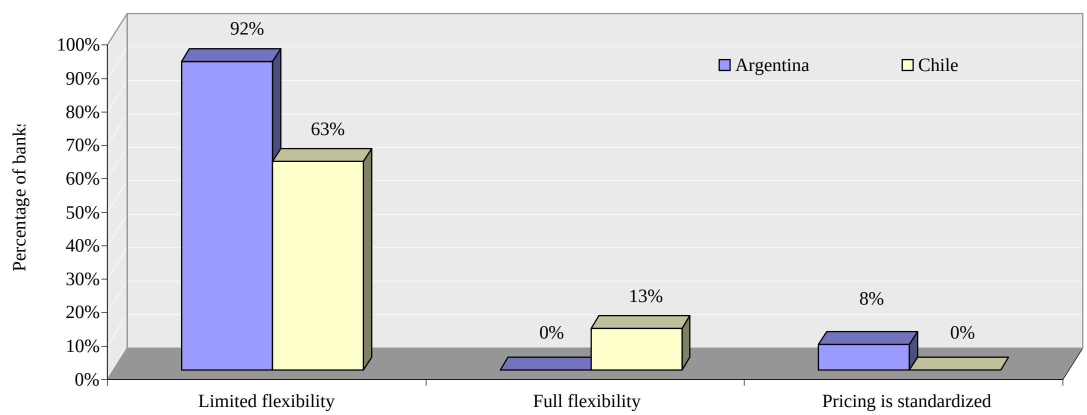
Appendix Figure 14
Business model (II)

For Appendix Figure 14.A banks are asked: "List and provide the following information for the main financing products offered to SMEs: i) Number of days to process a disbursement under pre-approved client limit, ii) Number of days to process a request without pre-approved limit, iii) Specific documentation needed to process a disbursement, and iv) Collateral required as percentage of financing." The title of Appendix Figure 14.B displays the question we asked banks as stated in the Questionnaire.

A. Average number of days to process a disbursement of main products



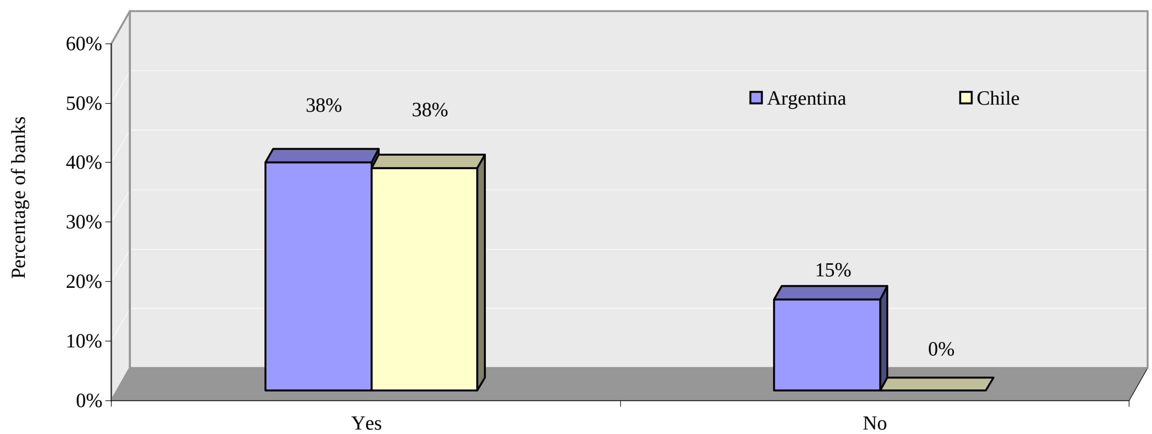
B. Which statement is more relevant for your bank when it comes to product pricing?



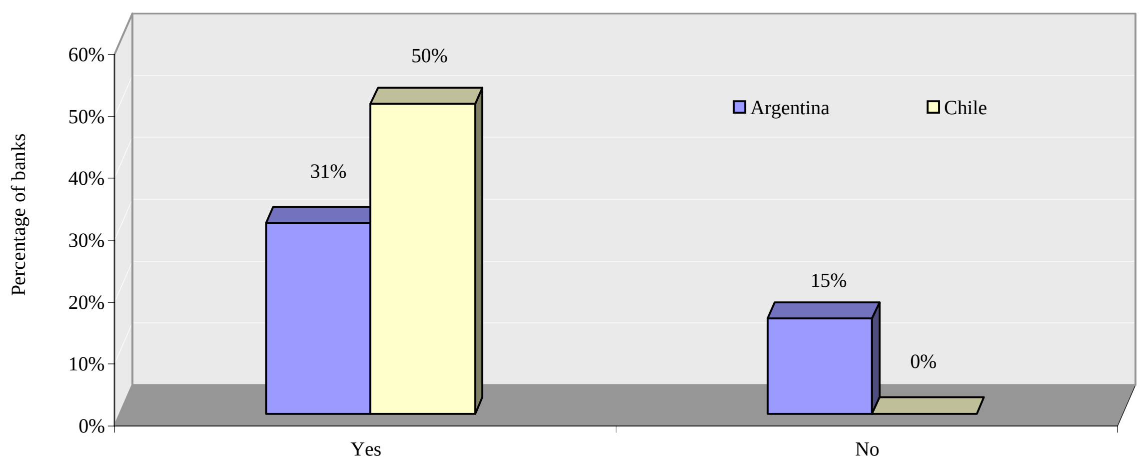
Appendix Figure 15
Business model (III)

The titles of these panels display the questions we ask banks as stated in the Questionnaire.

