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EVALUATION OF SOCIETE FINANCIERE
HAITIENNE
DE DEVELOPPEMENT S.A.
(SOFIHDES)

FWA First Washington Associates

Best Available Document

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EVALUATION OF SOCIETE FINANCIERE
HAITIENNE
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Prepared For
SOFIHDES
August 1985

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AN EXECUTIVE SUMMARY
PREPARED FOR
SOCIETE FINANCIERE HAITIENNE
DE DEVELOPPEMENT S.A.

(SOFIHDES)

BY
FIRST WASHINGTON ASSOCIATES
AUGUST, 1985

EXECUTIVE SUMMARY

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I. INTRODUCTION

This summary has been prepared to provide a concise presentation of the report prepared for SOFIHDES by First Washington Associates (FWA). The full report is available for interested readers in SOFIHDES' office. FWA carried out the evaluation covered in this summary under contract with SOFIHDES dated May 10, 1985. The evaluation was conducted in Haiti from June 17th to July 9th, 1985. Specific tasks carried out by FWA are spelled out in Chapter I of the main report.

II. EVALUATION OF SOFIHDES' POLICIES AND PROCEDURES.

A. Objectives and Policies

SOFIHDES' objectives mandated by its shareholders and its agreements with USAID are ambitious and some, by their nature, conflicting. As in many development finance corporations, the major dilemma is to balance profitability and financial viability with risk taking and development objectives. One of the primary objectives in the initial period, as in other development banks, has been to establish the organization on a sound basis with projects which have excellent chances of success and loans which have a sound basis for repayment. In order to achieve this SOFIHDES has established a strong staff with skills and capability to grow on the job through training and experience. In achieving its goals SOFIHDES has to choose at times between the early attainment of some goals at the expense of others. For example, to arrive at a sound portfolio and a good cash flow based on timely payments, it may be necessary as in the case of SOFIHDES to accommodate experienced sponsors and concentrate activities on larger projects in the already established industrial areas. Later goals such as the development of industry outside of the industrial areas and greater risk taking with smaller projects and less experienced management can then follow based on the soundness of the portfolio and the established reserves.

Currently SOFIHDES uses a three tier system to recognize the degree of project complexity and risk (category 1: small company/high risk; category 3: established company/lower risk; category 2: in between). The breakdown of the portfolio in those categories as of June 30, 1985 was 28%, 20% and 52%, for categories 1, 2 and 3 respectively.

SOFIHDES' management is aware of the importance of meeting all objectives over time and is clearly giving emphasis to

this in its operations. One of SOFIHDES' major objectives is to mobilize domestic capital thereby developing additional resources. To do this, however, profits must be established and dividends prospects must be clear so that new equity can be obtained. FWA believes that SOFIHDES has put the right weight on each of its objectives during its initial period. SOFIHDES has also succeeded in having a variety of industrial sub-sectors in its portfolio, representing a major accomplishment. Further, it has balanced its portfolio in terms of long-term and medium-term loans and has made a few short-term loans to accomplish the important goal of income generation. In providing short-term funds for working capital, SOFIHDES has filled not only the need of its clients, but also an opportunity to develop business with firms whose immediate needs are short-term but whose long-term needs are clearly in line with SOFIHDES' development goals.

SOFIHDES' procedures were reviewed in detail, including the operating manuals, internal reports, filing system, policy guidelines, committee functions, etc. Procedures are well conceived, well documented, and being implemented. Specifically: 1) Project identification is carried out by a call program as well as limited public relations and visits to SOFIHDES' office; 2) Loan evaluation is carried out thoroughly and the documentation is appropriate; and 3) the review of existing loans is beginning and detailed procedures are established. The system of review, however, has not been fully tested. This is an area which is now receiving attention from SOFIHDES' management in order to be sure that the portfolio is followed closely and that the need for internal checks and balances between the administration and credit areas is established.

B. Management Performance and Systems

SOFIHDES has succeeded in establishing a strong Board with effective Committees and in securing a General Manager who has effectively established leadership and systems appropriate to the organization. It is important to recognize, however, that the shortage of Haitian managers with the appropriate experience has meant that SOFIHDES has relied on expatriate staff and advisors while searching for Haitian management, using technical assistance funds from USAID. Significant resources have been committed to the search of management personnel both locally and overseas. Results to date have been only partially successful as the market has proved to be extremely thin. Despite such recruiting problems, SOFIHDES has been able to establish an organization appropriate for the initial period and systems which have been effective in achieving sound judgment and independent decision making, which is recognized by the

business community.

