

PJ-ABY-592

ISN 99359

ROYAUME DU MAROC

USAID

Fonds d'Equipement Communal

**Agence Américaine
pour le Développement
International**

***ETUDE SUR LA RESTRUCTURATION DU
FONDS D'EQUIPEMENT COMMUNAL***

***Division des Programmes
Urbains et Environnementaux
Agence pour le Développement International***

Mai 1995

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FONDS D'EQUIPEMENT COMMUNAL (FEC)

SUMMARY OF OUR REPORTS

FONDS D'EQUIPEMENT COMMUNAL (FEC) - SUMMARY OF REPORTS

I- THE FEC'S MISSION

Restructured by Dahir N° 1-92-5 dated 5 August 1992, promulgating law N°. 31-90, the aim of the FEC is to contribute to the development of the municipalities, to the pooling of their means and interests and to their local operations.

This assignment was conducted in the context of the declared general policy, expressed through four objectives which refer to two different functions:

- The Function of a public service as described in the first three objectives;
- The Function of a specialised financial establishment bearing in mind the management requirements of the private sector, expressed in the fourth objective: "To preserve the viability of the FEC".

The recent actions of the FEC, show its will to satisfy the public service function: it increased employees in order to expand its capacity to provide technical assistance, and made efforts in communication and providing information. Further, the FEC is managed by a Board of Directors whose 16 members are appointed by the government, headed by the Minister of Interior and is guided in its policy of loans by a Credit Committee, whose members are also appointed by the government. These members, excluding the Managing Director, are public figures not connected with the Funds.

II- ISSUES

The new FEC organisation defined by Dahir n° 1-92-58, places the FEC in a new context, without involving a fundamental change within its structure and means. As a result, the objectives of the Managing Director are to reinforce the FEC's autonomy and efficiency by identifying new means of operations within the context of both, its original mission and of the administration and financial environment as defined by the Dahir mentioned above.

Nevertheless, even though the overall current situation remains unchanged, the FEC should, in line with the financial situation of Morocco, allow itself adequate means in order to be competitive with the other financial institutions, as the banks are already in a position to give loans to the municipalities (even though in practice none have yet done so). It is necessary for measures to be taken, as certain privileges accorded to the FEC, such as the State warranties, will no longer be given in the future.

The FEC is faced with the difficulties of ensuring its public service function and to responding more efficiently to the requirements of the private sector management.

In this respect the FEC must respond to three major challenges:

1. Obtain finance sources compatible to the nature of its operations including non remunerative equipment.

Currently, the borrowing conditions of the FEC are too expensive and consequently the interest rates on loans accorded are too high for the kind of clients they deal with.

The FEC has already considered two solutions to lower the costs of its resources, in the medium and long term:

- To give the grants and loans at reduced rates to environmental projects through a "green" credit line;
- Collecting funds from local municipalities and other agencies. This is one of the more sensitive parts of the projected transformation of the Funds. Such a transition is not conceivable in the short term;
- Another more feasible and short term solution is to increase the internal profitability of the FEC in order to reduce its margins of profit.

2. To serve the interests of all the municipalities

While respecting the structure of the institution

The diversity of the clientele, in respect of competence, income and size is a challenge for the FEC. Hence, the FEC will have to select its clients and to deal with them on a case by case basis.

There are 1 544 municipalities, all of whom cannot have access to loans for two major reasons:

- They do not have the technical competence to prepare an investment program

In order to help them and to fulfil its objective of being a public service, the FEC provides a financial engineering service as well as technical assistance for the identification and the documentation of capital projects. The issue raised is where to draw the line between the institutions responsible for the administrative ministries in charge of the follow up of the policy of development of the municipalities and the mission of the FEC which deals with the new cases.

This objective bears a cost that is difficult to support given the present resources of the FEC. Hence, the FEC will only be able to carry out assignments if it receives grants from the Moroccan government, a situation which does not seem feasible considering the present recession, or, from foreign donors (such as l'USAID, KFW,...).

- They are in a precarious financial situation

FEC has been criticized for having over leveraged and for not having assisted townships with a budget deficit (80% have a structural budget deficit). It is unimaginable for a lending institution to act otherwise.

