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INVESTMENT PROPOSAL
FOR
REVOLVING FUND

SOCIETE MAROCAINE DE DEPOT ET CREDIT

US$2,100,000 FACILITY CONSISTING OF
US$2,000,000 LOAN AND US$100,000 GRANT GUARANTEE FACILITY
ON BEHALF OF
SOCIETE MAROCAINE DE DEPOT ET CREDIT

OFFICE OF INVESTMENT
BUREAU FOR PRIVATE ENTERPRISE

AUGUST, 1985

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

INVESTMENT OPPORTUNITY PROPOSAL
FOR
REVOLVING FUND
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ABBREVIATIONS

USAID	-	U.S. Agency for International Development
SMDC	-	Sociėte Marocaine de Depot et Credit
DH	-	Dirhams
GOM	-	Government of Morocco
PRE/I	-	Office of Investment, Bureau for Private Enterprise
US$	-	United States Dollars
BNDC	-	Banque National de Credit et de Banque
CNCA	-	Caisse National de Credit Agricole
CIH	-	Credit Industrial et Hotlelier (Housing Finance)

CURRENCY EQUIVALENTS

1982:	Dirhams	6.27	=	US$1.00	(12/31/82)
1983:	Dirhams	8.06	=	US$1.00	(12/31/83)
1984:	Dirhams	9.48	=	US$1.00	(12/31/84)
1985:	Dirhams	10.15	=	US$1.00	(05/15/85)

SOCIETE MAROCAINE DE DEPOT ET CREDIT

I. EXECUTIVE SUMMARY

The Project

1.01 The Office of Investment, Bureau for Private Enterprise recommends as outlined below a US$2,100,00 facility be extended to Societe Marocaine de Depot et Credit (SMDC), the "Borrower", a privately-owned bank for the purpose of supporting the initial operation of a private Moroccan trading company - GENEX. This investment complements a similar loan made last year in Morocco to Wafabank to support lending to small- and medium-size Moroccan companies. The investment with SMDC will be utilized to finance two distinct export promotion projects:

(1) A US$100M reimburseable grant to assist SMDC finance marketing efforts outside Morocco including marketing studies and initial operating expenses outside Morocco and to offer marketing and packaging assistance for potential Moroccan exporters. A portion of this may also be used to cover costs of evaluation required under this agreement;

(2) A US$2MM loan guaranty facility from the revolving fund. On the basis of this facility loans will be made by local banks to GENEX which is jointly owned by SMDC and SCOA (a French export company). GENEX will operate as an export trading company, identifying exportable items, compiling and acquiring product lines, and exporting them as well as providing small exporters with the necessary export trade credits. This operation will assist small- and medium-size companies that do not have the ability to export full product lines, nor access to the necessary export credits. Small-scale enterprises are those whose total assets do not exceed DH6,500,000;

The guaranty facility will be funded through a collateral account mechanism whereby the funds will be deposited by AID in the borrower's account in an international bank in the U.S. On the basis of these funds the U.S. bank will issue a standby letter of credit for the account of SMDC covering loans made to GENEX by Moroccan banks. Since GENEX is a subsidiary, SMDC will guarantee all loans to GENEX. AID's guaranty facility will go into effect in the event that SMDC's guaranty is not sufficient to cover any losses. PRE/I will have recourse to SMDC and GENEX;

SMDC will pay an up-front commitment fee of 1 percent for the AID collateral account facility. SMDC will also pay a guaranty fee of .25 to .5 percent on any amounts blocked in the collateral account for guaranty purposes;

AID will receive the interest income on all funds in the collateral account. The collateral account will be concluded three years after the loan is disbursed;

The previous AID/PRE initiative in Morocco with Wafabank mobilized foreign exchange credit on behalf of small- and medium-scale (SMSE) businesses. The credit has been used for the importation of production inputs to enable SMSE to increase their capacity utilization;

The proposed project to SMDC complements this experience by focusing directly on development of exports by these SMSE. As a result of the proposed facility, an export trading company will be created to provide exporting services on behalf of SMSE Moroccan firms;

The proposed project also complements USAID's export promotion initiative by providing support directly to the private sector and is consistent with the GOM expressed goal of increasing Moroccan exports. The project has been reviewed by USAID/Morocco and has Mission support.

Capitalization

1.02 Project capitalization entails the mobilization of up to US$2.0MM equivalent in Moroccan Dirhams by Moroccan banks to cover pre-export financing loans to GENEX. The source of these loan funds will be the deposit base of the Moroccan banks. All credit to GENEX will be supported by a U.S. bank standby letter of credit issued for the account of SMDC. Initially, because of the low capital of GENEX, loans to GENEX will be limited to the standby letter of credit in the amount of US$2MM. As earnings are retained and volumes are increased, total loans outstanding to GENEX could exceed the short-term US$2MM limit.

Products

1.03 As a capital markets project, the product will be the delivery of credit to a newly-formed trading company which will aid in the export activity of small- and medium-scale businesses. Presently large companies have been able to export reasonably well. Smaller businesses do not have the technical expertise or capital to enter the export market. The trading company will assist these smaller companies to expand sales through export and thereby meet the objectives of the GOM to improve its trade balance.

Developmental Benefits

1.04 The target group for this facility is consistent with USAID's emphasis on export firms generating hard currencies and is expected to result in increased employment. Moreover it will demonstrate methodology by which AID can collaborate directly with private financial corporations to assist in the development of the export market.

Project Timetable

1.05	IOP	07/18
	IP	08/30
	L/A Negotiation	08/15 - 09/15
	L/A Signing	09/15
	First Disbursement	12/85

Risk

1.06 The risk of loss to the R.F. from this project is low and would require first that GENEX is unsuccessful and unable to service its debt and second that SMDC, as a result of liquidity or capital problems, is unable to honor its guarantee to the other Moroccan banks lending to GENEX. The R.F. credit risk is therefore the overall creditworthiness of SMDC. SMDC will manage its risks through its management of GENEX and its borrowings. To give an indication of the level of conservatism of SMDC, this bank's losses on loans in 1984 was less than .25 percent of loans outstanding. The loans proposed in this project may have a higher risk than normal commercial bank loans because of the limited capitalization of GENEX (US$20M paid in). However all loans to GENEX will be predicated on firm orders for export and will be secured. With a source of repayment and security, the risk to the Moroccan banks should be well covered, notwithstanding, the nominal equity of the borrower.

The event which will trigger a call on the A.I.D. collateral for the standby letter of credit supporting loans to GENEX will be a default on GENEX loans from any Moroccan bank and the subsequent inability of SMDC to cover its guaranty. This could be caused by bankruptcy or liquidity crisis of SMDC. Since loans will be short-term and primarily in Dirhams there is limited foreign exchange risk.

The historically sound liquidity position of SMDC and its capital of 4.4 percent of total assets as well as its recognized position as a sound bank gives confidence the borrowings of GENEX will be conservative and that bankruptcy or liquidity crises of SMDC are highly unlikely.

Loans under this project are by Moroccan banks to GENEX. These loans are guaranteed fully by SMDC and that guarantee is supported by the letter of credit issued by a U.S. bank which is in turn supported by the collateral account. Therefore, SMDC is responsible for all of A.I.D.'s exposure. In similar transactions, such as one bank confirming the letter of credit of another bank the fee is approximately 1/20 of 1 percent. In other IFI arrangements of PRE/I there has been a sharing of risk on subloans and the guarantee fee was higher. There is no sharing of risk with SMDC and therefore the guarantee fee under negotiation will be between .25 to .50 percent.

II. THE SPONSOR

A. Overview

2.01 SMDC is primarily a commercial bank but also engages in investment banking through minority equity investments in foreign owned ventures in Morocco. The majority ownership is held by Moroccans but a 40% minority interest is held by Banque Paribas and Banque Worms of France. SMDC is a relatively small bank with total assets of 1837 million dirhams (about $187 million) as compared to the other A.I.D. PRE client in Morocco, Wafabank, which has total assets of 3871 million dirhams in 1983.

SMDC is well regarded in Morocco and in discussions with senior management an impression is developed of a well managed, relatively conservative bank enjoying profitable operations.