A. Are collateral requirements higher for SMEs than for large corporations?



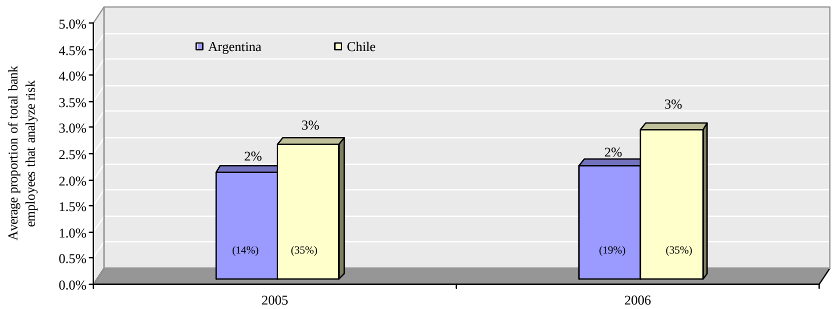
B. Are collateral requirements higher for SMEs than for consumers?



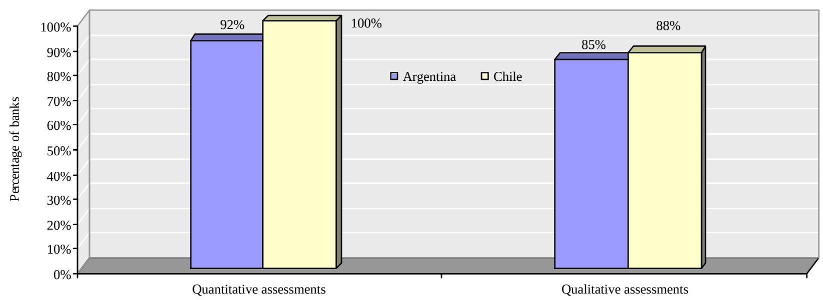
Appendix Figure 16
Risk management (I)

The source of Appendix Figure 16.A is the data collected from banks. The panel reports the average values of the information that banks provide. We present in parentheses the percentage of private sector loans that corresponds to the banks that answered. For Appendix Figures 16.B, 16.C, and 16.D the titles display the questions we asked banks as stated in the Questionnaire. Appendix Figure 16.C displays the information for the sample of Argentine banks while Appendix Figure 16.D displays the information for the sample of Chilean banks.

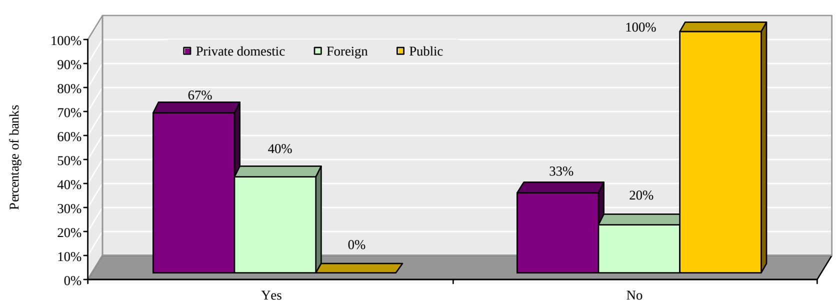
A. Average percentage of total employees that analyze risk



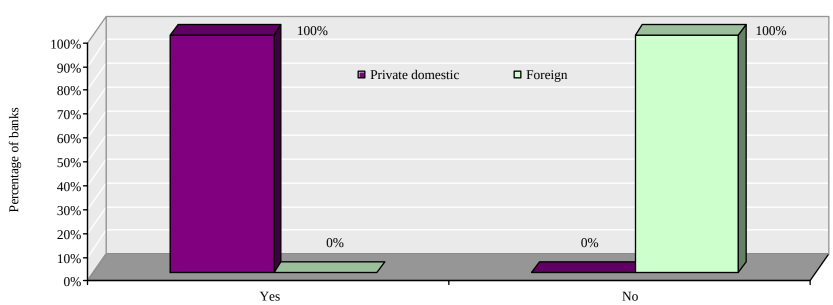
B. Does credit analysis rely on quantitative assessments? And on qualitative assessments?



C. Does your bank use scoring models to select SMEs? (Argentina)



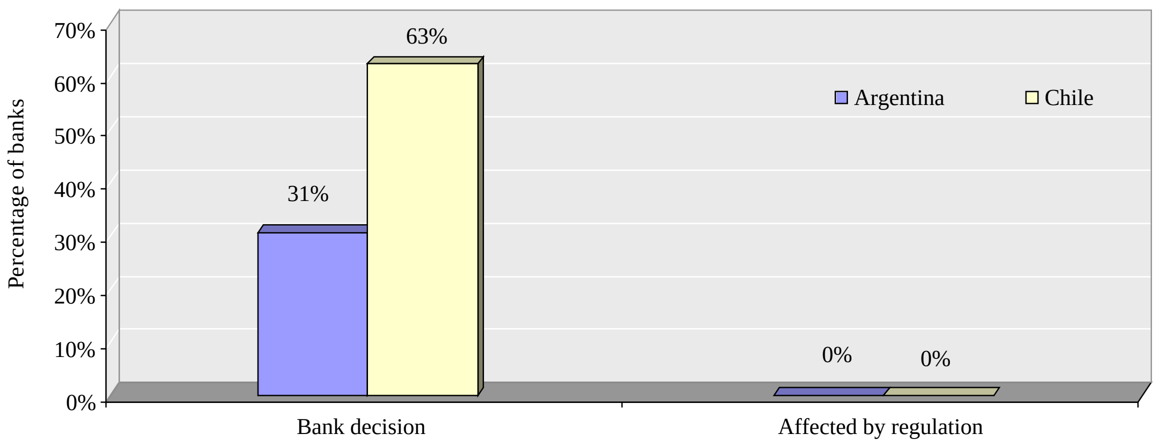
D. Does your bank use scoring models to select SMEs? (Chile)



