

Policies for *small and medium-sized* enterprises in Chile

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In 1991, the Government of Chile began to pursue a new business development strategy. The Small and Medium-sized Enterprise Support Programme (Programa de Apoyo a la Pequeña y Mediana Empresa) provides for a number of instruments to correct market failures and improve the efficiency, productivity, competitiveness and international trading position of Chilean products made by these firms. The importance of small and medium-sized enterprises (SMEs) in the national economy is illustrated by their number and by the share of jobs they create. The particularly adverse experience of the economic crises of the 1970s and 1980s, and the difficulty these companies had in adapting to the new ground rules of the open economy model, were what led the Government to decide on this new development strategy. The objective of this article is to identify and analyse the policies applied and the effects of the different actions undertaken and instruments used. Although the strategic development framework has included new instruments that have made important contributions to the SME sector, the overall impact of these is less encouraging. The challenge now facing companies of this type in Chile is to find ways of applying successful experiments on a mass scale and reformulating strategies that have not worked as well as hoped.

I

Introduction

In Chile, as in almost all the countries of Latin America, small and medium-sized enterprises (SMEs) are important for both economic and social reasons. Their contribution to job creation and output is substantial, and increased over the course of the 1990s.

The particularly adverse experience of the economic crises of the 1970s and 1980s, and the difficulty that most SMEs had in adapting to the new ground rules of the open economy model and the reduced and altered role of the State, led the Government to develop a support strategy designed both to correct the market failures that limited these companies' access to factor markets and to increase their

efficiency, productivity and international trade participation. The Chilean experience includes some major achievements, at least where the introduction of innovative policy instruments and approaches is concerned. The results have probably been less encouraging as regards the mass application, and thus the overall impact, of these instruments and actions.

This article will analyse the place of SMEs in the country's economy, the characteristics of the different lines of business development action, the policies applied and the role these have played in solving the problems of such companies. Lastly, the impact of the policies is considered, and the article's conclusions are presented.

II

The place of SMEs in the economy

Different definitions of SMEs are used in Chile. The Ministry of Economic Affairs, Development and Reconstruction (Ministry of Economic Affairs), the National Institute of Statistics (INE) and other bodies use different criteria to define them, which makes their information difficult to compare.

Until 1993, the Ministry of Economic Affairs defined small companies as production units with net annual sales of between 2,400 and 25,000 development units (unidades de fomento, or UF), i.e., between US\$ 72,000 and US\$ 750,000, while medium-sized enterprises were deemed to be those with sales of between 25,001 UF and 50,000 UF (between US\$ 750,000 and US\$ 1.5 million).¹ Companies with higher sales were classified as large, while those with sales of less than 2,400 UF were classified as microenterprises. In 1994, the sales threshold above which a company qualified as medium-sized was raised to 100,000 UF (about US\$ 3 million). This is the criterion currently used by the Ministry of Economic Affairs.

Table 1 shows the number of companies of different sizes, in accordance with the Ministry of Economic Affairs classification and information supplied by the Production Development Corporation (Corfo), which uses data from the Internal Revenue Service (SII). The change in the definition of medium-sized and large enterprises in 1994 meant a break in the series for these two categories, so that two four-year periods, 1990-1993 and 1994-1997, have to be considered separately.

In both periods, it can be seen that the proportion of all companies that were SMEs had increased by the end of the series. The 1994 change in the definition of medium-sized and large companies also affects the data on sales, so two four-year periods need to be taken in this case as well. The data in table 2 show that, in both the first and the second periods, large companies were the only ones whose sales grew by more than the average.

By contrast, the sales of the other categories (microenterprises and SMEs) grew by less than the average and thus lost market share (table 3). After accounting for 20.2% of total sales in 1990, by 1993 SMEs had seen their share decline to 19.4%. Similarly, after the medium-sized enterprise category was expanded, the sales share of SMEs fell from 25.9% in 1994 to 23.7% in 1997.

□ This paper was last revised by the authors in July 2000.

¹ The UF is an inflation-indexed unit of real value. On 12 September 2000, one UF was worth 15,507.4 pesos (about US\$ 27).

TABLE 1

Chile: Number of companies^a

	Series 1				Series 2			
	1990	1991	1992	1993	1994	1995	1996	1997
Microenterprises	364 110	372 311	387 016	400 529	404 599	408 371	423 319	432 431
Small	52 473	59 249	65 611	69 489	71 984	75 570	77 798	78 805
Medium-sized	4 598	5 327	5 797	6 147	9 649	10 260	10 721	10 870
SMES	57 071	64 576	71 408	75 636	81 633	85 830	88 519	89 675
Large	5 160	6 087	6 838	7 314	4 054	4 388	4 670	4 814
<i>Total</i>	<i>426 341</i>	<i>442 974</i>	<i>465 262</i>	<i>483 479</i>	<i>491 286</i>	<i>498 589</i>	<i>516 508</i>	<i>526 920</i>

Source: Production Development Corporation (2000), on the basis of SII information.

^a The series 1 data are not comparable with those of series 2.

The employment information is also affected by statistical problems. Firstly, the data do not come from the same source as the one used for the other variables (company sales and number of companies). The employment data were collected through the National Socio-economic Survey (Casen) conducted by the Ministry of Planning and Cooperation (Mideplan) through the Economics Department of the University of Chile. As was mentioned earlier, the classification in this case is based on the number of people in work, and is therefore not compatible with the one used by Corfo, which is based on sales.

Until 1994, furthermore, production units employing between one and five people were defined as microenterprises, those employing between six and 49 people as small enterprises, those employing between 50 and 199 people as medium-sized enterprises, and those employing more than this as large enterprises. In that year, however, the upper limit for microenterprises was reduced to four, so that the

TABLE 2

Chile: Total increase in company sales, 1990-1993 and 1994-1997

(Percentages)

	1990-1993	1994-1997
Microenterprises	22.8	10.4
Small	32.5	10.3
Medium-sized	32.9	13.2
SMES	32.6	11.6
Large	41.0	26.8
<i>Total</i>	<i>38.3</i>	<i>22.0</i>

Source: Prepared by the authors on the basis of information from the Production Development Corporation (2000).

threshold for small enterprises was lowered to five. As a result, the information for years prior to 1994 is not comparable with that for the following years, at least for microenterprises and small enterprises.