A growth in total assets of 26% was recorded in 1983. In 1984, a year of lessened economic activity for Morocco, the bank grew 9%. Operations in both years were profitable at 11% on capital in 1983 and 10% on year end capital in 1984. This is comparable to Wafa Bank which recorded an 11.8% return on ending capital in 1983. Return on total assets as of 1984 at .40% is comparable to other Moroccan banks. Profits, while low on an international scale, were sufficient to keep pace with asset growth. Retained earnings allowed the bank to increase capital 10% while total assets grew only 9%. Capital as of December 31, 1984 was at 3.7% of total assets which is low compared to U.S. standards but comparable to other Moroccan and European banks. On May 2, 1985, the capital stock of the bank was doubled and total equity is now 4.4% of total assets.

Losses on loans were reported at .22% of outstanding loans which is low compared to U.S. standards at about .5%. This supports the impression that SMDC is a conservatively managed bank. The balance sheet of the bank reveals only an average bank by U.S. standards but the conservative nature of its management, very favorable reports from competitors and regulators as well as impressions received from a long interview indicate a well managed bank.

B. Shareholders

2.02 SMDC ownership is widely held with the exception of 40 percent interests by Banque Paribas and Banque Worms of France.

III. FINANCIAL PLAN

A. Project Cost and Method

3.01 The project entails the mobilization of the dirham equivalent of US$2.0MM at a minimum, entirely from local banks. The funds will be provided from deposits. PRE's role will be to support SMDC's 100 percent guarantee of the loans by local Moroccan banks to GENEX.

B. Operating Projections

3.02 Presently there is no private export trading company in Morocco. Traditionally an export trading company, acting on behalf of small local firms, will market overseas the products of these small firms. In addition to marketing the trading company may warehouse, process, package and ship the products. Credit may be extended to the SMSE in the form of open credit for raw materials and supplies. The trading company must therefore have access to substantial amounts of credit to market, buy, package and ship local products. This facility will provide GENEX with the required credit.

GENEX is a new venture and it is difficult to forecast the acceptance of its services to small business throughout Morocco. It is expected that only US$1.0MM equivalent will be drawn under this facility within the first six-months. But with the strong support of SMDC which now reportedly handles 12 percent of Moroccan foreign trade it is expected GENEX volume will grow rapidly and that this facility will be fully employed within a year from loan signing.

Before funds are disbursed under this project SMDC will present a business plan for GENEX. This plan will, among other things, include pro forma financials for GENEX including cash flow estimates, GENEX management organization, and plans for marketing its services in Morocco and offshore. Based on SMDC's present experience in financing 12 percent of Moroccan import trade the business plan will also estimate, what types of businesses will be assisted by GENEX. Estimates will also include the amount of financing to be done by other Moroccan banks over and above the approximate US$800M in loan committed by SMDC. It is proposed that these estimates will cover the respective amounts to be financed through the various stages of manufacture, warehouse, and export packaging and shipment. Estimates of products shipped, numbers and size of firms assisted and limit of SMDC guarantee will be addressed.

GENEX capitalization is currently US$20,000 paid in 50/50 by SMDC and SCOA. Additional working capital will be provided by SMDC to cover all GENEX expenses in Morocco. Further details on the financial plan is a condition precedent to the project.

C. Project Grant

3.03 One of the major goals of the GOM is the expansion of exports. However, the majority of small Moroccan exporters have not been able to market and package their products properly for the U.S. and European market. Therefore, SMDC with SCOA (a french trading company) is forming GENEX as an export trading company to assist these small exporters. SMDC has committed to pay the overhead and operating expenses of GENEX in Morocco but will need foreign exchange relating to GENEX's start up expenses abroad. These expenses will include marketing research in U.S. and Europe to identify appropriate products, marketing and distribution channels including importers committed to selling and warehousing Moroccan products. Disbursements from the grant will be made after a proposal prepared by SMDC/GENEX and approved by A.I.D. outlining how funds will be expended to achieve the results outlined above. Disbursements will be as reimbursement of such expenses. Grant funds may also be used up to a maximum of US$10M for evaluation required by A.I.D. from SMDC and GENEX to assure that SMSE exporters are receiving the assistance specified in the project.

The grant will be matched by SMDC's expenditures to cover GENEX's overhead in Morocco. Grant funds to be used outside Morocco and SMDC's funds to be used by GENEX in Morocco will further the Mission strategy to: "Improve ability of Moroccan exporters to develop new export markets.".

IV. ECONOMIC BACKGROUND

A. Overview

4.01 The Moroccan economy has been damaged over the last several years as a result of:

1. high interest rates and a strong U.S. dollar which impacts on its ability to service its foreign debt;

2. depressed export markets and slow export growth; and

3. a significant increase in imports, particularly food and fuel imports which together represents more than 40 percent of Morrocco's total imports.

This discrepancy between exports and imports caused the trade deficit to widen in 1984 by almost 45 percent. The increase in the level of imports reflects the impact that the drought has had on Morocco's domestic agricultural productivity. While fuel imports have stabilized at roughly 28 percent of total imports, the level of food imports has increased tremendously over the last 5 years.

Nineteen eighty-four was the second year for Morocco's austerity policies which are designed to establish some balance in the economy by the late 1980s. At a meeting of the World Bank consultative group in Paris in January 1985, GOM stated the following goals:

1. to increase the GDP growth rate to 2.9 percent by 1988;

2. to increase the level of exports by 7 percent p.a.;

3. to further remove restrictive regulations which limit imports into the Country;

4. to increase the level of foreign investments in Morocco, primarily in the private sector in order to promote the transfer of technology to Moroccan small enterprises;

5. to reduce the budget deficit to 5 percent of GDP by 1988 and 3 percent of GDP by 1990;

6. to bring the balance of payments into balance by 1988 from its present deficit level of 6 percent of GDP.

These goals are to be achieved through the expansion of the phosphate sector of the economy, the promotion of the private sector (particularly export-oriented industries), and the development of the agricultural sector in the hopes that Morocco will one day become self-sufficient in food.

The World Bank consultative group approved Morocco's plans paving the way for the rescheduling of much of Morocco's foreign debt. Morocco's foreign outstanding debt is now at just over US$13 billion and it is expected to grow to about US$14 billion by the end of 1985. It is estimated that Morocco will require some US$3 billion annually over the next 3 or 4 years to finance its debt repayments on outstanding loans - principal and interest - and its current account deficit which is projected to reach just over US$1.5 billion by the end of 1985. Morocco's preferred method for rescheduling its debt is a multi-annual rescheduling agreement similar to that which was negotiated with Mexico.

Private sector activities increased significantly during 1984. Increases in the level of medium- and long-term loans and partnership agreements with the private sector increased by almost 98 percent for the Banque Nationale pour le Developement Economique. Further increases in the level of private sector activities can be expected as the Moroccan Government attempts to exchange public expenditures for private investment. The recent trade liberalizing actions taken by the Government - reducing the upper limit for customs duties and no longer requiring import certificates for most imports - represent the first stages of the liberalization of the economy which is currently about 50 percent state-controlled.

KEY ECONOMIC INDICATORS
Values in millions of U.S. dollars

	1981	1982	1983	1984(e)
GDP (current prices)	14,903	15,015	13,046	14,000
CPI (1980=100)	112.5	126.4	140.1	155.5
Exchange Rate (DH/$)	5.33	6.27	8.06	9.48
<u>Balance of Payments</u>:				
Reserves (incl. gold)	519.1	530.5	378.1	292.5
Current Account	-1,843	-1,877	-894	-1,092
Foreign Trade	-2,010	-2,258	-1,498	-2,172
<u>Foreign Debt</u>:				
Outstanding Debt	8,000	9,000	11,000	13,000
Debt Service Ratio (%)	42	48	37	34

4.02 The Moroccan economy is primarily a service economy. The service sector accounts for about 51 percent of all production. The agricultural sector currently represents about 18 percent of total production, down from 23 percent in 1960. The industrial sector has grown from 26 percent of production in 1960 to 31 percent in 1984. The manufacturing component of the industrial sector accounts for about 16 percent of total production and about 65 percent of industrial production.

Currently, the public sector controls half of all enterprises. However, attempts are being made to promote the private sector as well as to diversify Morocco's exports. Export revenues are primarily dependent on exports of phosphates and phosphate derivatives, food products - fruits, vegetables, and fish - and the tourist industry.

In the past, the Government has maintained an overvalued Dirham which has stunted export growth. In addition, the over reliance of Morocco on the sale of phosphates and phosphate products as the source of foreign exchange has led to the current account problems which Morocco is now facing. To finance the current account deficits Morocco has borrowed extensively from abroad, resulting in a heavy debt servicing burden. The external debt quadrupled between 1976 and 1983, and the debt service rate increased almost 5-fold. One of the Government's goals today is to maintain the debt service rate at no more than 30 - 35 percent of exports.