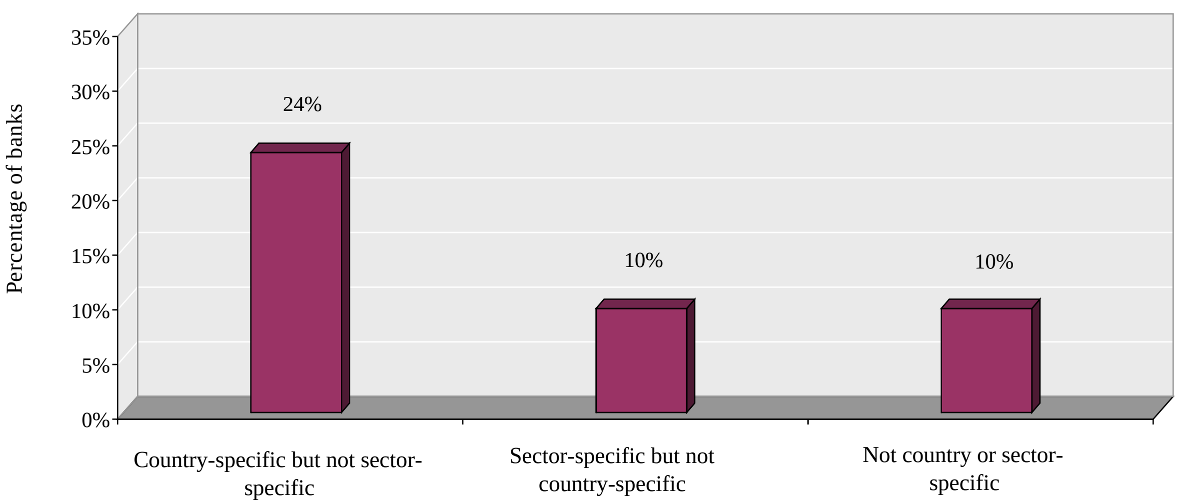
Appendix Figure 17
Risk management (II)

The titles of these panels display the questions we ask banks as stated in the Questionnaire. Appendix Figure 17.B shows the information for the aggregated sample of Argentine and Chilean banks.

A. If your bank does not use scoring models, is this a bank decision or is this decision affected by regulation?



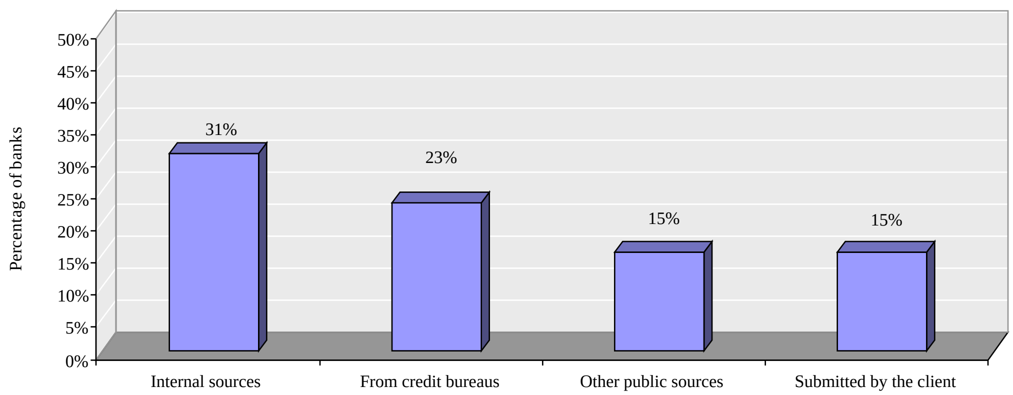
B. Is your scoring model country and/or sector specific?



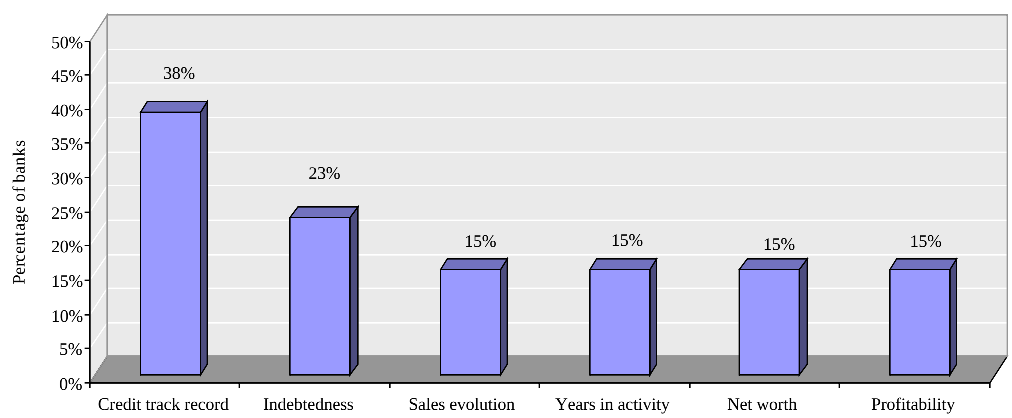
Appendix Figure 18
Risk management (III)

The titles of these panels display the questions we ask banks as stated in the Questionnaire. The panels only display the information for Argentina because few Chilean banks provided this information.