Taking these limitations into account, table 4 shows that SMES account for some 50% of all employment in

TABLE 3

Chile: Company sales^a

(Percentages)

	Series 1				Series 2			
	1990	1991	1992	1993	1994	1995	1996	1997
Microenterprises	5.5	4.8	4.9	4.8	4.9	4.6	4.6	4.4
Small	14.1	13.3	13.9	13.5	13.8	13.2	13.0	12.5
Medium-sized	6.1	5.8	5.9	5.8	12.1	11.7	11.6	11.3
SMES	20.2	19.1	19.8	19.4	25.9	25.0	24.6	23.7
Large	74.4	76.0	75.3	75.8	69.2	70.4	70.9	71.9
<i>Total</i>	<i>100.0</i>	<i>100.0</i>	<i>100.0</i>	<i>100.0</i>	<i>100.0</i>	<i>100.0</i>	<i>100.0</i>	<i>100.0</i>

Source: Prepared by the authors on the basis of data from the Production Development Corporation (2000).

^a The series 1 data are not comparable with those of series 2.

TABLE 4

Chile: Employment in companies
(Percentages)

	1990	1992	1994	1996
Microenterprises ^a	43.9	41.8	39.7	40.4
Small ^a	29.0	31.6	33.6	36.6
Medium-sized	12.7	13.2	12.8	13.0
SMEs	41.7	44.9	46.4	49.6
Large	14.4	13.3	13.9	10.1
<i>Total</i>	<i>100.0</i>	<i>100.0</i>	<i>100.0</i>	<i>100.0</i>

Source: National Socio-economic Survey (Casen).

^a The definitions of microenterprise and small enterprise used for the 1994 and 1996 data are different from those used for the 1990 and 1992 data.

the country, while their share of total sales is about 24%. Comparison of these two figures gives an initial insight into the productivity differences between SMEs and large enterprises.

As regards sectoral distribution, SMEs have a very large presence in commercial activities (36.2% of the SME total) and a much smaller one (12.9%) in industry (table 5). The commerce sector, indeed, accounts for the highest percentage of production units in the cases of microenterprises and large enterprises as well: 40.5% of all the country's enterprises operate in that sector, as against a figure of only 7.5% for the industrial sector.

Analysis of these data shows that SMEs are very important for jobs, employing about half of all those in work. Their share of total sales, however, is much lower (about 24%). The performance gap between these companies and large enterprises in the 1990s was not only large, but widened over the decade. In other words, despite the positive employment and sales results achieved by SMEs, the relative weight of large enterprises increased over the 1990s in terms not just of absolute sales, but also of sales per worker and per company, and even of the number of companies.

TABLE 5

Chile: Sectoral distribution of companies, 1997
(Numbers and percentages)

Sector	Company size						
	Microenterprises	SMEs	Large		Total		
Agricultural production	54 174	12.5	8 672	9.7	121	2.5	62 967
Agricultural and hunting services	1 444	0.3	479	0.5	18	0.4	1 941
Silviculture	2 380	0.6	965	1.1	41	0.9	3 386
Fishing	1 223	0.3	427	0.5	74	1.5	1 724
Mining, petroleum and quarrying	966	0.2	476	0.5	97	2.0	1 539
Foods, beverages and tobacco	4 455	1.0	2 679	3.0	313	6.5	7 447
Textiles and leather	6 033	1.4	2 290	2.6	158	3.3	8 481
Wood and paper	7 675	1.8	2 363	2.6	174	3.6	10 212
Chemicals, petroleum, rubber and metals	5 668	1.3	2 903	3.2	442	9.2	9 013
Machinery and instruments	2 136	0.5	1 185	1.3	118	2.5	3 439
Other manufactures	638	0.1	157	0.2	6	0.1	801
Industry total	26 605	6.2	11 577	12.9	1 211	25.2	39 393
Electricity, gas, water	530	0.1	116	0.1	72	1.5	718
Construction	15 407	3.6	6 618	7.4	587	12.2	22 612
Commerce	179 320	41.5	32 462	36.2	1 765	36.7	213 547
Restaurants and the like	22 355	5.2	3 480	3.9	62	1.3	25 897
Transport	33 727	7.8	7 956	8.9	234	4.9	41 917
Financial services	7 329	1.7	2 956	3.3	166	3.4	10 451
Technical and professional services	21 954	5.1	6 654	7.4	230	4.8	28 838
State, social and institutional services	4 830	1.1	978	1.1	49	1.0	5 857
Recreation and leisure services	3 640	0.8	651	0.7	26	0.5	4 317
Personal and household services	33 407	7.7	3 626	4.0	41	0.9	37 074
Other activities	18 347	4.2	1 435	1.6	15	0.3	19 797
No information available	4 793	1.1	147	0.2	5	0.1	4 945
<i>Total</i>	<i>432 431</i>	<i>100.0</i>	<i>89 675</i>	<i>100.0</i>	<i>4 814</i>	<i>100.0</i>	<i>526 920</i>

Source: Production Development Corporation (1998).

III

Policies to support SMEs

The Small and Medium-sized Enterprise Support Programme (hereinafter the Programme) came into operation in 1991. This represented a major shift away from the strategy followed by the military Government, which saw no need to make distinctions in the way it treated economic units of different sizes (Labarca, 1997) and affirmed that “the beneficial effects of trade opening could be enjoyed on a symmetrical and equal footing by different economic agents” (Cabrera, 1994).

The diagnosis on which the 1991 programme was based, on the other hand, identified restrictions on access by SMEs to the factor and service markets, owing chiefly to information asymmetries, externalities, lack of appropriability, and indivisibilities and economies of scale.