The past emphasis on public sector directed development through public expenditures resulted in an increase in both the domestic resource gap and the current account deficit. Furthermore, Morocco's vulnerable position as an exporter of primary commodities and its dependence on foreign suppliers for much of its fuel needs (fuel imports represent 27 percent of the total import bill) during a time when the international economy was experiencing strains - high interest rates, depressed primary commodity prices, and general world recession - simply exacerbated its problems and pointed to the structural nature of Morocco's problems.

Economic growth was very rapid from 1960 to 1970 with the GDP growing at a rate of about 4.4 percent p.a. Growth continued during the 1970s at about 5 percent p.a., however, the 1980s have seen a sharp slowdown in the rate of growth of GDP. At present, GDP is growing at less than 2.5 percent p.a.

GNP per capita stood at about US$900 at the end of 1984 with the GNP growth rate running at about 2.5 percent p.a. The future prospects for the growth rate of per capita GNP is, at least partially, dependent on the population growth rate, which is approximately 2.6 percent p.a.

Current Problems and Credit Need

4.03 In the absence of an effective market for the sale of bonds and stocks to the public, and in view of the limited possibilities for direct access on the part of non-financial companies to international credit, industrial firms derive their resources almost exclusively from (a) borrowings from banks or specialized financial agencies; and (b) capital from private subscriptions and accrued undistributed profits.

The macroeconomic indicators - current account position, debt service ratio, level of imports of food and fuel, and the GDP growth rate - point to an economy with major structural problems. It is unlikely that these problems will be rectified before the end of 1985. Therefore, the prospects for economic growth in the short-term are not good. It is likely that Morocco's current account position will continue to decline through 1985. The medium- to long-term prospects must inevitably be more optimistic as the new emphasis on private sector development begins to bear fruit. One important event which warrants close attention will be the entrance of both Spain and Portugal into the European Economic Community (EEC) in early 1986. This could have a detrimental effect on Morocco's exports to Europe as both Spain and Portugal will be competing directly with many of Morocco's food exports.

The success of Morocco's private sector development plans is heavily dependent upon the diversification of its exports and the amount of foreign capital which can be attracted. Gross domestic investment as a percent of GDP rose from 10 percent in 1960 to 23 percent in 1982 while at the same time gross domestic saving as a percent of GDP fell from 11 percent in 1960 to 8 percent in 1982. The savings-to-investment gap indicates Morocco's dependence on foreign sources of capital to implement its development plans. Morocco has begun to take steps towards increasing the attractiveness of its economy to foreign investors by dismantling many of its import and export restrictions. In addition, the Governmental has demonstrated its sincerity to both the international Monetary Fund (IMF) and the World Bank both of which have approved Morocco's development goals and have continued to extend project loans and stand-by credits to Morocco.

V. CREDIT ANALYSIS OF SPONSOR

5.01 The US$2,100,000 facility will be extended to Societe Marocaine de Depot et Credit (SMDC). SMDC is a private bank owned 60 percent by a diverse group of Moroccan citizens and 40 percent by French banks - Banque de Paribas (20%), and Banque de Worms (20%). SMDC is considered to be a conservative institution and conducts extensive project and investment analyses prior to its making any commitment. Within its investment banking activities SMDC specializes in assisting foreign joint venture investments in Morocco as it prefers to promote technology transfer to Morocco as opposed to financing all-Moroccan investments. Among the services which SMDC provides to foreign participants in joint ventures are:

- assistance in locating Moroccan partners;
- assistance in obtaining Government approvals;
- provision of local credit;
- direct equity participation (not greater than 50 percent and preferably much less).

The day-to-day management of SMDC is Moroccan. The managing director, Omar Akalay, is highly respected in Moroccan government and banking circles.

5.02 As of December 31, 1984, SMDC had total assets of DH1,837 million (approximately US$193.7MM) and stockholders equity of DH68 million (approximately US$7.1MM). The balance sheet of 1984 indicates an 8.9 percent increase in total assets between the years 1983 and 1984. The increase primarily the result of increases in bonds - treasury and investment - and loans to clientele. The loans to clientele are primarily (84 percet) short-term in maturity. As of December 31, 1984, SMDC had an equity-to-total assets ratio of 3.7 percent. This ratio is low, however, SMDC's capital stock was doubled on May 2, 1985, as stockholders bought two-thirds of the new capital and the corporation used its profits to purchase one-third of the new capital. As a result, equity was increased to DH 80842 or 4.4 percent year end assets.

5.03 The tables following summarize the balance sheets for years 1982 - 1984 audited by Societe Fiduciare Marocaine Juridaque et d'Expertise. These reveal a bank with a liquid investment and loan portfolio, few problem loans, a growing deposit base and profitable operations.

SMDC BALANCE SHEET
TABLE I - Assets
('000 Moroccan Dirhams)

Earning Assets:	1982	1983	1984
Loans to Clientele	684,821	767,733	907,531
Registered Banks	33,997	63,772	26,455
Fin. Institutions Abroad	17,016	35,776	35,251
Central Bank, Treas. & Postal Bonds	36,322	65,881	11,615
Treasury Bonds	240,600	418,900	490,300
Investment Bonds	75,153	80,313	88,607
Receivables	191,341	192,824	188,405
Securities	13,294	13,449	13,412
TOTAL E.A.	1,292,543	1,638,648	1,761,577
Cash	5,698	6,069	10,152
Fixed Assets	11,355	16,240	19,349
Other	22,426	25,357	45,989
TOTAL ASSETS	1,332,022	1,686,314	1,837,067
Bad Debt (loans in collection)	3,077	3,324	9,383

Note: Exchange Rates, Dirhams/Dollar
1982 = DH 6.27/dollar (end of period)
1983 = DH 8.06/dollar (end of period)
1984 = DH 9.48/dollar (end of period)

SMDC BALANCE SHEET (CONT.)
TABLE I - Liabilities and Equity
('000 Moroccan Dirhams)

Loans from:	1982	1983	1984
Registered Banks	44,137	637	1,372
Special Financial Institutions	16,391	12,748	13,142
Financial Institutions Abroad	4,629	5,040	2,972
Other Liabilities	1,209,708	1,605,824	1,737,826
Total Liabilities	1,274,864	1,624,249	1,768,313
Equity	57,158	62,065	68,754
Total Liab. & Equity	1,332,022	1,686,314	1,837,067
Equity/Total Assets (%)	4.3	3.7	3.7
Net Income	6,829	6,535	7,348
Net Income/ Equity (%)	11.9	10.5	10.7

VI. TRANSACTION SUMMARY

Amount	: US$100,000
Instrument	: Reimburseable grant to partially underwrite the cost of marketing studies primarily in the U.S. and Europe of Moroccan products and technical assistance on marketing and packaging to small Moroccan exporters.
Utilization	: Specifications for drawing under grant will be mutually agreed before disbursement.
Amount	: US$2,000,000
Instrument	: A loan consisting of a collateral account established on behalf of SMDC. Bank holding collateral account ("Depository Bank") will issue standby L/C's guaranteeing the principal value up to US$2.0MM of a segregated portfolio of loans by Moroccan banks to GENEX. The collateral account will be established in a U.S. bank of mutual choice. Loan proceeds disbursed into collateral account will be invested in U.S. government securities. The

	balance of the credit risk not covered by the collateral account will be borne by SMDC or Moroccan banks making loans to GENEX over and above US$2.00MM limit of this facility.
Interest	: Equal to yield on investments in collateral account.
Fees	: a) Commitment Fee: A one-time fee of 1 percent in U.S. dollars will be charged on the amount of the AID facility payable at loan execution.
	: b) Guarantee Fee: A guarantee fee of 1/4 to 1/2 percent p.a. payable in U.S. dollars semi-annually in arrears would be charged on all amounts in the collateral account. This is still being negotiated.
Blocking of Account Funds	: Funds in collateral account will be fully encumbered by security interests of A.I.D. and Depository Bank.
First Disbursement Date	: Four months after loan execution.
Qualifying Subborrowers	: Moroccan banks will provide loans to GENEX who will be marshalling goods for export from small business firms,

	defined as firms having total assets of less than 6,500,000 dirhams .
Loan Terms	: The A.I.D. loan will be for 3 years. Loans to GENEX will be customary trade financing and therefore should be termed at 60 to 180 days.
Reporting Requirements	: Financial reporting according to forms provided by USAID/PRE to be submitted on a semi-annual basis and SMDC's audited annual reports and annual reports of GENEX.