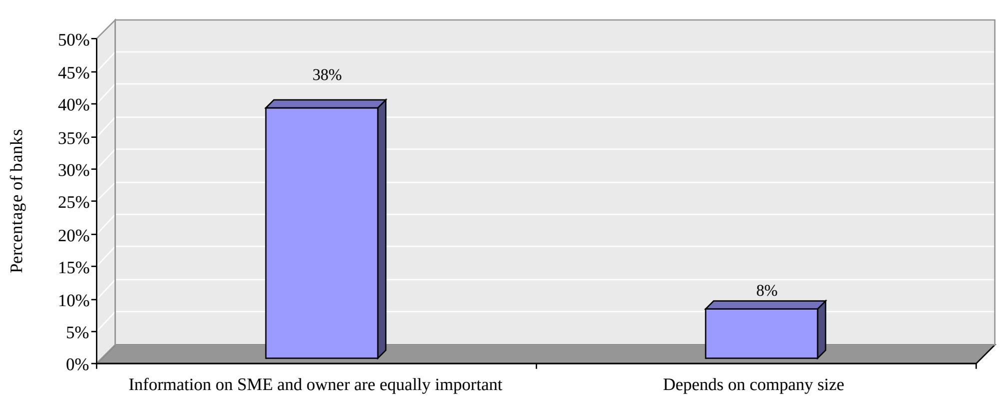
A. From where do you collect the variables for your scoring models? (Argentina)



B. List the main variables used in scoring models (Argentina)



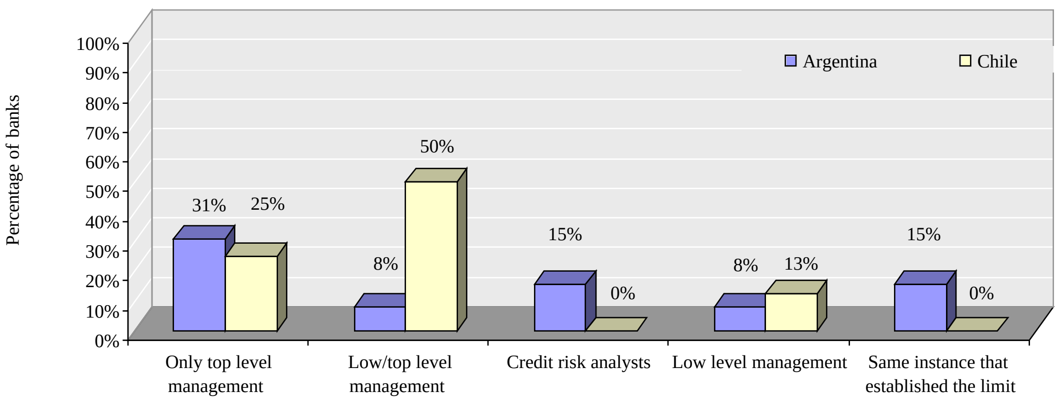
C. In scoring models, how important is information about the SME compared to information about the SME owner? (Argentina)



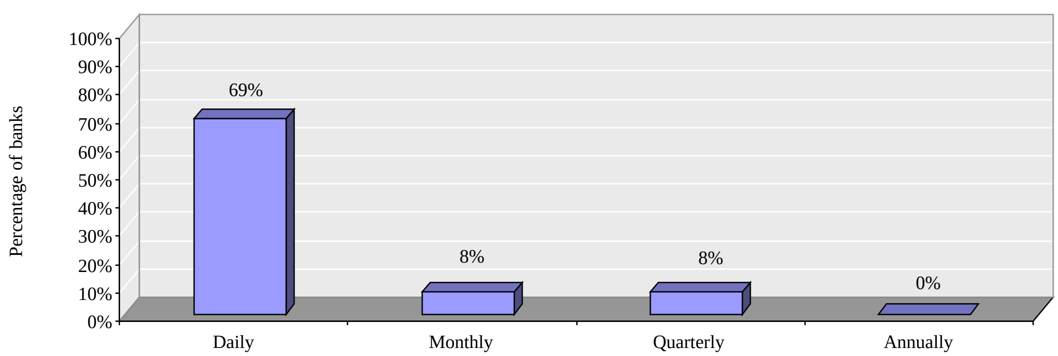
Appendix Figure 19
Monitoring and credit exposure analysis (I)

The titles of these panels display the questions we ask banks as stated in the Questionnaire. The two bottom panels only display the information for Argentina because few Chilean banks provided this information.

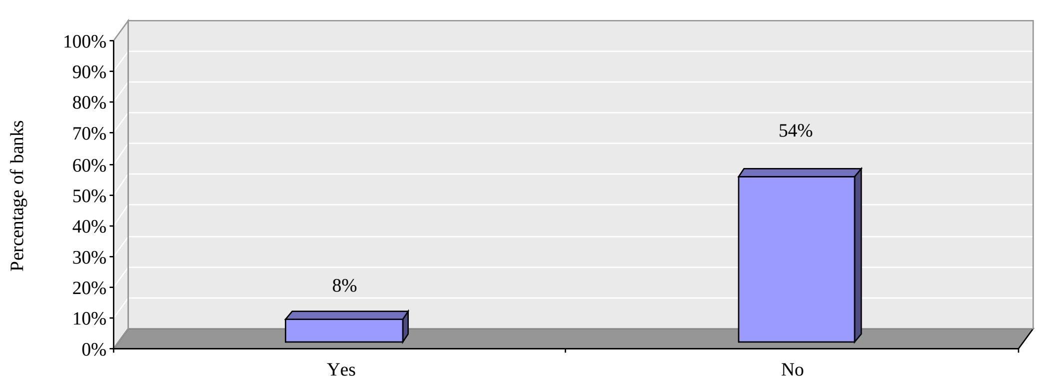
A. Who has the authority to change credit limits?