If the institution did, it would have to resort to public funds to cover the unpaid debts. It is logical therefore that public funds should be employed to subsidize, up to 100% if necessary, the investments of the municipalities with deficits.

3. To establish itself in an administrative environment as well as in the Moroccan financial environment

without being either just an administrator or a bank.

In order to meet its objectives, the FEC's activities should integrate in an adaptable and flexible way, both, the administrative and financial environments of the municipalities. However, even though theoretically the relationships with the ministries, are fairly flexible, in practice it may not be the case, as multiple signatures are required from the different ministries concerned.

It is necessary to find a way to accelerate the administrative process and to encourage direct interaction between the municipalities and the FEC.

The issue at hand is, whether the FEC has the means to accept these challenges or not.

This question is even more critical as the answer could determine the viability of the institution.

III- STRATEGIC ANALYSIS

* **The FEC has a certain number of positive aspects**

1. **The FEC is the most consulted bank by the municipalities**

With 25 years of experience, its know-how in the field of local capital projects cannot be equalled by any other Moroccan bank. The FEC's technical expertise and competence can be capitalized on : the standardisation of the technical analysis files represents a gain of time for the managerial personnel, and help the client municipalities to establish and evaluate their own projects.

2. **The FEC is a well known establishment that has a good knowledge of all the Moroccan as well as foreign administrative matters.**

As a result of its legal form, it benefits from a privileged relationship with the Moroccan ministries. The President of the Board of Directors, is also the head of the municipalities.

Most donor agencies have been involved in the services offered by the FEC by providing credits or through technical assistance.

3. **The FEC's personnel is motivated**

The creation of a specific status for the FEC's personnel and a review of salaries, have attracted highly qualified personnel.

The personnel's qualifications, backgrounds and experiences are very varied and this creates a dynamic and successful team.

* **The FEC will have to take into account a certain number of weaknesses, the most significant of which are:**

1. An under capitalization of the FEC (refer to our report "Financial Analysis of the FEC");
2. Not understanding the new objective given to the FEC by its partners;

3. The inflexibility of the majority of the administrative circuit;
4. The high cost of the resources and their incompatibility with the nature of their application (equipment of the municipalities);
5. The inadequacy of financial revenue and the absence of the policy of separating the different segments of clients (predominancy of a single output rate, no variable rates);
6. The high cost of technical assistance and of the process of evaluation of projects, often justified by the nature of clients;
7. The pace of project encashment. This is essentially due to the review of projects on the arrival of new managers of the collectivities as well as the delay in project execution;
8. The lack of adequacy in treasury management.

* **The FEC will have to anticipate events and to face the threats to which it is exposed:**

1. Scarcity of resources: The Treasury gives priority to the liberation of concessional resources and the municipalities funds, there is a possibility of losing the government's warranty on the debenture loans, and the world bank might withdraw it's credit lines depending on the reform of the VAT distribution;
2. Loss of its monopoly;
3. The fragile financial situation of clients;
4. The possibility of direct access for the municipalities to concessional loans;
5. The private financial institutions will, in the future be able to freely determine the interest rates on loan they will apply. They will have a competitive advantage over the FEC;
6. The overheads increase faster than the Net Banking Revenue (Produits Nets Bancaires - PNB).

* **The possibilities offered today to the FEC**

1. Important equipment needs of the municipalities;
2. The "green" credit line (loans at a reduced rate for environmental projects);
3. Consortium with other banks;
4. The commercialisation of the experience of the FEC: by selling the FEC's know-how and proficiency regarding the technical evaluation of projects to other financial institutions.

* **The FEC can achieve its goals if some prerequisites are respected:**

1. **To control its growth bearing in mind the markets' growth and to limit its growth to its capacity of obtaining inexpensive resources.**
2. **To increase its capital stock in order to balance and improve its profitability.**
3. **To clarify its mission: where does its mission of public service start and end.**

We refer here to the 3 challenges mentioned above: to be in the administrative environment and in the Moroccan financial environment, without being an administrative entity or a bank.

4. **To improve the financial means of its clients**

The increase of the FEC's activities as a credit institution is not conceivable without a parallel development of the capacity of the borrowers to support the indebtedness. The level of indebtedness of 40% of the ordinary resources, is a maximum level, which is already superior to the acceptable level in Europe. The reform of the distribution of the VAT funds considered by the government should contribute to improve the solvency of the municipalities. In fact, the development potential of the FEC could be limited.