Setting out from this diagnosis, the Programme took the approach from the outset that there were market failures which required correction. While Corfo took on the functions of an executive secretariat for SME development policy, the Ministry of Economic Affairs took responsibility for the strategic design of this policy.

The institutional structure designed to implement the Programme included different public- and private-sector bodies acting at different levels. This design has gradually been modified as the policies have been implemented. Initially, Corfo used a system of direct administration of the two main development instruments, with partial delegation to a subsidiary agency, the Service of Technical Cooperation (Sercotec). As the coverage of these instruments grew, however (because more and more beneficiary companies were being brought in), it had to alter the administration system owing to the impossibility of increasing the number of public officials significantly to meet the new demand.

For this reason, in mid-1994 a new operating scheme was introduced in which three levels or “tiers” were defined (Maggi, 1999). At the first level are the private-sector companies and consultants providing technical assistance services for SMEs. At the second level are intermediate operating agents, namely Sercotec and a number of Corfo-accredited private-sector organizations. The basic tasks of these agents are to promote the use of development instruments by companies; act as intermediaries between these and Corfo during the formulation stage, the application

procedure and subsequent follow-up of the use and outcome of these instruments; administer the public and private resources involved in the programmes accountably, and oversee the contractual relationship between companies and providers.

“Right from the outset, the system established a strict separation between first and second tier functions, the intention being that intermediate operating agents should remain absolutely neutral among providers and should focus on reducing information asymmetries between the supply and demand for consultancy, so as to be in a position to arbitrate if any disagreements should arise between the providers and the companies using these services” (Maggi, 1999).

At the third and highest level is Corfo, which is the institution responsible for designing operations and regulating instruments, designing framework agreements with agents, allocating and transferring programme subsidies to these when they are approved, and evaluating programme performance.

The instruments used in SME development policies fall into six categories: financing, technical assistance, technology transfer and innovation, training, export promotion and partnership.

1. Financing

Access to financing is one of the most complex problems that SMEs have to face. The diagnosis carried out by the Government in the early 1990s revealed stark segmentation and discrimination by company size in product and factor markets, resulting among other things in inequality of access to these markets. For this reason, the Programme introduced an array of instruments to narrow the disadvantages faced by SMEs in the credit market.

Where credit and financing programmes were concerned, Corfo had previously acted as a direct lender, i.e., as a first tier institution. A quantitative evaluation of this experience concluded that it had resulted in large losses for the State. In 1990, Corfo closed down the direct lending mechanism and auctioned off its portfolio, which at that time had a nominal value of US\$ 714 million. The difference between the value realized by the sale of the portfolio

and its nominal value meant a loss of US\$ 514 million for the State (Foxley, 1998).

In 1990, Corfo began to operate as a second tier institution, direct lending to final users being replaced by financing for banks and other specialist intermediaries that channelled resources to the final customers. This considerably reduced the risk of losses to the State. The new second tier scheme now includes a range of programmes that can be classified as lending, quasi-capital and subsidy programmes. The main characteristics of these groups of programmes are described below.

a) *Lending programmes*

- *Investment financing for small and medium-sized enterprises.* This programme is for the financing of investment projects by companies with turnover of up to US\$ 30 million. It covers investments in machinery, installations, construction, civil works and engineering and assembly services, plus the working capital required for these investments, up to 30% of the total amount with a maximum of US\$ 5 million. Repayment periods are from two to 10 years.
- *Investment financing for small manufacturers.* This funding is supplied by the Government of Germany through Kreditanstalt für Wiederaufbau, and is used to finance investments and working capital for manufacturing companies with turnover of up to US\$ 3 million in the form of loans of up to US\$ 450,000. Repayment terms range from three to 10 years.
- *Financing for production inputs and marketing abroad.* This programme is for the purchase of inputs to produce exportable goods and services. It can be taken up by companies with turnover of up to US\$ 30 million, the maximum loan is US\$ 3 million, and the term is two to eight years.

b) *Quasi-capital programmes*

- *Purchase of subordinated bonds from banks to finance SMEs.* Corfo buys subordinated bonds from issuing banks, making the purchase conditional on these same banks lending to small companies with annual turnover of up to 25,000 UF (about US\$ 750,000) and developing business platforms that specialize in dealing with small companies.²

² “Subordinate bonds are publicly issued securities whose main characteristic is that they can be redeemed against the capital of the issuing bank in a proportion that decreases as the expiry date of the instrument approaches” (Foxley, 1998).

- *Financing of Business Development Investment Funds (FIDES) for venture capital.* This consists of loans that Corfo grants to FIDES on condition that the funds be used to provide capital to SMEs that generate high value added or can be identified as having a high technology content.

c) *Subsidy programmes*

- *Credit Insurance Discount Coupons (Cubos).* The aim of this programme is to remedy the inability of SMEs to offer any or sufficient collateral for lending by financial institutions. These institutions take out credit insurance with an insurance company to cover the risk of default by the borrower. The State uses Cubos to co-finance 72% of the premium for this insurance. The companies that can take up this subsidy are those with turnover of less than 25,000 UF (about US\$ 750,000), which means that it is aimed at small enterprises. There are special rules for granting Cubos to companies seeking to implement projects in areas that have suffered severe economic crises and are undergoing economic restructuring.³ In these cases the subsidy is 80% and is also available to medium-sized enterprises.

Other financial instruments, now discontinued, were also used in the 1990s to support SMEs. They included in particular the Financial Assistance Subsidy (Suaf), created in November 1991 to “do away with the discrimination suffered by small and medium-sized enterprises that apply for credit without having organized accounting information or without being able to submit their investment plan in the requisite form” (Cabrera, 1994).

Suaf could be applied for by companies with annual turnover of less than 25,000 UF (about US\$ 750,000), and was to be used to engage consultants who would prepare and submit the information that financial institutions required before they would grant a loan to the Suaf beneficiary company. As the instrument aroused little interest, medium-sized enterprises were subsequently allowed to apply as well. In 1996, Suaf was abolished because of administrative shortcomings resulting from inadequate oversight of consultants. In any case, what made the instrument unsuccessful was the difficulty of “inducing financial institutions to rely

³ This is the case with the coal mining zone (province of Arauco and communes of Lota and Coronel), the provinces of Arica and Parinacota, and regions XI and XII.

on evaluations of borrowers carried out by third parties, in this case consultants working for a State subsidy” (Foxley, 1998).