B. How often are exposures relative to limits monitored? (Argentina)



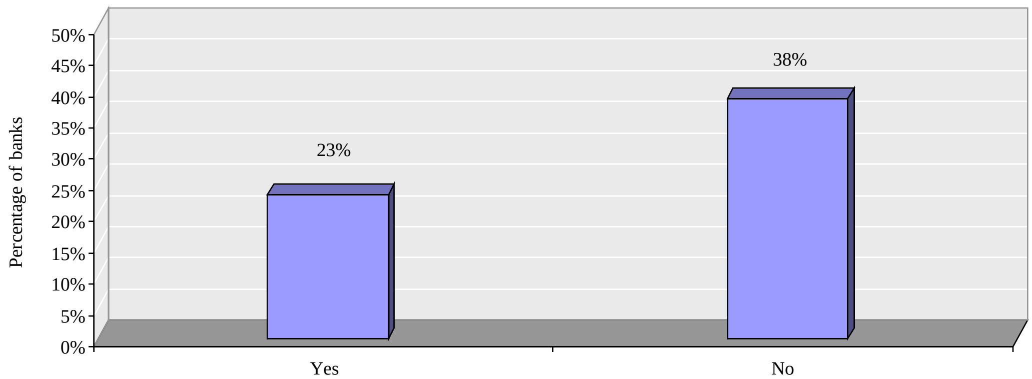
C. Can excesses in credit limits occur? (Argentina)



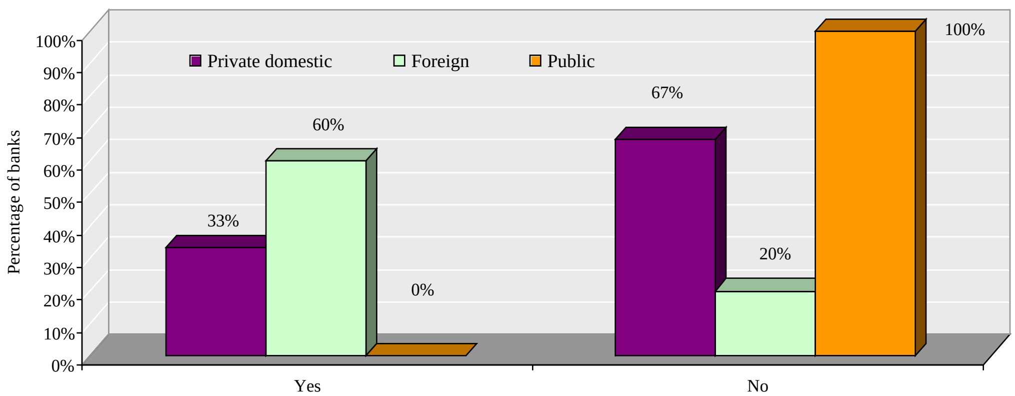
Appendix Figure 20
Monitoring and credit exposure analysis (II)

The titles of these panels display the questions we ask banks as stated in the Questionnaire. The top panel only displays the information for Argentina because few Chilean banks provided this information. The two bottom panels are presented for Argentina and Chile respectively.

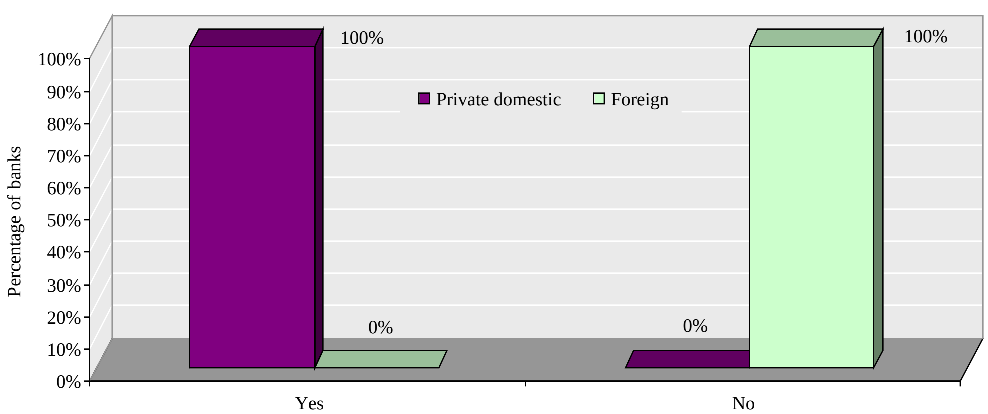
A. Is the case reviewed if excesses in credit limit occur? (Argentina)



B. Does the bank manage the exposure to SMEs using a portfolio approach? (Argentina)



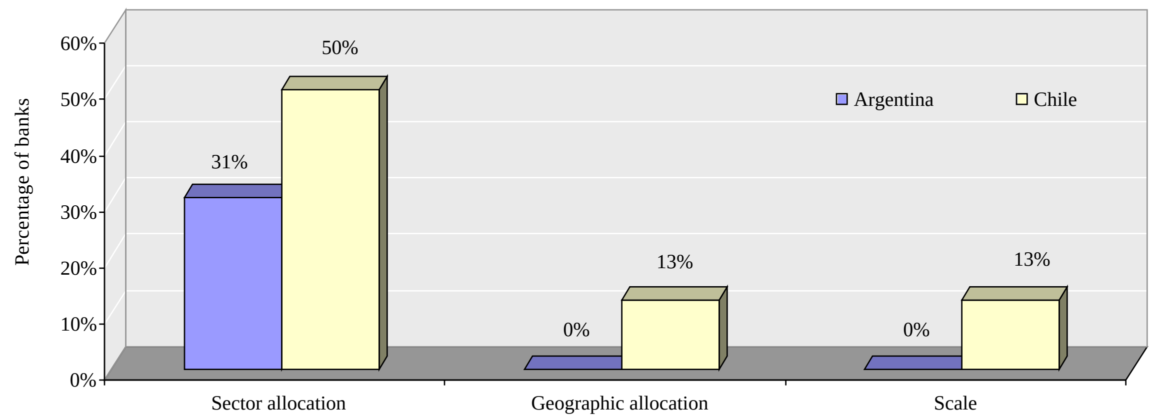
C. Does the bank manage the exposure to SMEs using a portfolio approach? (Chile)