VII. CONTRIBUTION TO DEVELOPMENT

A. Impact of PRE Participation on USAID Policy Areas

7.01 The proposed PRE intervention offers positive results in three of the major AID policy areas, private sector development, institution building, and policy dialogue.

7.02 Private Sector Development: The project provides stimulus to private enterprise growth in several ways. First, the provision of short-term financing for the acquisition of raw materials for small exporters will assist those presently outside normal financing circles. Secondly, the availability of imported production inputs will result in improvement of existing plant utilization. Third, the loan will be administered strictly by a private sector institution in support of a credit program targeting the productive participation of small-scale enterprises producing non-traditional export products. Finally, the supply and utilization of credit at market rates will discipline allocation decision making by rationalizing investment activities with international market conditions. This will, ultimately, strengthen Morocco's competitive export position by directing resources towards markets with competitive staying power.

Institution Building: The project has the potential to move a private financial institution permanently down market to small-scale enterprises. It will help to establish for SMDC a broader level of exposure in the area of private sector development, especially in the areas of foreign trade.

Policy Dialogue: The proposed project will contribute to USAID's pro-active platform for engaging GOM in activities to free the capital market and credit systems from distorting subsidies and strengthening export activities. The project will be a tangible indication of USAID's commitment to the concept of market-determined credit allocation.

7.03 This proposal will be the catalyst to help SMDC form Morocco's first major private export trading company and support the financing of that trading company by all Moroccan banks.

B. Relationship to the CDSS

7.04 This project conforms with the priorities of the USAID CDSS particularly as it concerns development through non-governmental entities. The Mission objective states: "It is the strategy of this Mission to enhance the role of the private sector throughout the Moroccan economy, but our initial intensive concentration will be on expanding private sector exports through technical assistance and training for export producers and exporters, an improved export credit insurance program and greater availability of credit to private exporters." GENEX will offer the technical assistance in Morocco through the financial support of SMDC. External marketing assistance will be supported by the grant. Greater availability of credit to private exporters will be delivered by GENEX through this project. The Mission supports the project and has assisted in its preparation.

C. Relation to PRE Objectives and Policies

7.05 PRE's objective is to meet the Basic Human Needs mandate of the Foreign Assistance Act of 1961, as amended, using self-sustaining private sector vehicles. In addition, PRE utilizes a variety of operating policies for its Revolving Fund investments to ensure high development and secure financial returns. The SMDC credit project satisfies both. The proposed investment is responsive to the Basic Human Needs mandate by targeting its resources towards the smaller enterprise sector. This sector is typically the most disadvantaged, especially in the area of credit. Without credit, the employment generation potential of small business investment is stifled. This project will mobilize at least US$2.0MM equivalent in credit on a self-sustaining basis. This credit will be net addition to the investment resources available to the small-scale sector.

The project also meets PRE guidelines for management of Revolving Fund investments. These are as follows:

- Has a Demonstration Effect by: a) introducing the first major Moroccan export trading firm.

- <u>Exhibits Financial Viability</u> based on a backdrop of effective demand, proven management, and focused marketing.

- <u>Targets Development Impacts Appropriate to Morocco</u> and compliments USAID's export promotion initiative by assisting small Moroccan exporters thereby aiding Morocco's balance of trade and improving capacity utilization in the private sector.

- <u>Makes Resources Available to the Small and Medium-size Enterprise Sector</u> by using the PRE/AID facility to create a pool of credit to smaller firms through the loans to a trading company.

In addition, the facility meets project-specific financial constraints, namely: a) the facility cannot exceed US$2,000,000; and b) the facility must be near market interest rates (the local currency borrowings will be at market). The facility will be financed under Section 106 as legislatively permitted.

D. <u>Economic Impacts on the SMSE Enterprise Sector</u>

7.06 The proposed PRE/AID facility specifically targets the smaller-scale enterprise sector by loans to GENEX through SMDC and other Moroccan banks up to US$2MM. This amount will be made available to provide short term credit to enterprises selling for export through GENEX. This source of capital represents additive credit and, as such, will stimulate incremental investment, sales, and employment.

The incremental impact will be essentially in the growth of exports so sorely needed in the present economic environment.

The primary goal is the incremental exports being financed by this project that would not have been financed without AID support. Estimates of increased exports is quantifiable at a minimum of twice the loan level and conceivably could be 12 times depending upon the ultimate SMSE benefiting from GENEX's export trading activity. For example, if GENEXborrowed and used the proceeds to extend credit in the form of inventory to a manufacturer, it might take six months for the inventory to be processed and sold and the loan to GENEX repaid. Similar credit to a wholesaler could be repaid in 30 days. Therefore the economic impact of this US$2MM facility could be US$4MM to US$24MM.

VIII. MONITORING

8.01 Project monitoring will consist of review of: a) loan and financial performance; and b) adherence to development covenants. Both (a) and (b) will be done on a semi-annual basis based on debt service schedules and reporting requirements of loans made imposed on the borrower.

8.02 Reporting on the project will consist of semi-annual reporting by borrower of data describing firms aided by GENEX by size, product, and estimated increased sales, employment, etc. as a result of financing. A reporting form prepared by PRE is included in the annex. These type of data are similar to data typically collected by Banks and will largely be the empirical basis on which the evaluation is performed. Augmenting the periodic reports will be semi-annual discussions by PRE staff with the borrower concerning implementation issues. Site visits to selected SMSE would be made with SMDC and GENEX staff during project implementation.

8.03 Responsibility for project monitoring will reside with AID/PRE/I which will coordinate its efforts with USAID/Morocco. AID/PRE/I will receive reports from SMDC on loans by Moroccan banks to GENEX. Reports will cover names and size of SMSE's assisted by GENEX, types of merchandise exported, destination of exports and impact of GENEX support of exporters in the form of growth, profits and employment increases, similar to Annex II. These reports will be shared with the Mission to assure compliance with objectives of GOM and the Mission.

IX. EVALUATION

9.01 The first evaluation of this demonstration project will be conducted in Morocco by AID/PRE one year following initial disbursement of the loan funds to determine the project's success toward achieving its objectives; potential for replicability to other AID-assisted countries; and to provide guidance to AID/PRE and the borrower allowing for adjustments in project design and implementation, if necessary. An end-of-project review will not be necessary.[1] Up to US$10M of the grant provided by AID/PRE may be used to perform the evaluation.

9.02 The quarterly reporting requirements by the bank and GENEX to AID will provide baseline data for the evaluation in the following areas: (1) employment generation; (2) foreign exchange generation; (3) management and technical skills development; (4) technology transfer; and (5) increased income and economic activity. The reporting form is attached in draft annex II. An interim report from one of PRE's ongoing projects has been included in the Annex. The report is an indication of the variety of data which can be compiled in reports submitted by borrowers and the usefulness of this data for evaluation purposes.

9.04 The following topics will be of particular interest to PRE and will be addressed in the evaluation reports:

1. Economic Overview: Brief inquiry into the regulatory environment incumbent on SMDC and other commercial lenders to identify which constraints inhibit the delivery of nonconcessional credit to SMSE sector;

   Data for economic overview will be gathered from secondary data and from selected interviews with USAID and GOM officials and, to a limited extent, with bank management.

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[1]Though duration of the project is three years, PRE judges that findings one year after initial disbursement will not vary significantly from findings conducted at a later date.

2. <u>Institutional Review</u>: A review of the bank's management system for delivering credit to GENEX for the assistance of the SMSE sector and how management indicates that this has changed over the life to date of the loan facility; and conclusions as to the bank's institutional capability to service the SMSE sector. These findings will have an important bearing on project replicability.

   PRE's established criteria for measuring the replicability of this project will be determined foremost by the profitability of GENEX and the success of SMSE exporters as calculated from statistics reported on: (1) volume; (2) merchandise; and (3) profits. This data will also be reported to PRE on a quarterly basis as reflected in the form attached as Annex II.

   AID will also wish to determine extent of institutionalization of SMSE support as indicated by the portion of GENEX's volume made up of such Credit to SMSE, the number and type of staff dedicated principally to SMSE assistance and plans to expand further into SSE assistance. Data for forming conclusions in these areas will come from discussions with bank and GENEX management. Specific variables reported will be:

   - Percent of volume which qualifies as SMSE.