In describing SOFIHDES' management as strong and effective, it is important to also indicate the difficulties of managing a new type of organization in an environment which faces difficulty in terms of economic development. It is also important to recognize that the day-to-day operations require fast responses, flexibility in dealing with a large clientele and a growing portfolio. The exchange of views among the key officials - the Board and Committees, and the senior officers - has enabled SOFIHDES to cope well with the day-to-day problems and to successfully achieve its strong reputation as an effective long-term financing institution. Continuation of this strong leadership will enable SOFIHDES to meet growing challenges as it seeks to widen the scope of its activities. Further, continued cooperation and the excellent support provided by USAID, both in terms of technical assistance and the interpretation of guidelines as issues arise, is essential.

C. Staff and Training

SOFIHDES has recruited a small, capable staff with good background and learning skills. The sample survey of the business community carried out by FWA confirmed that the staff is respected for its professional ability and methods of operation. SOFIHDES is now actively planning an offsite staff training program, using technical assistance funds provided by USAID to better meet the job requirements. As indicated, the staff has good opportunities to exchange views with the management. SOFIHDES' staff size is appropriate for its present operations but with the growing portfolio as well as new business, the staff must expand to meet needs and to have sufficient flexibility to receive training, and address the day-to-day operational requirements. Continued recruitment of local staff is an important task facing SOFIHDES. Adequate staff incentives may be key to growth and stability.

Continued technical assistance funds for advisors and consultants is important during this period of establishment of the staff and its consolidation. The technical assistance provided to date from advisors and consultants has been effective and well-structured. The assistance depends on, essentially, a few individuals and firms, and SOFIHDES' relationship and effectiveness with both parties is notable and again is due in large measure to the leadership of SOFIHDES' management, the operating procedures, and open relationships between the Board, management and staff.

D. Recommendations

1. Surveys should be undertaken to determine: (i) financial and other needs which SOFIHDES can provide potential clients; and (ii) motivation and other factors of concern to potential investors in SOFIHDES' share capital and debenture issues.

2. Based on the surveys, SOFIHDES should develop imaginative, thorough and effective marketing campaigns, including publicizing success stories and better differentiating its services from other financial institutions (emphasizing technical assistance with project development, personal touch, responsiveness, outreach and quality of staff).

3. To identify new projects, SOFIHDES should continue and increase its contacts with lawyers, notaries, accountants and others.

4. SOFIHDES should offer, in due course, consulting services (apart from financing) for a fee.

5. SOFIHDES should undertake direct planning and studies necessary to develop selective subsectors, particularly in agro-industry, where comparative advantages exist.

6. SOFIHDES should attempt to identify or promote projects outside Port-au-Prince. It should also move the structure of the portfolio with a goal of one-third in each of its three project categories by 1990 if not earlier. SOFIHDES should, overtime, achieve a wider spread of subsectors as well as terms and conditions, for example repayment periods and grace periods.

7. SOFIHDES should continue its search for Haitians with engineering, financial and support experience to meet its growing staffing needs and to eventually replace expatriate staff. An agro-business consultant/advisor should be hired to assist in identifying and appraising projects.

8. Continued development of staff is necessary including specialized external courses, in-house/on-the-job training, a library of reference material/publication, and up-to-date job descriptions.

III. FINANCIAL RESULTS AND PROJECTIONS

A. Performance

The management, Board of Directors, and staff of SOFIHDES have followed policies and approved projects which have led to the establishment of a sound financial condition in a relatively short operating period. SOFIHDES is projected to be near the breakeven point by the end of the current fiscal period, and profitability should be attained during the 1986 fiscal year. In spite of several tangible market constraints, including a difficult economic conjuncture, a restricted universe of possible projects as well as a situation of excess market liquidity resulting in strong competition among financial institutions, SOFIHDES has achieved a successful record in developing a sound project portfolio. This respectable level of growth has been attained mainly through diligent efforts on the part of SOFIHDES' staff and the close working relationship established between management, the Board, and its committees, in conjunction with an excellent level of on-going consultation with AID.

In achieving this solid project portfolio, SOFIHDES has assured continued and growing positive cash flow through interest and fee income. As in any start-up situation, operating expenses have been high relative to revenues, but through careful management SOFIHDES is containing operating and general expenses in a commendable manner. SOFIHDES' existing low leverage can not be compared with other development finance companies (DFC's) due to its relative low cost, low risk source of funding, but overall SOFIHDES compares extremely favorably with other DFCs at this stage of its existence, and is on a relatively very sound financial footing.

B. Market Prospects and Projections

SOFIHDES can not realistically expect to maintain its current high level of project portfolio growth over the next five year period due to the above-mentioned constraints. Due to limited market possibilities and the limited capacity of the company operationally to accommodate an increasing number of small loans,

projections assume that new loan commitments will average approximately \$2.5 million per annum during fiscal years 1986 - 1990. Interest and fee income during this period are expected to average 14% and 1.5% per project respectively, and as recommended below, pricing will be carefully monitored internally. As it has done in the past, SOFIHDES will assure profitability and fulfillment of its development mission through continued careful attention to risk and return factors, and diversification of the project portfolio by industry sectors. During the coming five-year-period, SOFIHDES will endeavor to spread its project risk equally among its three project categories, and will limit working capital loans to project-related loans. It is also expected that terms will generally be longer on average than the existing four year project loan average.