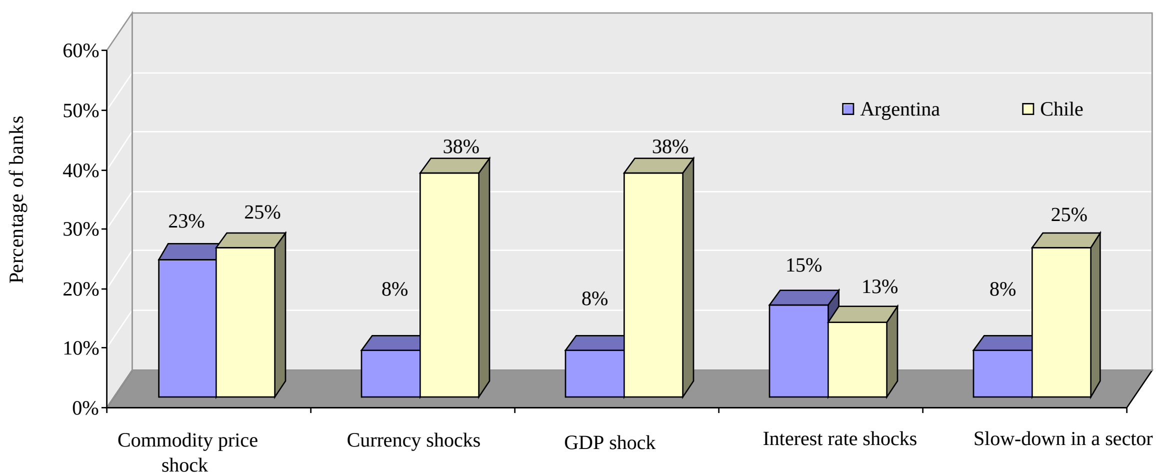
Appendix Figure 21
Monitoring and credit exposure analysis (III)

The titles of these panels display the questions we ask banks as stated in the Questionnaire.

A. Does your bank seek portfolio diversification through any of the following?



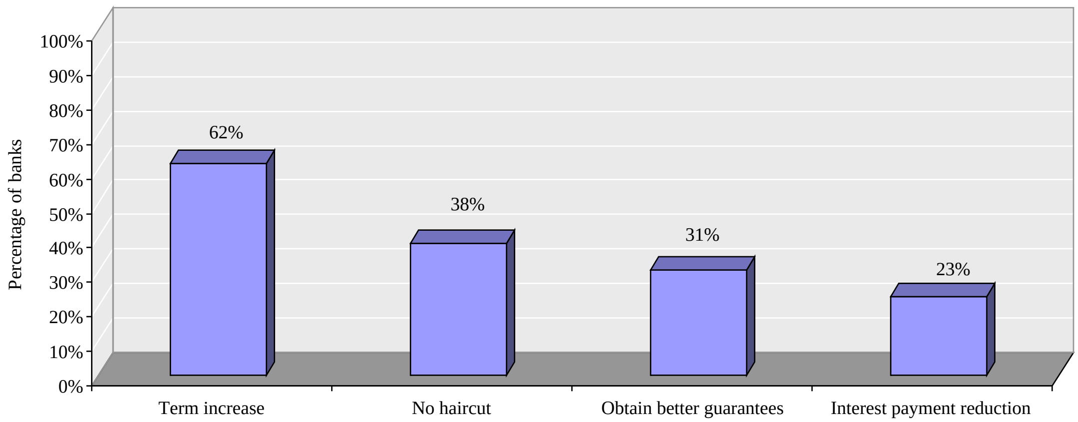
B. Do you run any of the below mentioned stress-test excercises on the SME portfolio?



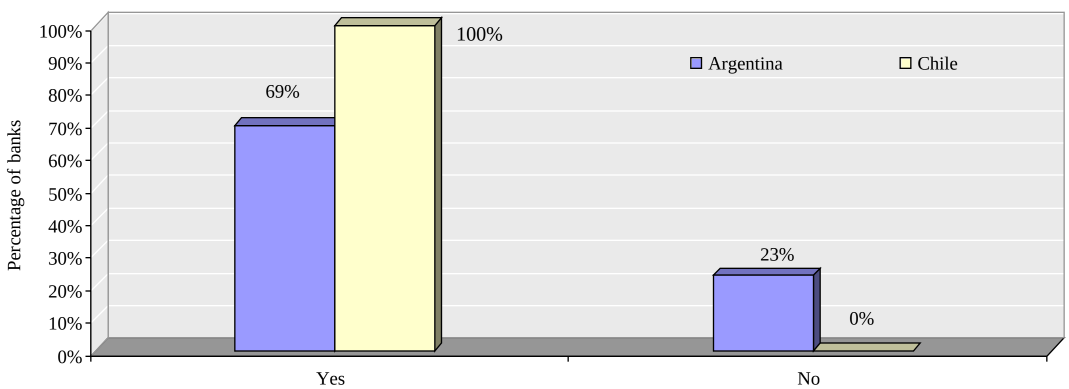
Appendix Figure 22
Management of the non-performing loans portfolio (I)

The titles of these panels display the questions we ask banks as stated in the Questionnaire. The top panel only displays the information for Argentina because few Chilean banks provided this information.

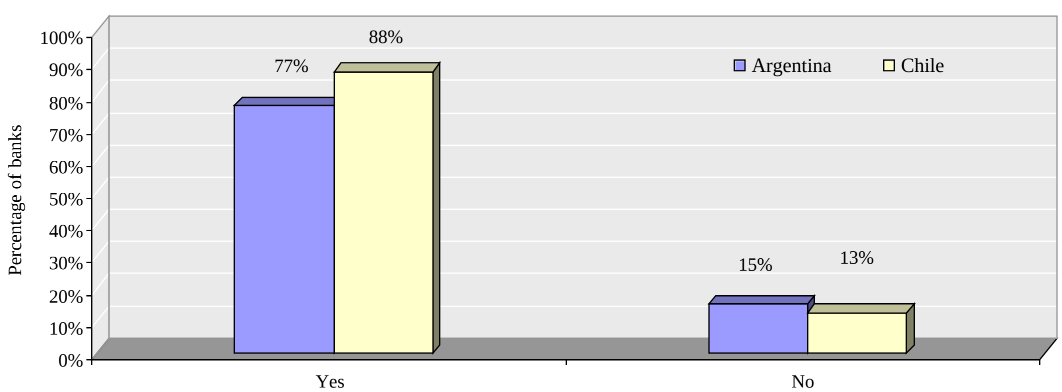
A. What is the policy for restructuring SME loans? (Argentina)