Another instrument that was abolished was a variant of the Cubos which operated from 1995 to 1997, and which subsidized 50% of small exporters’ credit insurance premiums. It was discontinued because of possible incompatibility with World Trade Organization (WTO) rules.

2. Technical assistance

In order to improve the management of SMEs and help them introduce new technologies, Technical Assistance Funds (FATS) were launched in 1993. These funds can be spent by SMEs on engaging a consultant to improve overall management or solve specific problems with issues such as market analysis, product design, production process redesign, pollution control and information systems.

The aim of FATS is to facilitate access by SMEs to advisory services of this kind, while at the same time encouraging the formation of a consultancy market specializing in these firms. The great majority of SMEs use this instrument on an individual basis, although it is permissible for a number of firms to join forces to purchase the same service. To use FATS, companies must have net annual sales of more than 2,400 UF but no more than 100,000 UF.⁴

Since 1999, financing for the diagnostic stage has been included in the programme. To start with, Corfo provides 12 UF and the business has to contribute 3 UF. At the actual technical assistance stage, Corfo co-finances up to 50% of the total cost of the consultancy work⁵ up to a maximum of 450 UF (about US\$ 13,000) per company, with an annual limit of 150 UF (about US\$ 4,400).

In the case of a Group FAT (at least three companies), Corfo provides 30 UF for the diagnostic stage and the businesses contribute 10 UF. For the actual technical assistance, Corfo co-finances up to 50% of the total cost of the consultancy work, with a maximum of 100 UF per company per year.

⁴ Companies with net annual sales of less than 2,400 UF or more than 100,000 UF may apply provided that on the date of the application they are participating in some other Corfo development programme or in ProChile-financed Export Committees.

⁵ The co-financing percentage rises to 60% in the case of companies with annual sales of less than 25,000 UF and to 70% for technical assistance in subject areas to which Corfo gives priority, such as irrigation, quality and the environment.

TABLE 6

Chile: Number of operations financed by Technical Assistance Funds (FATS)

1994	1995	1996	1997	1998	1999
349	1 428	1 487	4 406	4 652	6 632

Source: Production Development Corporation (1998).

Corfo delegates the administration of these funds to intermediaries (“second tier” organizations) whose specialization and closeness to the final users is supposed to make their operations more efficient. These organizations are responsible for assessing the relevance of consultancy services, approving consultancy contracts, monitoring execution and disbursing the subsidies once execution has been verified.

The central purpose of FATS is to remedy the information asymmetries that discourage the use of external consultancy services by SMEs, while deepening this market by showing applicant firms how useful external consultancies are for solving operational problems and drawing up business and modernization strategies. Although demand has grown, however (table 6), surveys carried out using samples of companies have not yielded conclusive results, mainly owing to the difficulty of isolating the effects of consultancy on the subsequent performance of the firm (University of Chile, 1997b). Nonetheless, one of these assessments affirms that “the FAT scheme has produced good results in two main areas: the creation of a supply of consultancies specializing in SMEs, which was not organized before, and a growing appreciation among SMEs of the technical assistance services supplied by private-sector consultancies” (Castillo, 2000).

One aspect of this instrument that is the subject of continuing debate is the fact that the main incentive is for those supplying the consultancy services, who often encourage their customers to make more use of the instrument than is really necessary. Companies taking up the service are often not fully aware of its value, perceiving as the full cost that minority share of it which is borne by them, and do not demand a minimum of relevance and thoroughness from the results. To prevent poor-quality consultancy services being chosen or subsidies being misused (simulated payment of the company’s share), Corfo and the operating agents have taken steps to establish selection criteria in the register of consultants and to punish severely any illicit practices they detect (Maggi, 1999).

3. Technological development

The main instrument used to stimulate the technological development of businesses is the National Fund for Technological Development and Productive Research (Fontec). This fund, which was created in 1991, can be used by companies of all kinds (and is thus not an exclusively SME-oriented instrument), and is intended to promote, guide, finance and subsidize the implementation of technological research and development and technological infrastructure acquisition projects and, in general, projects to further any stage in the development of technology products.

This fund operates through five financing lines:

- *Technological innovation.* This covers research and development projects for product, process and services technologies, including models, prototypes and market testing. The funding provided by Fontec is a subsidy which may not exceed 50% of the total cost of the project.
- *Technological infrastructure.* This line includes investments in physical infrastructure, installations and science and technology equipment, and in technical training for staff connected with the infrastructure project who play a supporting role in the company's production processes and technological development. The maximum subsidy granted by Fontec is 20% or 30% of the total cost of the project, depending on whether the submission is an individual or group one.
- *Group transfer.* In this case, subsidy is provided for projects involving five or more companies in the same sector or in allied sectors. It generally covers the planning and implementation of technology missions abroad, for which Fontec provides a maximum subsidy of 45% of the total cost, subject to a US\$ 100,000 limit.
- *Transfer organizations and centres.* This line is also for group undertakings, specifically when the purpose is to set up organizations (technology transfer centres) for the study, development, dissemination, transfer and adaptation of technologies with a view to modernizing the companies involved. The maximum subsidy is 50% of the cost of the project, with a limit of US\$ 400,000.
- *Pre-investment studies.* This line is aimed at stimulating innovative investments by funding pre-investment studies. The maximum subsidy is 50% of the value of the study, with a limit of US\$ 15,000.

Between September 1991 and July 1998, Fontec approved and financed 997 projects (tables 7 and 8). Although Fontec is not specifically aimed at SMEs, they are likely to have been the beneficiaries of a large percentage of the funding granted. In fact, data for the period from September 1991 to June 1994 show that 75.8% of the 236 projects approved, and 72% of the funds, were for small, medium-sized and newly formed enterprises (Cabrera, 1994).

