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The Risk Management Profit-Sharing Fund (RMPS) Procedures Manual

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RMPS Procedures Manual

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Introduction

The Risk Management Profit Sharing (RMPS) Fund is an initiative of the United States Agency for International Development (USAID) and The Business Center (TBC) in support of The Business Center's prime objective: facilitating the emergence, growth and sustainability of responsible, well–managed businesses in Tanzania. Specifically, the RMPS Fund is an attempt to address the problem of access to commercial finance currently being experienced by many micro and small-scale indigenous entrepreneurs during this interim period as new private financial institutions gear up in Tanzania. As a response to transitional problems, it is expected that the void which the RMPS Fund is responding to will effectively be filled by private sector financial players within the near future (2-3 years).

Objectives of RMPS Fund

The RMPS Fund objectives are:

A.) to stimulate access by TBC clients - particularly micro and small scale indigenous enterprises - to commercial financial services offerred by private sector lenders. The RMPS Fund should be viewed as a bridge which should lead participating TBC clientele to develop banking relationships on a basis that leads to mutual trust and future access to credit.

B.) to broaden access for micro and small businesses to business advisory services and financing, and simultaneously expand utilization of TBC services and leverage capacity.

C.) to be a revolving, self-sustaining fund. Lending and investment decisions must be based on sound business, not developmental, terms. In the final analysis, if the Fund does not attain commercially acceptable repayment rates, not only will it be unable to assist more than a handful of indigenous entrepreneurs, but commercial lenders will cite its failure as one more reason for not addressing the needs of this market segment.

D.) to test a methodology which, if successful, should facilitate enhanced private financial institutional lending to credit-worthy micro and small scale indigenous enterpreneurs.

Eligibility

For enterprises to be eligible for the RMPS Fund, they must be:

- TBC clients;
- Legally registered, with an official name and address;
- For-profit private entrepreneurship;
- Micro and small scale businesses. Enterprises should not have more than 49 employees;
- Indigenously owned enterprises.

They must <u>not</u> be:

- Public or non-profit businesses;
- Entities owned or operated by members or relatives of the staffs of the U.S. Agency for International Development, The Business Center, the First Adili Bancorp, or private business consultants affiliated with TBC.

Preferably, applicants will:

- be already existent, proprietor–run businesses or entrepreneur–managed corporations who have expansion or rapid growth potential;
- meet standard bank criteria in terms of character and capacity to manage financing, but may lack the credit record, capital or collateral normally required;
- have the potential to move rapidly through the RMPS program into arms–length relationships with formal– sector financial institutions;
- have strong references, both business and personal.

All parties to each loan transaction will be required to sign an affidavit affirming the above conditions and to certify that no conflicts of interest exist.