   - Number of full-time employees devoted to SMSE assistance.

3. <u>Technical Performance of Guarantee Mechanism</u>: Review of costs and performance of the loan guarantee structure. The cost of the standby letter of credit and the degree to which this mechanism responds to the needs of local lenders is of interest, particularly in light of PRE's use of collateral accounts and other loan guarantee structures in other AID-assisted countries. This information will largely be available from data submitted by the borrower and the depository bank on price of Standby L/C's; acceptance of concept as evidenced by Moroccan bank participation in loans to GENEX.

4. <u>Subborrower Portfolio</u>: A review of the compiled data describing the portfolio to determine the profile of beneficiaries and the developmental benefits of credit availability. The specific data to be reported on includes: new or expansion, total assets before and after assistance, imported or domestic raw material, number of jobs created, sales volume before and after assistance, foreign exchange earnings, and type of business activity, location, etc.

X. PROPOSED TIMETABLE

o	IOP	: July 18, 1985
o	Loan Review Board	: July 11, 1985
o	Initialed Loan Agreement	: September, 1985
o	IP	: August 30, 1985
o	Authorization	: September, 1985
o	Loan Execution	: September, 1985
o	First Disbursement	: December, 1985
o	Mid-Term Evaluation	: December, 1986
o	Final Disbursement	: September 1986
o	Project Completion	: December 1988

XI. DISBURSEMENT PROCEDURES

11.01 The US$2,000,000 PRE loan to SMDC will be disbursed to an Agent Bank for the purpose of establishing a blocked account collateralizing standby letter of credit covering loans to GENEX. AID will receive an effective security interest in the account which, however, would be junior to the security interest created when account funds are blocked or otherwise committed to secure guarantees of SMDC.

11.02 Interest paid on the PRE loan will be tied to yield on three year U.S. Treasury Notes. The interest paid will be generated from earnings on the collateral account: the Agent bank will be directed by SMDC and AID to invest loan proceeds in U.S. Treasury securities. Net earnings from investments and fees will be assigned to AID's Revolving Fund.

11.03 PRE anticipates disbursing loan proceeds in two lump sums. Justification for lump sum disbursement is based on the need to minimize banking fees payable by the borrower in order to achieve lending margins required for project success.

11.04 Target first disbursement date will be within four months after loan execution and will be conditioned on SMDC preparation and submission of an acceptable business plan for GENEX.

11.05 Disbursements under the grant will be based upon agreed marketing studies and technical assistance to be expended outside Morocco. Such disbursements will be matched by SMDC which will pay overhead and operating expenses in Morocco of GENEX.

Annex I

ATTACHMENT 5-10
REF: 5.4.1

BORROWER'S QUARTERLY PROJECT PERFORMANCE REPORT

Quarter Ending _____, 19__

Project Name:
Loan Number:

		___ Qtr. 19__	Cum. to Date
		US$( )	US$( )(1)
1.	Funds Rec'd from AID	US$ xxxxxx	US$ xxxxxx
2.	Funds Disbursed to GENEX		
	By SMDC	DH xxxxxx	DH xxxxxx
	By Others	xxxxxx	xxxxxx
	Outstanding SMDC	US$ xxxxxx	US$ xxxxxx
	Outstanding Other	"	"
		AMOUNT	NUMBER
3.	GENEX Receivables	DH xxxxxx	DH xxxxxx
	GENEX A/R SMSE	"	"
		Quarter	Year to Date
4.	Net Profit GENEX	DH xxxxxx	DH xxxxxx
5.	Int. Pd. to AID	US$ xxxxxx	US$ xxxxxx
	Commitment Fees Pd. to AID	"	"
	Other Fees Pd. to AID	"	"
	Principal Pd. to AID	"	"

GENEX ASSISTED SMSE

Annex II

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Name	Total Assets	Total Credit	Merchandise	Development Impact*

*Development Impact
Quantified e.g. ____________ Increase employment numbers
Nontraditional imports in DH
Increased sales in DH

Collateral Account

Background

The Bureau for Private Enterprise ("PRE") developed the "Collateral Account" loan structure during the summer of 1984 after the PRE Investment Office found, during various project origination trips, that there were many developmentally and commercially sound projects in A.I.D.-recipient countries that could benefit from A.I.D. financing but only if the loan were structured in a way that minimized the foreign exchange risk to the Borrower. Accordingly, PRE/I working together with GC/PRE, devised a loan structure through which A.I.D. can lend and be repaid in U.S. dollars in a way which mobilizes extensions of needed local currency credit to the target beneficiary class but does not involve the conversion of A.I.D. loan proceeds into local currency so long as the projects remain commercially viable.

Structure

There is no single "standard" Collateral Account loan structure. In fact, one of the Collateral Account's principal virtues is its flexibility in being customized to the particular needs of the Borrower. There are, however, certain basic features common to most, if not all, uses. First, before any A.I.D. loan proceeds are disbursed, A.I.D., the Borrower and a bank located in the United States ("Depository Bank") enter into a "Three-Party Agreement" which establishes an account in the Borrower's name ("Collateral Account") to be held and managed by the Depository Bank. The Three-Party Agreement also spells out whatever additional responsibilities the Depository Bank may be willing to assume.

Upon the request of the Borrower, A.I.D. disburses the needed amount of loan proceeds into the Collateral Account. The Depository Bank invests those proceeds in a type of investment approved by A.I.D., generally U.S. Treasury obligations. The Depository Bank then either issues or confirms a letter of credit guarantying an extension of local currency credit. The Depository Bank is willing to undertake the contingent liability associated with the letter of credit issuance or confirmation because, under the Three-Party Agreement, the Depository Bank receives a security interest in the investments in the Collateral Account. This security interest secures the Borrower's obligation to reimburse the Depository Bank in the event a payment must be made under the letter of credit.

The Borrower's interest obligation to A.I.D. under the loan agreement is measured in relation to the rate of earnings on the investments in the Collateral Account. The Borrower will also generally pay a "Utilization Fee" for this facility which is

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measured as a percentage of the amount of investments in the Collateral Account that have been "blocked" (i.e., made subject to the Depository Bank's security interest) to back up issued or confirmed letters of credit. The loan agreement, for example, may provide for interest at a rate equal to the yield of ninety (90) day Treasury Bills plus a Utilization Fee equal to two percent (2%) of the average amount of Treasury Bills utilized or blocked.

The loan agreement will also provide for an orthodox principal repayment schedule. The dollars in the Collateral Account are expected to serve as the Borrower's source of repayment, and thus the terms of the Depository Bank letters of credit must result in enough Treasury Bills being unblocked to permit periodic disbursements to A.I.D. in accordance with the loan agreement's principal repayment schedule.

Two examples of the types of local currency loans that can be effected by a Collateral Account loan are PRE's fiscal year 1984 loans for low-cost health product production in Thailand and Indonesia ("PATH" project) and for term agricultural credit in Ecuador. In the PATH project, loan proceeds deposited in a U.S. bank serve as collateral to permit that bank's issuance of a standby letter of credit guarantying fifty percent (50%) of term local currency loans by Thai and Indonesia commercial banks to health product manufacturers in Thailand and Indonesia. As the local currency loans are repaid, the amount of the U.S. Depository Bank's outstanding liability under the standby letters of credit is reduced, thus releasing investments in the Collateral Account from the Depository Bank's security interest and making them available for disbursement to A.I.D. as principal repayments.

The Thai and Indonesia banks have the responsibility to assure that the principal amortization schedules of the local currency loans match the coverage reduction schedules of the standby letters of credit. The A.I.D. Borrower has the responsibility to assure that the letter of credit coverage reduction schedules match the principal amortization schedule under the A.I.D. loan agreement.

Unlike the PATH project in which the local lending bank is the beneficiary of the letter of credit, the Ecuador project involves the guaranty of borrowings by two Ecuadorean financieras. A serious constraint on the ability of the financieras to make long term credit available to their customers is the financieras' inability to borrow on a long term basis themselves. The beneficiaries of the letter of credit in this project, therefore, are the purchasers of development bonds issued by the financieras. The financieras are obligated under the A.I.D. loan agreement to lend the funds raised through the sale of these guarantied bonds to a designated class of target beneficiaries. As with the PATH project, the amortization schedule of the bonds matches the coverage reduction schedule of the letters of credit which in turn match the financieras' principal repayment obligation under the loan agreement.