5. To be experts in banking engineering. This skill should become a major strength for the FEC.

The compatibility of the resources with their that employment should be a daily concern for the financial managers, having in mind the cost of the resources will allow to determine the loan's interests rates, and to eventually adapt them to the different commercial policies (loans for the environment, for the local municipalities).

6. The operating expenses should be under control

The evolution of the operating expenses, including the investment in personnel, should be compared to the evolution of the PNB. Currently, PNB factor is not considered. In a specialised financial institution, the international standards limit the operating expenses to 25 % of the PNB. Our financial analysis (refer to "Financial analysis of the FEC") refer to a level of operating expenses of 37% of the PNB. It is currently 6% for the FEC. As a comparison, the BNDE's PNB margin is 25% (according to the BNDE's brochure).

7. Stability of the municipalities' resources because of the reform of the allocation system of the VAT.

The viability of the FEC could be endangered if these prerequisites are not respected.

IV- RESULTS OF THE ANALYSIS

The managers of the FEC are aware of the challenges they will have to accept, as well as the conditions and prerequisites these involve. This is the reason why they have decided to involve an external point of view of their organisation and on their project of evolution.

Our role is to determine and indicate the areas that could restrict or impair the FEC's evolution.

Therefore, for this assignment we have emphasised the weaknesses of the organisation. Most of these weaknesses are quickly corrected by defining the different functions and by standardising the procedures. These measures will allow the decentralisation of decision making and hence the managers will shift part of the responsibility to the executives. Also a redistribution of tasks will follow from the above measures, resulting sometimes in the allocation of new duties to the executives.

The FEC is not under-staffed, but the duties are badly allocated. If we compare the number of employees at the FEC to other financial institutions, there is not much difference. Hence the FEC has enough personnel to be able to insure its two roles (the public service function and the specialised financial establishment function).

This double function characterises the originality of the FEC and increases the complexity of this institution.

For a long time the FEC has provided consultancy and assistance services without evaluating the costs incurred, thereby acting more like a technical agency for the development of the municipality than as a bank.

Its margin of action is limited by his own constraints. The FEC must be careful prudent: its lack of profitability will not be accepted and the services rendered as a result of its activities as a public service will soon be forgotten.

Our main comments, based on our analysis of the present organisation are listed below: (a more detailed analysis is presented in the documents "Analysis and evaluation" and "Proposal of a new organisation for credit management").

* **The decision making is centralised at the top of the hierarchy**

This centralisation has the following consequences:

- The control and orientation system are disrupted;
- A lack of flexibility of the procedures.

* **The different functions are not defined and, as a result:**

- There are redundancies between the managers and internal management;
- Non-operational managerial entities exist and are implicated in the running of the FEC;
- There is an inconsistency between the qualifications of the personnel and their allocated duties;
- There are certain undefined utilities.

* **A lack of standardisation of the procedures**

As a result, the administrative process for paper work is slow.

* **The financial management presents weaknesses**

- No compatibility between the resources and their employment;
- Inappropriateness of treasury management;
- No measure of the profit margin, and of the PNB.

* **The information system is poor**

- Lack of measures of effectiveness and efficiency.

* **The lack of a planning of the computerised information system**

- Purchase of hardware without a feasibility plan.

* **Difficulties in the allocation of duties for newly recruited staff.**

- The number of personnel has increased from 41 in 1992 up to 78 in 1994.

* **Some duties are inappropriately allocated**

V- PRINCIPLES OF THE NEW ORGANISATION

The new organisation, is based on four major principles:

1. Giving a new image to the FEC

Giving a new image to the FEC by clarifying its role and its work procedures. This principle implies the development of an external communication function which should be attached to the administrative staff.

2. Reinforcing it's position in the decision making process

This strategic mission should be carried out by the Managing Director, with the help and support of the General Secretary. Also, one of the FEC's employees important tasks is to ensure adequate reporting to the two main decision making bodies ie:

- The board of directors;
- The committee of credit.

3. Greater job specialisation

Job specialisation while respecting the positions already defined, at every level of the hierarchy.