4. Training

In 1976, the military Government privatized managerial and administrative responsibility for national training services by transferring control of almost 70 industrial schools and the National Professional Training Institute (Inacap) to the country's main business association (the Confederation of Production and Commerce) and by devolving to companies the responsibility for initiating and running training programmes financed by the State through the National Training and Employment Service (Salazar, 1997).

The main instrument in this field is a tax exemption that allows businesses to discount up to 1% of taxable annual remuneration, or a value equivalent to 13 monthly tax units (unidades tributarias mensuales, or UTM) (about US\$ 660 dollars), when they file their tax returns.⁶ It is therefore a demand subsidy for corporate training, in which different agents are involved. In the first place, the National Training and Employment Service (Sence), a decentralized State technical body that relates to the Government through the Ministry of Labour and Social Security, administers the tax incentive offered by the State to companies to train their staff (National Training and Employment Service, 1998). Secondly, there are the private training organizations (technical provider organizations, universities, professional institutes and technical training centres) which carry out the training programmes. Lastly, there are the companies themselves, which determine the demand for training.

The results of this instrument have not been very encouraging for SMEs. In fact, "between 1990 and 1994, only 18.84% of these companies used the tax exemption, taking up just 7.56% of the sums available"

⁶ In accordance with article 8 of the Tax Code (Decree Law No. 830/74), the UTM is a legally determined, constantly recalculated sum of money that serves as a measure or reference point for tax purposes. In August 1999, its value was 26,153 pesos (about US\$ 51).

TABLE 7

Chile: Projects financed by the National Fund for Technological Development and Productive Research (Fontec), by sector

Sector	Number of projects	Total cost (thousands of dollars)	Fontec contribution (thousands of dollars)	Company contribution (thousands of dollars)	Structure of Fontec contribution (percentage)
Agriculture	236	27 414	12 281	15 133	20.2
Forestry	28	3 537	1 628	1 909	2.7
Fishing and fish farming	74	13 338	6 018	7 320	9.9
Mining	36	7 522	3 141	4 381	5.2
Manufacturing	394	59 152	23 651	35 501	38.9
Energy, gas and water	5	1 188	763	424	1.3
Construction	28	3 173	1 318	1 855	2.2
Services	63	10 484	4 912	5 572	8.1
Information technology	104	14 495	5 395	9 099	8.9
Biotechnology	29	3 271	1 599	1 671	2.6
<i>Total</i>	<i>997</i>	<i>143 574</i>	<i>60 705</i>	<i>82 865</i>	<i>100.0</i>

Source: Production Development Corporation (1998).

TABLE 8

Chile: Projects financed by the National Fund for Technological Development and Productive Research (Fontec), by financing line
(Thousands of dollars)

Line	Number of projects	Fontec contribution (thousands of dollars)	Structure (percentage)
Technological innovation	812	50 882	83.8
Technological infrastructure	17	2 833	4.7
Group transfer	152	4 853	8.0
Transfer organizations and centres	6	2 014	3.3
Pre-investment studies	10	123	0.2
<i>Total</i>	<i>997</i>	<i>60 705</i>	<i>100.0</i>

Source: Production Development Corporation (1998).

(Salazar, 1997). The main problem is that the sum total of wages paid by a small business (and often by a medium-sized one) is quite small, which means that the exemption is not worth enough to justify paying for training services. For this reason, beginning in 1997, the limit up to which the exemption could be used was raised from three to 13 UTM, provided this was no more than 1% of all taxable annual remuneration. This change is unlikely to produce significantly different results, however.

For the same reason, since 1995 Sence has been operating a training programme for microenterprises and small businesses that contains two components, both designed to improve management. The first is aimed at owners, managers or those performing administrative functions in companies with annual

turnover of less than 25,000 UF (about US\$ 750,000). The second is aimed at small agricultural producers.

Another measure designed to improve smaller businesses' access to occupational training was the 1998 creation of the National Training Fund (Foncap), whose activities include the provision of subsidies that can be applied for by companies whose annual turnover does not exceed 13,000 UTM (about US\$ 663,000). These subsidies are limited to a maximum of 26 UTM (about US\$ 1,300) per company per year.

5. Export promotion

The way most of the export promotion instruments available in Chile have been designed does not take account, at least explicitly, of the different sizes of the

companies that may sell into external markets. Certain programmes have proved to be of some importance to SMEs, however.

The Simplified System of Refunds for Minor Exports, known as Simplified Refunds, allows companies exporting non-traditional products to claim back a small percentage of the fob value of their exports (between 3.5% and 10%). There is a general reimbursement mechanism in the country that enables companies to recover import tariffs paid on inputs used to produce goods that are then exported. This instrument involves a complicated application procedure, however, so that it is mainly used by large companies that have the staff and information needed to carry this out. Simplified Refunds was introduced to facilitate this procedure for SMEs and companies that export occasionally, and has been very effective in encouraging a variety of SMEs to begin exporting (Macario, 1998). The percentage of reimbursement varies, being linked to total exports of the product concerned: the higher total exports are, the smaller the percentage applied, until after a certain point the subsidy disappears.

Despite its success, however, Simplified Refunds is to be abolished soon, as it is possible for an exporting company to receive the reimbursement without having used imported inputs, in which case the instrument acts as a subsidy. This conflicts with the Uruguay Round agreements, which provide for all export subsidies to be abolished by 2002 (Macario, 1998).

A second instrument, aimed more explicitly at SMEs, is the Support Programme for the Management of Export Firms (Premex), whose objective is to enhance the export capabilities of companies producing manufactures and software. Premex co-finances the cost of engaging high-level consultants to carry out diagnostics and to design and introduce improvements in company management with a view to increasing the efficiency of production processes and production planning processes, raising product quality, optimizing the information systems that support production and furthering process automation.