B. Do you have a dedicated SME loan recovery unit?



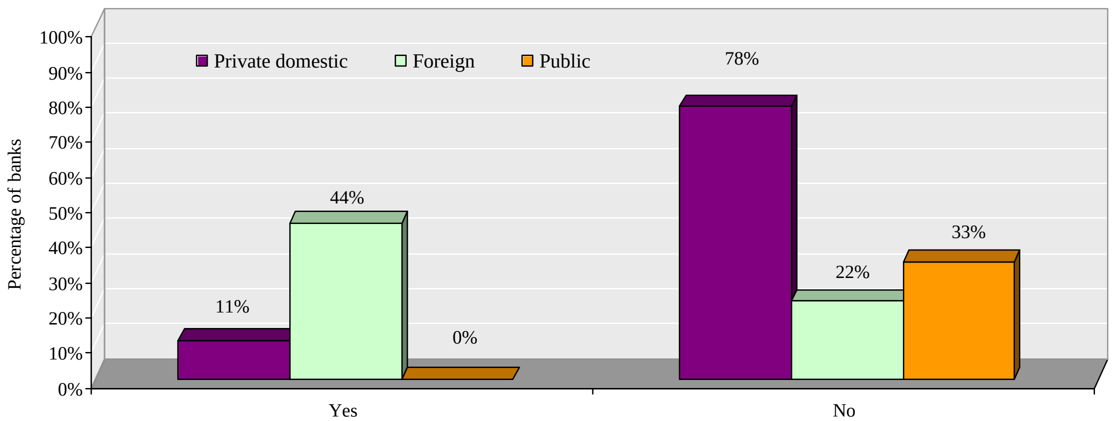
C. Do you outsource the SME loan recovery operations?



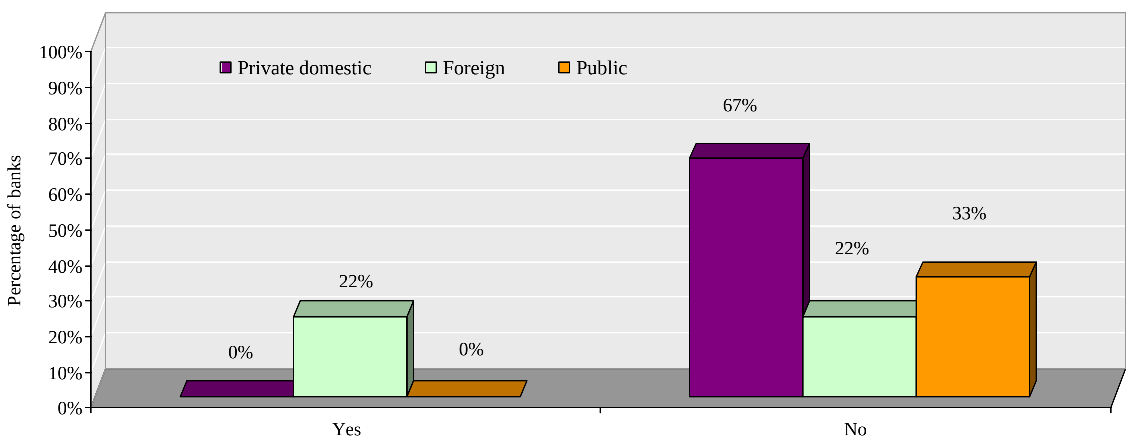
Appendix Figure 23
Management of the non-performing loans portfolio (II)

The titles of these panels display the questions we ask banks as stated in the Questionnaire. This figure displays the information of Argentina and Chile aggregated and discriminated by type of bank.

A. Do past losses feed into some model/estimate of minimum interest rate spread to cover expected losses?



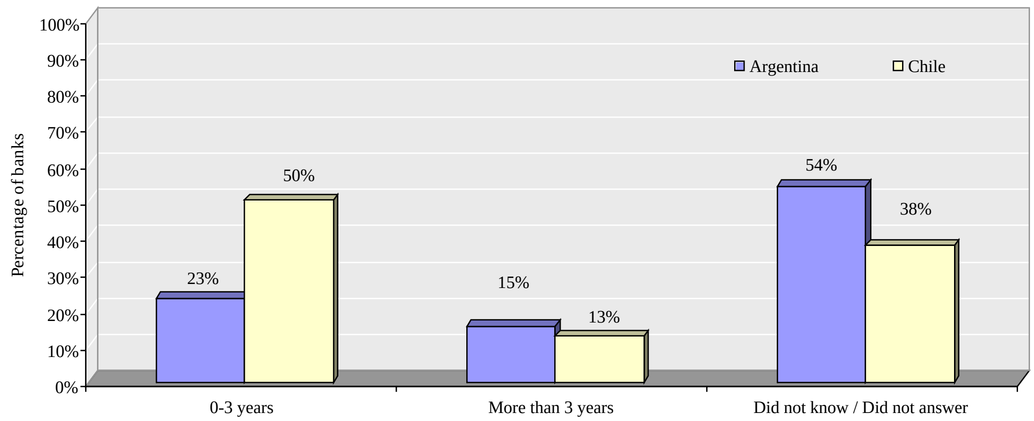
B. Do past losses feed into some estimate of capital requirements?