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AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON D C 20523

EMORANDUM FOR PRE STAFF July 25, 1984

FROM : PRE/I, MS. JUDITH A. KNUDSON jak

SUBJECT: KENYA COMMERCIAL BANK: AID LOAN NO. 615-T-018
INTERIM REPORT DATED JUNE 27, 1984

Attached is a statistical update to pages 3 and 4 of the Interim Report on the KCB/KCFC loan which you received recently.

The text of the June 27, 1984, Report reflects details of subloans as available through May 31, 1984. From the attached update you will see that:

- The US$180,000 disbursed by AID in June was used to increase subloans from 18 to 27
- KCB/KCFC continues to make more loans of smaller size in keeping with PRE objectives;
- Job generation has increased from 347 to 462 new full-time positions; and
- Cost per job has declined from US$4,265 to US$3,896 based upon total combined AID and KCB/KCFC resources committed of about US$1,800,000 as of June 30, 1984.

With regard to grant funds, KCB/KCFC has approved an IESC sponsored seminar leader and course curriculum planner for the first stage of the Business Advisory Services Training program which is now scheduled for October - November 1984.

Attachment: a/s

Kenya Commercial Bank:

Update June 30, 1984

II. STATISTICAL OVERVIEW: (@06/30/84)

A. Agribusiness/Light Manufacturing On-Lending Fund: $5,000,000

		A.I.D.	KCB
Total Funds Available for On-Lending:		$2,500,000	$2,500,000
Total Disbursed to Sub-Borrowers @06/30/84		$ 880,000	$ 915,000
Term Loans (% of funds)		100%	80%
Working Capital (% of funds)			20%
On-Lending Rate:	Range	16-1/2 - 20%	16-1/2 - 20%
	Current	19%	19%
Term: (minimum 4 yrs. for AID)		4 - 6-1/2 yrs.	1 - 6-1/2 yrs.
Grace Period:		0 - 2 yrs.	0 - 2 yrs.

Interest Paid to A.I.D. 02/23/84: $ 6,759.10
Interest Due A.I.D. 08/23/84 : $33,373.07

Last Disbursement Due 05/31/84 : $320,000 (of which US$160,000 was disbursed in June)

Disbursement Due 08/31/84 : $400,000

B. SUB-PROJECTS (05/31/84)

		Before Finance	After Finance
No. of Sub-borrowers	:	27	27
Size: Small (to $750M total assets)	:	27	26
Medium ($750M to $1,500M total assets)	:	0	1

Categories:

	No.	Percent
New Start-ups	21	78%
Expansion of Existing Facilities	6	22%
Rural (outside Nairobi and Mombassa)	27	100%

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Kenya Commercial Bank: Update June 30, 1984

Size of Subloans:

Largest (inclu. O/D):	$326,087
Smallest :	$ 5,072
Average :	$ 64,602

Average Assets

Before Financing:	$49,314
After Financing:	$131,421

Average Assets Before Financing is skewed by the fact that 78% of subloans are new start-ups, having few assets before financing. Only three subproject financings include overdraft facilities from KCB totalling 20% of KCB funds. KCB may use up to 50% of its contribution for short-term working capital purposes under terms of the Loan Agreement.

	No. of Sub-borrowers (Percent/of 27)	Total Funds Loaned (% of $1.80M)	New Jobs Created (% of 462)
Agribusiness	93%	64%	85%
2 Sugar Cane Haulers	7%	17%	39%
3 Bakeries	11%	7%	10%
11 Cereal/Grain Milling	41%	7%	9%
3 Farm Implement Leasing	11%	5%	4%
1 Farm Supply Distribution	4%	1%	---
1 Edible Oil Production	4%	19%	8%
3 Coffee Processing	11%	4%	8%
1 Tannery	4%	4%	7%
Light Manufacturing	7%	36%	15%
1 Insulated Electric Cables	3.5%	19%	7%
1 Multi-Use Adhesives	3.5%	17%	8%
TOTAL	100%	100%	100%

Location of Sub-Projects

Western	26%	25%	49%
Nyanza	22%	23%	13%
Central	26%	25%	20%
Rift Valley	19%	7%	10%
Eastern	7%	20%	8%
No. Eastern	0%	0%	0%
Coast	0%	0%	0%
	100%	100%	100%

As of June 30, 1984, using total combined funds disbursed of US$1.80 million, the cost per new job created is US$3,896. This amount is well below averages published by AID and other international development institutions.

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INTERIM REPORT ON

KENYA COMMERCIAL BANK/KENYA COMMERCIAL FINANCE COMPANY

(940-0002.03/615-T-018)

June 27, 1984

I. SUMMARY

The Kenya Commercial Bank/Kenya Commercial Finance Company (KCB/KCFC) Project is an example of one of PRE's first IFI commitments. The loan was obligated on January 6, 1983. AID/PRE is providing a loan of $2,500,000 which is matched by $2,500,000 in local currency from KCFC to form a $5,000,000 fund for on-lending to small- and medium-sized private Kenyan agribusiness and light manufacturing enterprises. As of June 1984, one-third of project funds had been disbursed to 18 sub-projects. An additional US$160,000 (raising the total to US$880,000) was disbursed in June 1984 but details on these new sub-borrowers are not yet available.

A related grant of $250,000 accompanied the loan. The grant was designed to cover the costs of seminars and courses in Nairobi and the U.S. respectively to train selected bank staff in those disciplines necessary to strengthen and broaden Business Advisory Services (BAS) to primarily rural small- and medium-sized private enterprises (SMPE) in Kenya and to improve the Bank's agribusiness credit evaluation capability. Also covered by the grant are related costs necessary to expand these capabilities within KCB/KCFC to regional and branch levels. These activities are in preparation and are expected to get underway by mid 1984.

The 18 sub-borrowers who have received loans are all located in rural areas and are all small enterprises within the Kenyan context. They include agribusinesses such as small milling operations for corn and other cereals, sugar cane hauling services from farm to factory, tractor leasing to small farmers, village bakeries, and the extension of quality sunflower seed sales, growing techniques and assured markets (a new cash crop) to 6,000 small farm families. Light industrial loans include a new manufacturing facility for insulated electric cables and another for multi-use adhesives.

The sub-loans range in term from 4 to 6-1/2 years. Fourteen of the sub-loans are new businesses; the remaining four are expansions. Net new employment generation and increased income to rural communities characterize all loans. New full-time jobs totalling 347 have been created. Due to the extensive outreach to small farm families which characterize several of the sub-loans, it is estimated that as many as 128,000 rural Kenyans will benefit from new cash crops, new growing techniques, and crop services. In addition, many others will be afforded an opportunity to learn new skills in manufacturing, tractor and hauler maintenance and repair, chemical compounding, bakery operation, and marketing. The number of indirect jobs created will be assessed in a formal evaluation to be scheduled when all funds have been disbursed.

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The AID loan was provided at 8-3/8%. Both AID and KCFC funds are on-lent at prevailing commercial rates which currently are set by law at 19%, inclusive of any fees. All sub-borrowers pay to the Government of Kenya an additional 1% fee on AID funds to cover foreign exchange risk. All on-lending, however, is in local currency. KCFC is current on its interest payments to AID.

KCB/KCFC has recently restructured its top management such that the Business Advisory Services group will form part of a new divisional area headed by an officer with the new title of Chief Manager, Marketing and Credit. The Manager/Principal Consultant of the BAS will, therefore, be working closely with the Chief Manager and with the Managers of Credit and of Marketing to mutual advantage. In addition, KCFC has assigned a head-office Loan Officer to co-ordinate all aspects of the joint facility with AID. These moves will both speed implementation of AID on-lending goals and achieve integration of sub-borrower advisory services into the sub-loan evaluation and monitoring process. The restructuring will also facilitate the extension of these services to branch and area levels. Until recently, the BAS capability remained centralized in Nairobi, outside of the mainstream lending process and was used almost solely for feasibility study purposes.

The KCB/KCFC management strategy along with grant funded training plans augur well for achievement of AID/PRE's loan purpose. PRE's primary goal is to strengthen KCB/KCFC institutional capability to reach out to new, primarily rural, agribusiness borrowers with medium to long-term fixed rate credit accompanied by business advisory services to encourage solid new long-term rural enterprises and to assure highest potential portfolio quality.

The Project is off to an excellent start with respect to desired development impacts and rural outreach. Success of the BAS training effort can accrue only over time, but recent developments are favorable. BAS training seminars are tentatively scheduled for late August/early September of this year.