At the diagnostic stage, Corfo finances up to 60% of the value of consultancy work through the same programme, the subsidy being limited to 80 UTM (about US\$ 4,000). At the implementation stage, the contribution may be as much as 870 UTM (about US\$ 44,000), covering up to 50% of the value of the process consultancy. Premex may be applied for by export companies with external sales of up to US\$ 200,000 and total net sales of up to US\$ 10 million the previous year. The emphasis on pre-competitive

support, the absence of export targets and the small size of the subsidy suggest that it can be considered as a non-actionable subsidy, and thus one that is compatible with WTO rules (Macario, 1998).

As regards support for export activities, two institutions have proved to be particularly important: ProChile and Asexma. The Export Promotion Bureau of the Ministry of Foreign Affairs (ProChile) was set up in 1975 with the objectives of promoting and diversifying exports, particularly in non-traditional categories, and opening up new markets. This institution has an annual budget of US\$ 22 million (of which US\$ 10 million goes on agricultural promotion) and co-finances market research, the publication of catalogues and participation in trade fairs and missions. It also helps groups of companies open offices abroad. ProChile seems to have been more successful in introducing medium-sized enterprises to exporting than small ones.

The Association of Exporters of Manufactures (Asexma) is a trade organization that provides its members with information services relating to tariffs, export procedures and incentives open to them. It also helps with market analysis and participation in trade fairs and missions. The Small and Medium-sized Enterprise Development Project (Propyme), which it runs with technical assistance from Germany, aims to improve the export capabilities of some 40 SMEs.

6. Partnership

Since 1991, the Government has sought to use Development Programmes (Profos) to encourage partnerships among companies that operate similar or complementary lines of business and are located in the same geographical area. The basic thinking behind this instrument is that the main problem of SMEs is not so much size as isolation, and that resources should therefore be channelled to groups of companies rather than individual ones.

Formally, a Profo is a partnership with a legal personality in which small and medium-sized businesses participate for a maximum of three to four years. Up to 30% of member companies (of which there must be at least five in total) may have turnover higher or lower than the SME limits. It is run by a manager appointed by the members themselves, running costs being shared between the public and private sectors. Corfo may finance up to 70% of the total costs of the working programme in the first year.

The businesses, for their part, must finance at least 30% of the costs the first year, 40% the second and 50% the third. Corfo generally co-finances activities for no more than three years, but an extension for a fourth year may be obtained if positive results can be shown and if the group of companies decides to extend its partnership by forming consortia or undertaking joint investments.

The amount of the subsidy can be as much as US\$ 100,000 or so a year per group, with a limit of US\$ 12,000 per participating company. The activities and types of expenditure that these funds can finance are: the remuneration of the Profo manager and other support staff, technology transfer seminars, exhibitions, shows and consultancy work, travel, training and purchases of specialist books and reviews. Corfo is the body responsible for regulating the general framework in which these programmes are carried out and for approving and allocating funds. The intermediaries responsible for starting up Profos, and in some cases for administering them, include public-sector bodies such as Sercotec and private-sector trade associations such as the Textile Institute and Asexma. Corfo acts as a third tier agency, which means it has no direct executive functions. Its role includes deciding on the characteristics of the programme, approving the creation of a Profo when a group of businesses requests this from the operating body, making available to the group a percentage of the total resources required for the project and regulating the conditions under which they operate.

Management has become decentralized over time. Sercotec was the institution that promoted and administered the first Profos. In 1994, it was decided that implementation of the programme could be left to private-sector operatives duly authorized by Corfo. The objective of this decision was to make management more flexible and lower administration costs. One interesting innovation was the inclusion of trade associations as potential operating agents.

The first Profos began in 1992, since when the number has grown year by year. The importance they have taken on in government SME development policy is reflected by the increase in funding allocated to them and by the number of companies involved.

In 1996, Corfo asked the University of Chile to carry out an assessment of this development instrument. From an analysis of 257 companies grouped into 29 Profos, the assessment identified a number of positive factors associated with the use of this instrument

(University of Chile, 1997a). More specifically, the results suggest that the main achievements have largely been in three fields:

- Company organization and management through the incorporation of planning elements, better specification of roles and functions, focusing of production to achieve economies of scale and introduction of modern marketing strategies.
- Accumulation of human capital through better access to management training for managers and to occupational training for production staff.
- Access to technology institutes, advisors, consultants and development funds such as Fontec and FATS.

The business people interviewed said that Profos had had a particularly positive effect as regards knowledge of markets and technologies and new business prospects (table 9).

The assessment of Profos shows that they can be useful for participating companies. Thanks to the assistance received, some of these have made quite substantial changes to certain production and business practices, as a result of which they have increased productivity and wages (University of Chile, 1997a).

The assessment also revealed that the type of intermediary involved was another factor that made a difference. It was found that, in general, private agents rooted in trade associations showed better financial results and were more likely to be able to achieve technical and business cooperation among participating companies.

As regards the make-up of the group, mention was made of the need for the companies involved to be reasonably diverse (the presence of one or two larger

TABLE 9

Chile: Benefits of Development Programmes (Profos) as perceived by companies
(Percentage of respondents)^a

Better knowledge of markets	48
New business opportunities	42
Knowledge of technologies	39
Improved competitive position	37
Increased profitability through higher sales volumes	27
Increased profitability through cost reductions	19
Improved financing capacity	18
Increased profitability through higher product prices	17

Source: University of Chile (1997a).

^a Each respondent could identify more than one factor.

companies, particularly exporters, can be instructive for the rest) and to have little overlap among their individual markets.

The same assessment made it clear, however, that the programme did not go far enough to correct major market failures, such as the inability of SMEs to obtain access on the same terms as large companies to investment and innovation financing, and to qualified staff. All the firms surveyed said that these problems were among the main obstacles they faced (table 10).

Similarly, the assessment (University of Chile, 1997a) states that “the results of the programme are found to be less far-reaching when evidence is sought of significant improvements that make a real difference to the development and enhancement of production processes and/or products (except for changes in lay-out or computerization)”. In other words, the impact of the programme on innovation processes seems to have been quite limited.