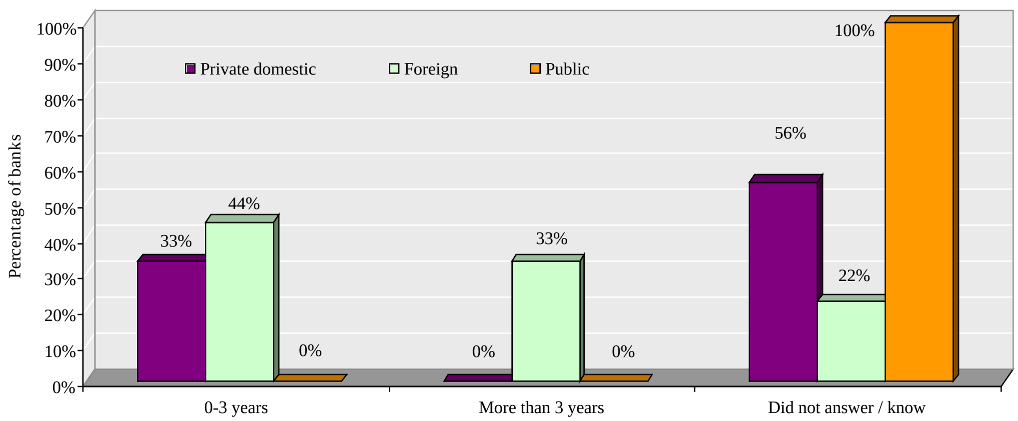
Appendix Figure 24
Management of the non-performing loans portfolio (III)

The titles of these panels display the questions we ask banks as stated in the Questionnaire. The top panel analyzes the answers by country while the middle panel distinguishes the answers by type of bank.

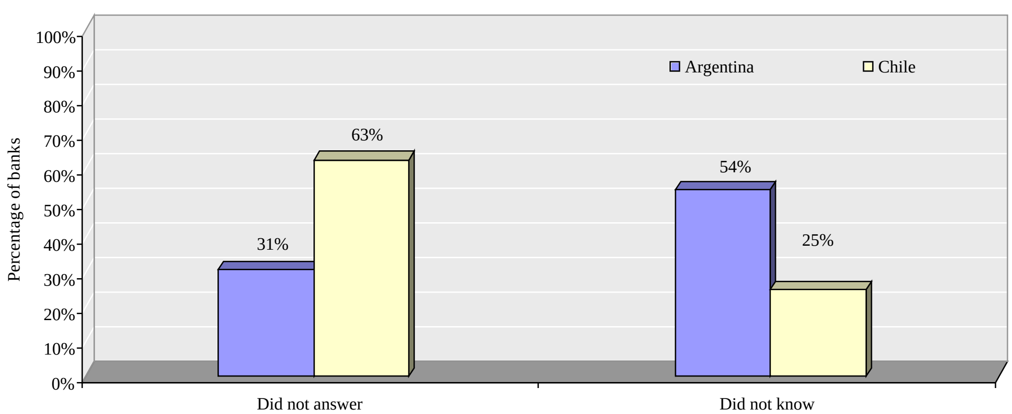
A. What is the average number of years it takes to recover an SME loan?



B. What is the average number of years it takes to recover an SME loan?
By type of bank



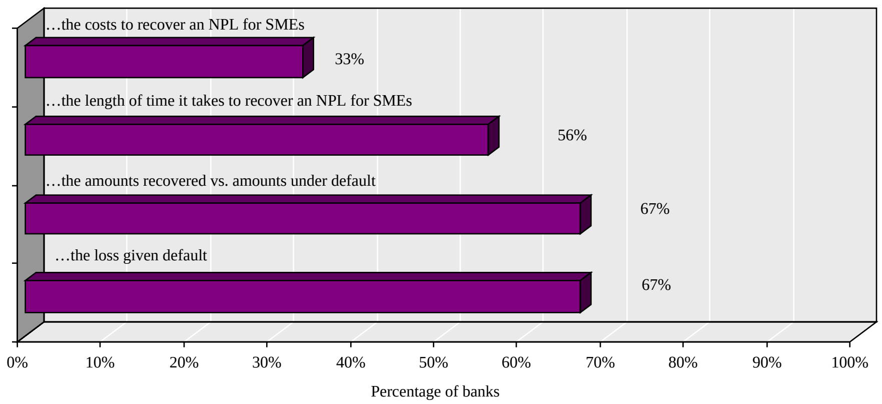
C. What is the average cost to recover an SME loan?



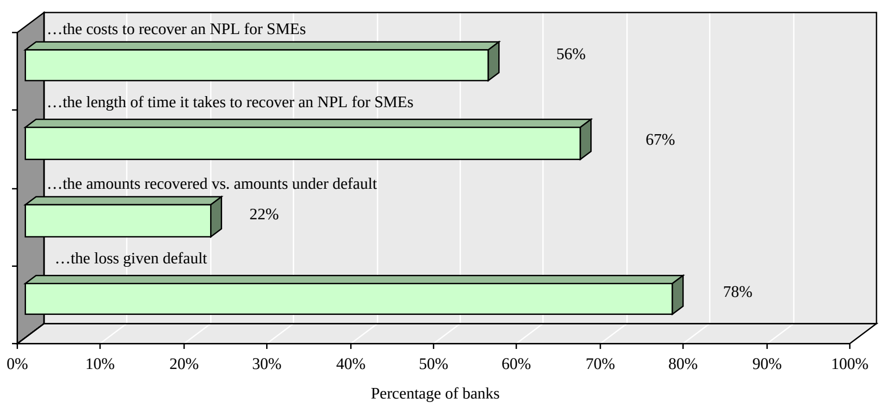
Appendix Figure 25
Management of the non-performing loans portfolio (IV)

The titles of these panels display the questions we ask banks as stated in the Questionnaire. The panels in this figure distinguish the answers by type of bank. Appendix Figure 25.A presents the answers of private domestic banks, Appendix Figure 25.B shows the answers of private foreign banks, and Appendix Figure 25.C displays the answers of public banks.

A. Private domestic banks - Do you keep track of…



B. Private foreign banks - Do you keep track of…



C. Public banks - Do you keep track of…