Most importantly, the expansion of KCB's formalized training curriculum to include agribusiness credit, related cash flow analysis, and BAS to all personnel engaged in loan assessment, booking and monitoring has the potential to broadly impact the bank's loan portfolio in years to come.

II. STATISTICAL OVERVIEW

A. Agribusiness/Light Manufacturing On-Lending Fund: $5,000,000

	A.I.D.	KCB
Total Funds Available for On-Lending:	$2,500,000	$2,500,000
Total Disbursed to Sub-Borrowers @05/31/84	$ 720,000	$ 763,000
Term Loans (%)	100%	65%
Working Capital (%)		35%
On-Lending Rate:	16-1/2 - 20%	16-1/2 - 20%
Term: (minimum 4 yrs. for AID)	4 - 6-1/2 yrs.	1 - 6-1/2 yrs.
Grace Period:	0 - 2 yrs.	0 - 2 yrs.

Interest Paid to A.I.D. 02/23/84: $ 6,759.10
Interest Due A.I.D. 08/23/84 : $33,373.07

Next Disbursement Due 05/31/84 : $320,000 (of which US$160,000 was disbursed in June)

Disbursement Due 08/31/84 : $400,000

B. SUB-PROJECTS (05/31/84)

No. of Sub-borrowers	:	18
Size: Small (to $750M total assets)	:	18
Medium ($750M to $1,500M total assets)	:	0

Categories:

	No.	Percent
New Start-ups	14	78%
Expansion of Existing Facilities	4	22%
Rural (outside Nairobi and Mombassa)	18	100%

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Size of Subloans:		Average Assets	
Largest (inclu. O/D):	$326,087	Before Financing:	$88,506
Smallest :	$ 5,072	After Financing:	$176,522
Average :	$ 82,389		

Average Assets Before Financing is skewed by the fact that 78% of subloans are new start-ups, having few assets before financing. Only two subproject financings include overdraft facilities from KCB totalling 23.7% of KCB funds. KCB may use up to 50% of its contribution for short-term working capital purposes under terms of the Loan Agreement.

	No. of Sub-borrowers (Percent/of 18)	Total Funds Loaned (% of $1.48M)	New Jobs Created (% of 347)
Agribusiness	89%	58%	79%
Sugar Cane Haulers	11.0%	19%	51%
Bakeries	11.0%	5%	4%
Cereal/Grain Milling	45.0%	6%	9%
Farm Implement Leasing	11.0%	5%	5%
Farm Supply Distribution	5.5%	1%	---
Edible Oil Production	5.5%	22%	10%
Light Manufacturing	11%	42%	21%
Insulated Electric Cables	5.5%	22%	9%
Multi-Use Adhesives	5.5%	20%	12%
TOTAL	100%	100%	100%
Location of Sub-Projects			
Western	39%	26%	56%
Nyanza	22%	25%	15%
Central	20%	35%	21%
Rift Valley	11%	2%	2%
Eastern	8%	12%	6%
	100%	100%	100%

As of May 31, 1984, using total combined funds disbursed of US$1.48 million, the cost per new job created is US$4,265. This amount is well below averages published by AID and other international development institutions.

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III. BRIEF EVALUATION

A. ATTAINMENT OF PROJECT OBJECTIVES

Project objectives include:

1) Providing fixed rate term and working capital financing to small- and medium-sized private enterprises (SMPE), located outside of Nairobi and Mombassa, and engaged in agribusiness, light industrial, or local resource based rural manufacturing.

2) Achieving development impacts on the Kenyan private sector such as net new employment generation; foreign exchange earnings; skills development; technology transfer; increased income, economic activity, and poverty alleviation in rural areas.

3) Institution building by expanding BAS capability to and through rural KCB/KCFC branches to increase management and operational skills of targeted entreprenuers and to ensure quality of the sub-project portfolio.

With respect to new financing for targeted businesses and impacts on rural populations and economies, progress toward objectives is satisfactory to date. Regarding BAS, objectives have not yet been reached, although implementation is proceeding.

PRE/I Staff on visit to Nairobi in January/February 1984 found that the Borrower had not taken the steps required by the loan agreement to staff its BAS department as planned and to disseminate BAS capability to its branches. BAS had been used, however, to aid the sub-project loan review process and, in selected cases, to help sub-borrowers with enterprise feasibility, management, and operational development.

From a compliance standpoint, KCB/KCFC, as of May 31, 1984: 1) has drawn down funds as scheduled; 2) is current on all payments to AID; 3) is providing timely and complete reports to PRE on a quarterly basis; and 4) is using AID and KCB/KCFC funds in accordance with project objectives, loan terms, and covenants.

B. IDENTIFIED CONSTRAINTS AND RECOMMENDATIONS

1. BUSINESS ADVISORY SERVICES (BAS)

As indicated earlier, BAS had not been staffed or its services disseminated as required. Reasons given by KCB/KCFC are:

- Two additional people were hired, but one left for higher pay elsewhere and the other was chosen by Citibank out of 1,000 applicants to receive training in the U.S. The latter hiree is expected to return to KCB/KCFC by summer 1984.

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- BAS Staff are perceived as a service rather than a line function. Thus personnel assigned to BAS feel sidetracked from mainstream banking advancement.

- BAS is a non-traditional function of the Bank.

Solutions explored by PRE with KCB/KCFC included:

- Publicizing the rotational aspect of BAS training as a prerequisite for employment and advancement, thus lending status and privilege to employee selection for BAS.

- Increasing efforts to secure salary scales competitive with those of local foreign banks in order to attract and keep qualified personnel.

- Aggressively using BAS capability in marketing, in attracting qualified personnel, in expanding the Bank's loyal customer base, and in assuring highest potential portfolio quality.

  KCB/KCFC agreed generally with using BAS capability more aggressively and to that end restructured management to form a new divisional area to be headed by a Chief Manager Marketing and Credit who will coordinate efforts of the Managers of the BAS, Credit and Marketing Departments.

  The Grant activities outlined in the Loan Agreement are being finalized with a view to exposing the widest possible spectrum of officers to BAS and agribusiness credit and cash flow analysis training. While BAS will remain centralized in Nairobi, KCB/KCFC has committed itself to recruiting appropriately qualified trainees to expand BAS capability. These officers may eventually be stationed in the field to work with Area Managers.

Arrangements for the three stage agribusiness credit and BAS services training program are now proceeding rapidly with full support from KCB/KCFC management. Current plans include sending a U.S. trainer to Nairobi to finalize the curriculum in early August and initiation of seminars in late August

2. DISBURSEMENTS TO SUB-BORROWERS

The Loan Agreement requires KCFC disbursement to sub-borrowers within 90 days of drawdown from AID. KCFC indicates potential difficulty in meeting this schedule because the transfer of collateral to bank ownership can take up to six months. Although it has sufficient commitments in hand, KCFC may well incur standby fees in future due to delays in actual disbursement. This is particularly true in view

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of the large proportion of new start-ups in the the portfolio, vagaries of construction schedules, and therefore the unpredictability of sub-borrower need for funds.

In view of the current spread received by KCFC on AID funds, KCFC has been told that standby fees will not be waived. The original disbursement schedule was extended by two months and no further action in this regard appears warranted. KCB/KCFC agrees with this plan.

3. SUB-PROJECT REPORTING REQUIREMENTS

Under Section IX, D of Annex A, KCB/KCFC, quarterly, must obtain extensive records and reports from each sub-borrower and if, after review of these reports, sub-borrower performance could be improved with the assistance of BAS, the Bank is to advise these clients to make use of that facility.

However, because KCB/KCFC cannot profitably spend the time to initiate and obtain these reports from small or new start-up sub-borrowers, these less sophisticated credits, when approved, are often funded by KCB or KCFC funds rather than the joint AID facility.

Thus the BAS was not being used to full advantage and AID was achieving less impact on small entrepreneur development.

BAS staff claim that such reporting - while onerous and resisted by entrepreneurs new to formal term banking - is highly praised by these same entrepreneurs later for the structured financial planning tools to which they have been held.

Many of these entrepreneurs willingly continue management information reporting systems after initial loans are repaid and as their businesses subsequently expand. These smaller entrepreneurs in fact become extremely loyal to KCB/KCFC as a result of the technical assistance received early in their businesses.

Recommendation: Please see #4 below.