4. Balancing the public service with the financial establishment

This major principle implies:

- The balance between the three operational management divisions;
- The creation of a financial management department;
- The focusing of the FEC on it's primary missions: giving loans (by subcontracting the secondary activities, defining the level of technical analysis and capitalizing on the accumulated know-how).

The operational missions of the FEC would be coordinated by a committee composed of the Managing Director, the heads of the operational departments and the General Secretary. A larger executive committee will be consulted when specific subjects arise, which will include, when required, the internal auditor, the head of the Organisation and Information System department and the person in charge of external communication.

The FEC has a choice of several organizational charts as the change in structure between the different departments does not impair the quality of the services provided, the final decision being taken by the Director General in line with his strategy, and the proficiency and technical know-how of his managerial team.

The organization chart aimed at by the FEC is one which balances the two functions of the FEC and with specific emphasis on the objective n°4, ie "Preserving the viability of the FEC".

We trust that our work, supported and enhanced by the efforts of the employees of the FEC, will contribute to achieve these goals.

VI- RECOMMENDATIONS

In order to optimize the reorganization of the FEC, we recommend that the areas of development and the means to carry these out, be clearly determined.

Two areas of development:

- To relate it's growth to that of the existing market;
- To limit it's development to it's capacity for acquiring low interest financing.

Three new means:

- To develop financial engineering proficiency;
- To identify and respond to individual needs;
- To install a rigorous cost accounting system.

This formula is consistent with the general policy.

However there are two drawbacks: the continuing confusing image as perceived by the clients and the public administration, and the risk of being less competitive than other financial institutions.

VII- FINANCIAL ANALYSIS OF THE FEC

SUMMARY

In the context of this assignment relating to the organization of the FEC, we have judged it useful to carry out a financial analysis of the FEC. This succinct analysis relates to the period 1989 to 1993 and leads to the following conclusions:

- The number of loans given to the municipalities has rapidly increased (an average of 17% per year since 1989). This growth would have been higher if releasing the loans was a more flexible process;
- The interest rate at which the FEC borrows money is too high. In December 1993, the average cost of the funds amounted to some 11,65%. This situation is due to the fact that in 1987, Bank Al Maghrib (Central bank of Morocco) has tapped rediscounting possibilities, hence forcing the FEC to convert its portfolio of public loans, with interests rates equalling 5% and 6%, to debenture loans, amounting to DH 800 millions, at a rate of 11% to 11.5%. The FEC has made great use of the debenture loans solution, therefore the FEC's remunerated resources, amounting on 31 December 1993 to some DH 3.13 billion, are made up of some 92% by debenture loans;
- On the other hand, about 25% of the FEC's portfolio is made up of loans whose interest rates are lower than 11%. These loans have been granted before 1987 and penalized the FEC's yield of its portfolio which was 11.7% in 1993.

As a result of the high cost of the resources of the FEC and the limited yield of its portfolio, its net revenue is about 6%. For example, the BNDE's net revenue is about 25% (according to the BNDE's information brochure). This situation will not allow the FEC to obtain a result which reinforces its capital stock in order to preserve the balance of its structure and allow the follow up and control of the increasing rate of loans accorded.

- The FEC is far from reaching financial autonomy. Its operating cash flow represents barely 1,3% of the annual resources;
- In 1992, foreign loans represented 22 times its capital stock. For comparison purposes, the same ratio at the BNDE is about 7 (according to the BNDE's information brochure). In 1993, due to an injection of capital amounting DH 75 millions combined with slow growth, the above ratio was brought down to DH 15.8 millions, without however reaching 12, the ratio targeted by the general policy declaration;

- Should be noted, that in 1992, the FEC built a new head office that cost DH 40 million, and that in 1994, it applied a new payroll policy, in line with its new status. Hence the overheads have greatly increased, and as a result impairs its profitability. In 1993 general costs represented 37% of the net profit;
- On the other hand, the FEC is (as of 1995), taxable, which penalizes its profitability further;
- In order to reestablish a balance and to achieve a profitability level that would ensure stability and financial autonomy during the medium term, the FEC must take the following measures :
 - . Increase its capital in order to reestablish a financial balance and to increase its profitability;
 - . Find cheaper interest rates by borrowing from foreign entities;
 - . Control, where possible the general costs and investments;
 - . Decrease the delays taken to release loans.