TABLE 10

Chile: Main obstacles identified by companies
(Percentage of respondents)^a

Lack of financing	42
Shortage of skilled production staff	31
Customer concentration	31
Economic policy	27
Old machinery and equipment	25
Shortage of skilled administrative staff	22
Lack of installed capacity	21
Customer payment problems	21
Inventory problems	19
Lack of information about technologies	19
Staff resistance to change	18
Delays in responding to customers	15
Narrow product range	15
Unreliable suppliers	10
Inability to comply with technical regulations	9
Poor quality	7
Staff turnover	7
Obsolete products	1

Source: University of Chile (1997a).

^a Each respondent could identify more than one factor.

IV

Reflections on policy

Unlike most Latin American countries, Chile has applied an explicit SME support and development policy for almost a decade. This policy was designed and has been implemented in the new framework of deregulation and State withdrawal from direct provision that has been in place in the country, albeit with different features at different stages, since the mid-1970s. The general characteristics of the instruments used have been based on a logic of corrective action to address market failures, horizontal intervention and demand subsidization.

The use of instruments with these characteristics was motivated by the desire to: i) ensure that the criteria on which measures were based were consistent all over the country, ii) limit the discretionary powers of public officials, both centrally and regionally, iii) achieve transparency in the use of public resources, iv) direct the resources available towards the spheres of action deemed most important, v) reduce the professional requirements of the institution managing the instruments, vi) determine the development level, degree of interest and response capacity of markets

about which there was no direct and specific knowledge, and vii) obtain private co-financing for development measures (Dini and Katz, 1997).

Until 1994, i.e., during the SME support programme's early years, Corfo operated these instruments directly. In that year the action strategy was revised, and Corfo confined its SME development activities to the strategic level (“third tier”) and encouraged the creation of a network of coordinating agents (in both the public and private sectors) “whose basic function is to design business development programmes for companies, using the instruments available to bring together customers (the companies) and providers of support services (consultants)” (Dini and Katz, 1997). One of the factors that led to this change was the impossibility of extending the coverage of the instruments in use without sharply increasing policy administration costs. Reorganization of the public-sector development agencies actually led to a reduction in the number of civil servants at Corfo (from 601 in 1994 to 464 in 1995) and Sercotec (from 315 in 1993 to 198 in 1995).

TABLE 11

Chile: Spending on SME development measures
(Millions of current dollars)

	Spent			Budgeted		
	1994	1995	1996	1997	1998	1999
Technical Assistance Funds (FATS)	0.33	1.43	4.58	6.97	8.42	0.00
Development Programmes (Profos)	1.00	3.54	8.48	4.96	6.69	15.26
Agricultural FATS and Profos	0.00	0.00	0.00	0.00	8.65	12.19
Credit Insurance Discount Coupons (Cubos)	0.41	0.30	0.27	0.46	0.96	0.83
Agricultural investment allowance	0.00	0.00	0.10	0.54	0.80	0.00
Financial Assistance Subsidy (Suaf)	1.95	0.39	0.06	0.00	0.00	0.00
Subtotal I (Corfo SME development measures)	3.70	5.67	13.49	12.93	25.52	28.29
Empresa Nacional de Minería (Enami) national mining company	7.97	6.48	12.61	11.31	12.35	10.84
Production Development Corporation-Service of Technical Cooperation (Corfo-Sercotec)	1.27	2.54	4.94	8.80	8.64	8.14
National Fund for Technological Development and Productive Research (Fontec)	8.01	11.92	11.80	12.78	12.03	11.76
Corfo-Premex ^a	0.00	0.00	0.00	0.11	1.08	1.02
Subtotal II	20.95	26.60	42.84	45.93	59.63	60.05
Training, except tax breaks	15.15	12.40	3.95	21.26	28.81	35.45
<i>Total</i>	<i>36.10</i>	<i>39.00</i>	<i>46.78</i>	<i>67.20</i>	<i>88.44</i>	<i>95.50</i>
Share of total production development spending (percentages)	8.1	7.5	7.9	10.3	13.4	15.8

Source: Prepared by the authors on the basis of Ministry of Economic Affairs data.

^a Support Programme for the Management of Export Firms

In addition, a number of the administrative functions of Corfo and Sercotec were decentralized, and the powers of regional directors were increased. The changes made to the operating system, with the introduction of a network of “second tier” private-sector agents, have been very important in increasing the coverage of the instruments, owing to the constraints on the extension of direct public-sector “supply” referred to, and have probably helped to make SME support policy more acceptable to businesses.

As regards annual coverage, the number of companies assisted increased from about 2,000 in 1993 to over 4,000 in 1996 and over 8,000 in 1998. The resources allocated to SME support activities increased substantially between 1994 and 1999 (table 11). Both the two subtotals and the total resources allocated to SME development increased sharply. The total rose from US\$ 36 million (actually spent) in 1994 to over US\$ 95 million (budgeted) for 1999, a real increase of 140%. Furthermore, the funds earmarked for SME support policies also increased as a share of all resources allocated to production development policies in general, rising from 8.1% of the total in 1994 to 15.8% of the budgeted total for 1999.

In short, governments since 1990 have shown a real interest in the problems of SMES, and this has been

reflected in an increase in the resources allocated, both in real absolute terms and as a proportion of the total spent on production development policies. At the same time, thinking within Corfo itself has led to a change of approach that has enabled the private sector to play a greater role in managing and applying the instruments. This change of approach and the extra funding available have resulted in a very substantial increase in the number of companies assisted, which rose from just over 2,000 to more than 8,000 in five years.

This concern with SME support policies has led Corfo to bring in outside organizations to assess the impact of some of the instruments used, something that is almost unparalleled in Latin America. Despite all these positive developments, however, the problems affecting SMES are very far from having been solved. Firstly, support policies reach somewhat less than 10% of the country's SMES. It would be difficult to increase this coverage substantially without doubling or trebling the funding available, and this is a real problem given the budgetary constraints within which the public authorities have to work.