4. STAFFING AND PORTFOLIO MANAGEMENT

KCB branch and area managers and loan officers were apparently overwhelmed with the usual operational work load, such that they are not able to provide anything but the most cursory type of feasibility and cash flow analysis and no BAS. However, management and personnel officials claim that the Bank is overstaffed, that BAS personnel have not enough to do.

Recommendation:

As branch, area, and local loan officers were previously unable to fulfill the servicing and technical assistance needs of these new sub-borrowers, the original purpose of the BAS is indeed confirmed as to concept and need and BAS should be institutionalized as rapidly as possible. The goal of current training plans is to fulfill this need.

KCB/KCFC management now express increased commitment to BAS services - both centrally and regionally. This should permit sufficient help with reporting requirements to less sophisticated sub-borrowers, as originally envisioned in the AID Loan Agreement, to enable them to be brought into the KCFC/AID loan portfolio. Skills of small but dedicated new entrepreneurs will be increased.

C. DEVELOPMENT IMPACTS

1. EMPLOYMENT GENERATION

From the statistical data on pages 3 and 4 which summarize quarterly reports from KCFC, and from on-site visits, are derived the following conclusions:

- 347 new jobs have been created using $1.48 million in loans, or a cost of $4,265 per job.
- Current cost per new job created at US$4,265, is well below U.S. international development institution and AID averages.
- As expected, agribusinesses are far more labor intensive and tend to require smaller infusions of capital than light manufacturing sub-projects. Agribusinesses provided 79% of new jobs created while using only 58% of funds disbursed to 16 of the 18 sub-borrowers.
- Two sugar cane haulers accounted for 51% of new employment thus far, or 176 jobs - drivers, handlers, mechanics - using only 19 percent of loans disbursed.
- One sub-borrower, using 22 percent of total loans disbursed to capitalize an edible oil production scheme, accounted for only 10 percent of new jobs created. These figures give no indication, however, of the expected foreign exchange savings and rural economic outreach to 6,000 small-farm families.

Indirect social, economic, and employment impacts cannot be estimated at this time but will be included in a formal evaluation at a later date.

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2. FOREIGN EXCHANGE EARNINGS/SAVINGS

It appears currently that only five of the 18 sub-projects have direct foreign exchange impact. Nearly all of the calculable foreign exchange savings can be attributed to a single project - the OCAF edible oil scheme.

- OCAF has the potential to produce foreign exchange savings estimated at US$43.8 million over eight years. These savings are derived from significant increases in locally produced edible oils - primarily from sunflower seeds - to replace local demand currently statisfied by imports.

- The two light industrial projects - production of insulated electric cables and multi-use adhesives - both use imported raw materials and have an element of export earnings. We are unable to determine at this time the relative benefit to gross foreign exchange earnings or savings to Kenya.

- Services to the sugar industry help to increase production, all of which is consumed in the Kenya market. Again exact figures are not available, but both of the sugar haulers in fact require imported equipment, thereby offsetting to a degree any foreign exchange savings from the elimination of sugar imports.*

3. INCREASED INCOME, ECONOMIC ACTIVITY, AND POVERTY ALLEVIATION IN RURAL AREAS

Most projects thus far have high income and economic benefit, providing a better standard of living to a very large segment of small rural farm communities.

- Kenby Cables and Gum Industries operations, located in the more prosperous Kisumu and Thika townships respectively, and supplying industrial and - in the case of Kenby's residential wiring - more affluent customers are of lesser interest in this regard.

- IMA Hauliers, M/S Musola Agricultural, and OCAF together, however, benefit extremely small private farmholder families collectively estimated at 14,000 to 16,000 when the three projects are fully operational. If, on average, one estimates family size as comprised of eight persons, the total outreach of these three projects extends to nearly 130,000 people.

Many projects are located in some of the most densely populated and growing outlying areas of Kenya north/northwest of Nairobi. New jobs and increased income in these areas is particularly beneficial to the local and national economies.

*Business International Corp. Study (1984), Vol. IV, pp 6 - 7, prepared for AID/PRE.

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- In the case of OCAF, an eventual 6,000 farm families are expected to benefit from two cash crops per year. We are told that the most likely immediate use of these funds is for educational expenses for farm children.

- Two of the sub-borrowers are micro-lessors of equipment to small farmers. One is a distributor of general farm supplies.

- Eight are micro-milling installations for maize and other cereals, while two are local bakeries which provide previously unavailable fresh breadstuffs daily.

4. MANAGEMENT/TECHNICAL SKILLS DEVELOPMENT

Many sub-projects funded to date have definite identifiable technical skills development components.

- Kenby Cables is training new employees in industrial and residential cable production, coating techniques, quality control, packaging and marketing.

- IMA Hauliers and M/S Musola provide training in agricultural vehicle maintenance and repair as well as a limited amount of transport management.

- Gum Industries will provide significant skills development in chemistry compounds, manufacturing, equipment maintenance, production and marketing.

- OCAF skills development is based on providing farmers with training in quality seeds and optimum growing techniques for an entirely new crop, sunflower seeds, in its areas of operations. OCAF management happily states that it has learned and adopted a few techniques from the farmers as well. Skills in beekeeping and pollination and using sunflower husks as animal feed additives are also taught.

- The various small bakeries offer opportunities in bakery management and production.

Overall, from the Intermediate Financial Institution standpoint, management and technical skills development accrues to the majority of sub-borrowers as well as to KCB/KCFC staff.

On the one hand the rigours of strict accounting and reporting systems required of sub-borrowers, while onerous at first, serve to create very loyal new private entrepreneurs who achieve solidly expanding indigenous private businesses as a result of this narrowly targeted lending program.

On the other hand, KCB/KCFC personnel will benefit from expanded agribusiness credit, related cash flow analysis techniques, and BAS skills development.

5. TECHNOLOGY TRANSFER

In addition to technology transfer in the sense of skills development as discussed above, Kenby Cables, Gum Industries, and to a lesser extent OCAF are involved in the actual employment of foreign technology and processes in Kenya.

- Kenby Cables technology derives almost entirely from foreign sources, largely German, British, and U.S., and includes: extrusion of heavy copper wire into progressively smaller widths; twisting, insulating, and rubber-coating the various final products for specialized uses.

  Kenby's owner keeps up with all the latest developments in cable production techniques - including optic fiber technology. While use of optic fibers is not practical currently, this technology is certainly a part of management's thinking for the future.

- Gum Industries' technologies came also from foreign sources but, we believe, most were already in use to some extent in Kenya. The new plant will manufacture industrial adhesives such as detrin, neoprin, and polyvinyl acetate-based glues. The glues are used for binding wallpaper, books, wood joints, carton sealants, container lables, cigarette filters, foam pieces, shoe soles, etc. Markets to major Kenyan shoe companies such as Bata and Tiger, to Kenya Canners, Ltd., and other well-established local companies have been secured.

- OCAF sunflower hybrids and optimum production technology came from the United States. The quality and abundance of the oil seed production - and therefore the success of this operation - is largely dependant upon this technology.

Technology transfer is not the dominant factor in any of the subprojects approved thus far, although skills training in these technologies - as noted earlier - is important.

6. INSTITUTION BUILDING

As indicated in part 4 of this development impacts section, elements of institution building accrue primarily in two ways - both of which are primary goals of this PRE loan.

- The institutionalization of medium- to long-term fixed rated financing to new rural agribusinesses as a usual part of a major Kenyan bank's loan portfolio; and

- The development of unique business advisory services and techniques at the regional and branch levels of the bank to help establish and maintain the long-term viability and expansion of these new enterprises.

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D. LESSONS LEARNED

1) A continuing definitive policy dialogue between PRE and its borrowers yields tangible measurable results in expediting implementation as related to project details.

2) It is critical to coordinate PRE loan terms, conditions and criteria with local government policies and procedures to insure compliance with AID/PRE requirements. The six-month period usually required to secure collaterial transfer to the Bank could have been reflected in the Loan Agreement.

3) PRE action is essential early in project implementation -- particularly when technical assistance (TA) is an integral part of the agreement.

4) Borrowers are most cooperative in providing whatever reporting information AID requires, but often need help with specific reporting elements and formats. PRE is designing standard report forms for all borrowers. It is expected that these standardized forms will be included as a separate Annex to future Loan Agreements.

5) Business advisory services and techniques and dissemination of these capabilities to regional and branch levels show every promise of proving effective and highly desireable in developing new rural sub-borrowers, loyal to well-managed banking institutions and capable of solid long-term expansion.