In addition, we recommend that the FEC review the methods used to determine the output rates. In effect, these are determined on the basis of the resources used over the last twelve months. It is advisable to calculate the output rates on the basis of the total amount of resources used in order to reflect the real cost of these resources.

IIX- OTHER COMMENTS

- The management ie : the General and Administrative Manager, the financial manager, the credit committee, and the research and development, do not presently use 100% of the human potential at their disposal. The availability rates of these departments vary from 25% to 60% of the theoretical chargeable hours. This translates, in 1994, into a total overcost of over DH 1.3 million, a figure that corresponds to the available hours of the employees;
- In addition, while the number of employees has increased by 90%, between the end of 1992 and the end of October 1994, the number of loans accorded has only increased by 35.7% (30.1% increase in value) and, in the same period, the number of loans released have increased by 15.57% (22.08% increase in value);

- There is a lack of standardisation in the operating process and internal control. No document describing the accounting process or the internal control process is presently available at the FEC. The day to day management is the sum of the different operating processes as executed by different persons, thereby impairing the optimization of activity cycles;
- The internal communication between management is weak, and there is minimum feed-back to the rest of the employees. Hence some of the managerial staff do not take part in the decision making process and in addition ignore the strategical objectives of the FEC and of their own departments;
- The document flow within the organisation is badly identified. Because of the existence of a multitude of computer files with independent processes, there is an excess of printed statements, containing different data. There is therefore an increasing number of redundant information which is also the result of duplication of duties. This lack of standardisation creates confusion when it is field in the archives, as the classification method and location of the documents are not clearly defined;
- A proper management computer information system has not been implemented. In reality, only a spreadsheet solution is used for the management of the activities (accounting, receipts, recovery,...). This tool cannot, in any case, substitute a computerised information system. In addition, this organization generates considerable losses in productivity (long delays of processing, repetition of tasks), as well as an increased risk of error;
- The highly qualified employees are under-employed, as they are not given tasks of responsibility, hence initiative is inhibited. As a result, there is demotivation of the personnel as well as untapped potential;
- There is no clear definition of the different tasks and responsibilities attributed to the employees. As a result, the employee is not made responsible for his work and redundant tasks arise;
- There is inadequate definition of the needs in hardware and software. We have noted during our review, that there is no consistency, in the way the computer devices are allocated. Powerful computers and software are under-employed because they are not allocated to the users with the greatest needs. These employees have to work on outdated devices which do not guarantee the quality of the computer processing;
- The normal work day at the FEC is 7.5 hours. This results in generating considerable loss in human potential. In order to be in line with the majority of the Moroccan economic organizations, the transition from 7,5 to 8 hours per day, would generate 8931 man/hours per year, which is equivalent to 4.8 work positions;

- The process of storing files is not clear and methodical thereby creating a great deal of confusion during document search. This results in costly inefficiencies for the personnel (waste of time,...);
- There is no training plan. This results from the failure of the FEC in determining the needs of the employees for training courses, while the budget allocated for this purpose is high. This severely hinders the development of the highly qualified employees and their capacity to remain up to date in key high growth areas;
- There is no cost accounting system: the reviews of the accountancy department revealed the lack of cost related analysis of the operations registered;
- There is no management control: no position at the FEC covers the duties generally allocated to a management controller;
- The user needs for information are not adequately expressed (statements, statistics,...): this fact is linked to the present situation of the computerised information system (multiple files for the different departments, the statements printed are numerous and not always useful and often contain the same information). This situation generates confusion in the documents flow and would not exist if every department would express it's needs to a single entity that would be in charge of the issuing the information documents and statements;

The application of the above listed recommendations should generate:

* **Added resources**

- 4.8 work positions, due to longer days of work for the employees of the FEC.

* **Gain of stations**

- 3 work positions eliminated at the DAG and one secretarial station added that specialises in Arabic (for the financial administration department);
- 8 work positions eliminated at the financial administration department (of which one should be muted to the DAG) and one position added that of financial manager (recruited either internally or externally);
- 1 work post will be eliminated in the event the credit committee and research and development merge.

On the other hand it is necessary to recruit either internally or externally:

- A management controller that would report directly to the General Manager.