The portfolio diversification goal, placing funds in the lower categories will be achieved concomitant with the increase in the level of previously projected provisions for losses (up to 6% on category 1 loans). This is in recognition of the substantial risk associated with the financing of those small/unstructured projects. This will reduce profitability.

C. Funding Needs and Technical Assistance

In order to maintain solvency and ensure its ongoing success and profitability, SOFIHDES will require a second tranche of AID project funds beginning in fiscal 1986. As SOFIHDES is still in a beginning phase, AID project monies are required to continue development of a solid funding base and to inspire continued confidence from the marketplace and existing as well as potential investors. These funds are also required as a stable source of foreign exchange inasmuch as SOFIHDES is repaid in gourdes. Furthermore, due to the tangible developmental impact which SOFIHDES has thus far achieved, a second AID tranche to SOFIHDES is deemed as a very productive use of bilateral funds and foreign exchange in the local economy. Continued financial soundness will also enable SOFIHDES to increase and diversify its equity capital (projected at \$500,000 share capital and \$500,000 in debentures in early 1986). The new funding is required not only to invest in new projects but also, together with loan reflows, to enable the establishment of a \$4 million time

deposit base, the stable earnings of which will ensure profitability and the possibility to continue to attract local investors. This earning base is required in order to offset the new increase and more realistic level of loan loss provisions.

D. Recommendations

1) Beginning in 1986, AID approve a new tranche of \$4,000,000 in project funds and \$500,000 in technical assistance funds.

2) SOFIHDES should plan an annual strategic review with five year rolling financial projections.

3) SOFIHDES should establish semi-annual, or quarterly (if conditions warrant this) pricing strategy meetings in which its pricing and fee structures are reviewed, substantiated, and revised if necessary.

4) SOFIHDES should obtain a waiver in the current AID-mandated dividend policy of 10% of net income payout. This waiver is viewed as essential in maintaining and increasing local investors and providing them with a competitive rate of return on their investment. FWA recommends that SOFIHDES' Board review its dividend policy annually in consultation with AID and establish a payout ratio which would provide a competitive rate of return to shareholders.

5) Following the completion of its investor survey, SOFIHDES will proceed with the issuance of \$500,000 in new share capital and raise \$500,000 in debentures.

6) SOFIHDES should continue to maintain and expand its interbank relationships providing not only an additional window for funding, but developing good relationships leading to additional co-financing opportunities.

7) As profitability and capital funds increase, SOFIHDES should accordingly scale its current maximum \$150,000 loan limit upward in order to accommodate larger-sized projects.

8) Starting in 1986 the reserve for bad debt should be established at 6% for category 1 loans;

4% for category 2 loans; and 2% for category 3 loans, adjusted quarterly. This policy will also ensure investor confidence.

9) SOFIHDES should be allowed by USAID to use loan reflows for investing in time deposits up to such time as \$4 million has been reached (expected in 1988 in order to enhance profitability and provide solid prospects for local investors' return.

IV. ECONOMIC DEVELOPMENT IMPACT

A. Results

SOFIHDES has contributed to the creation of 2,178 jobs in the 27 projects approved to date, projects are forecast to provide an average of US\$4.5 million in foreign exchange per year, and the average value added has been 58%. Through its loan preparation and appraisal process SOFIHDES has helped introduce analytical techniques including cash flow projections, management skills, and the advantages of long-term financing.

B. Future Strategy

Based on the structure of its loan portfolio and the capability of its staff SOFIHDES can concentrate greater efforts in assisting smaller projects, new entrepreneurs and projects outside Port-au-Prince. In addition, it can help develop projects in agro-business which will benefit the farmers to a greater extent. By building up earnings and reserves SOFIHDES will be in a position to take greater risks while continuing to balance such risks against more traditional projects with established companies which are expanding or creating new companies.

C. Recommendations

1. SOFIHDES should continue to play a leading role in seminars on development techniques, financial sector problems, macro-economic policy issues, and the removal of constraints such as lack of infrastructure and communications.

2. SOFIHDES should undertake or help direct sub-sector and other studies to develop projects such as agro-industry where Haiti has a comparative advantage.

3. In particular, SOFIHDES should consider the needs of potential projects outside Port-au-Prince which can be developed in due course.

4. SOFIHDES should develop the use of internationally recognized economic analysis techniques as appropriate, including the use of efficiency or border prices, economic rates of return calculations, and discussion of indirect benefits.