Secondly, it is not just a case of extending coverage by making greater use of existing development instruments. The interviews carried out with business people and trade association representatives by the

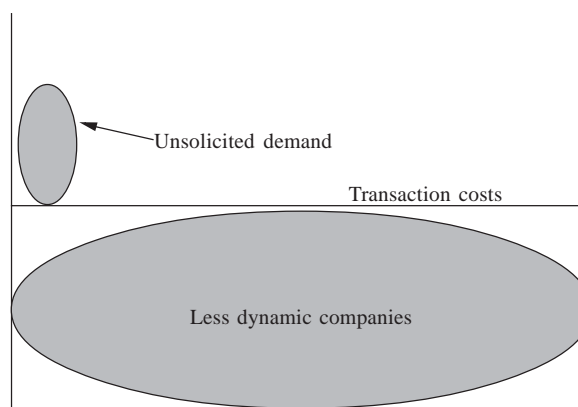
University of Chile for its assessments of Profos and FATS (1997a and 1997b), and the data presented in this section, show that many of the problems facing businesses stem from the serious difficulty they have in obtaining credit. The development instruments used are designed to solve management problems, but to promote investment or technological leaps they need to be supplemented by other instruments of a financial nature that can mobilize far greater resources than are currently available to SMES.

A third problem is the very nature of the policies implemented and the instruments used. Although demand-led policies have made it possible to implement measures that are much better suited to the needs of companies and to increase the involvement of the private sector, they have not greatly enhanced the linkages between businesses and other institutional actors, particularly local ones, such as the municipalities and other organizations that have been crucial to the success of efforts to develop clusters and highly competitive networks elsewhere in the world. For this to happen, it would be desirable for the public authorities to make more active use of incentives to encourage linkage between groups of companies and local institutions.

Fourthly and lastly, the very logic of horizontality and demand subsidies that characterizes much of development policy itself poses a very serious problem. In a policy guided strictly by demand, "the State has to confine itself to responding to requests from the private sector and provide assistance exclusively to companies that know their limitations and are able to draw up

FIGURE 1

Company access to the production development system



Source: Dini and Katz (1997).

proposals in the formats and within the time limits specified by the different development agencies" (Dini and Katz, 1997). Access to the production development system entails costs, however (the transaction costs shown in figure 1). There is a group of companies, quite few in number, that are in a position to defray these costs and formulate their proposals, but another group, which includes the great majority of SMES, is not in a position to do this, and its demand for services needs to be induced. This being the case, extending the coverage of support policies and improving the efficiency of the instruments used must involve not just increasing the amount of resources available, but seeing that public agencies play a more active role in encouraging this second group of companies.

V

Conclusions

Small and medium-sized enterprises are an important component of the Chilean economy, particularly as regards jobs: they account for some 50% of all employment, a percentage that rose significantly in the 1990s. When their sales are considered, however, the situation is different. Although these increased in the 1990s, so that by 1997 they represented 23.7% of the total, percentage sales growth was much less than employment growth. What is worse, the figure has been declining over recent years. This has its counterpart in

the large and widening gap between SMES and large companies in sales per person employed.

Industrial SMES (about 13% of all SMES) are in a similar situation.⁷ As regards SME development measures, since 1991 there has been an explicit support policy whose general approach is characterized by

⁷ For information on industrial SMES and an analysis of their participation in the manufacturing sector, industrial employment, productivity and exports, see Alarcón and Stumpo, 2000.

horizontality (there is no specific policy for industrial firms) and a focus on the correction of market failures. Among the wide range of instruments used, measures to encourage partnership among companies (Profos) have been quite successful, as assessments conducted by outside organizations have demonstrated.

The results have been less encouraging in the area of training, at least where the main instrument used (tax breaks) is concerned. The shortage of skilled labour in the areas of management and production continues to be identified as an intractable problem both by businesses themselves and by independent research into the subject (Salazar, 1997).

Difficulty in obtaining credit remains an unresolved problem for SMES. The policies applied, particularly the production development instruments and the operations of Corfo in this area, are generally well regarded. Their impact on SMES overall, however, seems to have been quite limited. This is partly due to the coverage of policy measures; although this has increased in the last eight years, it extends to barely 10% of SMES and is severely constrained by the limitations on the human and financial resources that the public authorities can spare for this purpose. Other problems faced by SMES range from the scarcity of credit and the inadequacy of the training system that supplies them with specialist personnel to the difficulty of building inter-company partnerships up into true networks and clusters that are internationally competitive.

If we look at average sales per worker employed (table 12), we find that in 1996 the figure for SMES (about US\$ 13,000) amounted to barely 7% of that for large companies (about US\$ 183,000). There is likewise quite

TABLE 12

Chile: Sales per worker, by company size^a

(Large company = 100)

	Series 1		Series 2	
	1990	1992	1994	1996
Microenterprises	2.4	2.1	2.4	1.6
Small	9.5	7.7	8.2	5.0
Medium-sized	9.3	7.9	19.0	12.7
SMES	9.4	7.8	11.2	7.0
Large	100.0	100.0	100.0	100.0
<i>Total</i>	<i>19.4</i>	<i>17.7</i>	<i>20.0</i>	<i>14.2</i>

Source: Prepared by the authors on the basis of data from the Production Development Corporation and the National Socio-economic Survey (Casen).

^a The series 1 data are not comparable with those of series 2.

a large gap between small enterprises (about US\$ 9,250) and medium-sized ones (about US\$ 23,200).

Furthermore, the disparity between SME sales and those of large companies increased not only between 1990 and 1992 (when the policies analysed in this article were still at a very early stage) but also between 1994 and 1996, by which time the great majority of the instruments considered were being fully applied.

The wide productivity gap between SMES and large companies, and the formers' lack of international competitiveness, are very much linked to the factors examined in this article. They pose SMES with an array of complex challenges that will have to be addressed if these are ever to achieve the competitiveness they need to insulate themselves, at least to some degree, from the vicissitudes of their domestic market.

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