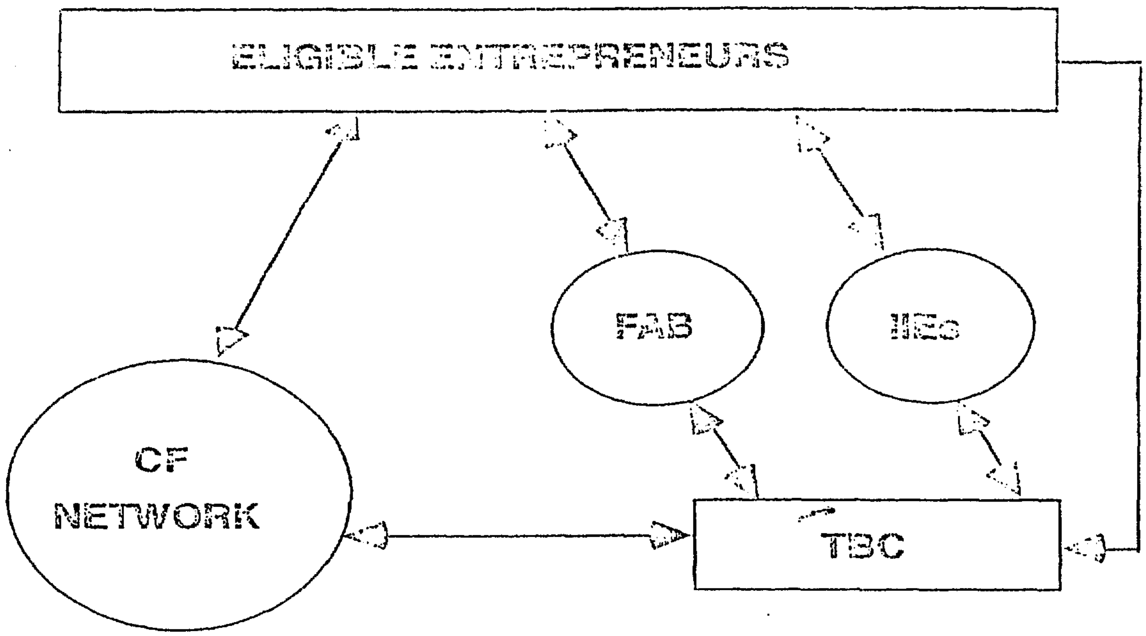
General RMPS Fund Conditions

A.) The normal range of lending will be between U.S.$10,000 and U.S.$50,000;
B.) The owner will be required to sign as co–borrower;
C.) All assets purchased with investment proceeds will be taken as collateral; additional collateral requirements will be evaluated on a case-by-case basis;
D.) The borrower must obtain written approval from the financial institution managing the RMPS Fund (First Adili Bank) and TBC before borrowing additional funds from other sources while still in debt to the Fund;
E.) The borrower must agree not to further encumber any of the assets taken as collateral for this loan or any other business or personal assets not now encumbered (negative pledge);
F.) Loan proceeds may not be used to repay existing debt of any kind.

For details on RMPS financial products, see Appendix 1.

Modes of Client Identification

Since access to the RMPS Fund is restricted to TBC clients, RMPS Fund clients will either be existent TBC clients, new TBC walk-ins, or referrals by TBC 's network of Consulting Firms (CFs). It is also anticipated that some clients will be referred to TBC by the First Adili Bank (FAB) and by established, influential indigenous entrepreneurs (IIEs) who will be made aware of the aims and purposes of the Fund. TBC 's network of Consulting Firms is expected to be the primary means of identifying eligible clients; however, all referees will be considered if eligible. They must first, though, establish a business relationship with TBC, who will in turn link them to its CF network. This process is illustrated in the graphic below:



When applicants are referred by the First Adili Bank or by IIEs, or even when they are TBC 'walk-ins', they must first become registered TBC Clients before being connected by TBC to their Consulting Firm Network.

TBC is responsible for ensuring that CF selections are consistent with the program goals - particularly with respect to character and capacity - and that inappropriate candidates are filtered out early. To fulfill this obligation, TBC will organize seminars to train CFs in the basics of prospect/customer identification, business planning, credit analysis, project appraisal and the specifics of the RMPS program. There will be a formal agreement governing the relationship between TBC and each CF which details the specific duties and responsibilities of each party, establish compensation rates, detail methods and timing of compensation and specify performance requirements leading to compensation.

Prior to undertaking any RMPS Fund activity, the CF agrees to provide TBC with an up-to-date list of all individual consultants earmarked for work on RMPS Fund projects, with their CVs. To enhance their consultancy skills, these earmarked consultants should attend all relevant TBC training sessions. TBC will provide periodic feedback on individual CF consultants and make recommendations on what kinds of work (i.e. market study, financial projections and analysis, or business plan) the consultant should be allowed to do within the program. Depending on their performance on RMPS consultancy assignments, the range of tasks a given consultant is certified for may either expand or contract. If TBC expresses dissatisfaction with the work of a given consultant, the CF agrees to withdraw the consultant from participation in the RMPS Fund.

Preliminary Meeting with the TBC Venture Finance Officer (VFO)
Prior to preparing a project proposal, a preliminary discussion will be held between the VFO, the CF and the pre-screened client candidates. This early discussion will focus on the nature of the proposed transaction, eligibility, the client, and the investment product and its structure. It provides an opportunity to guide the CF in the right direction in preparing investment packages and to inform the CF of concerns that may ultimately lead to a denial. The conference can also disqualify any projects or prospects that do not fit the RMPS program criteria. Disqualification may result from:

1.) Failure of to meet the defined target market criteria.
2.) Conflicts of interest.
3.) Serious doubts about the ability of the prospect to generate sufficient earnings and cash flow.
4.) Negative credit history or negative references.
5.) Significant inadequacies in the management team.
6.) Unwillingness or inability of the prospect to invest equity in the business.
7.) Unwillingness of the business owner to sign as co-obligor.

An affidavit attesting to the absence of conflicts of interest should be signed by the prospect, the CF and the VFO at the time qualification is established. A representative of FAB will be required to sign the affidavit if that is the referral source.

If a project is disqualified, the VFO will inform the CF in writing the reasons for the denial as rapidly as possible. The CF is responsible for informing the prospect of the denial. For those encouraged to continue, a standard loan application form will be provided. At this point it will be emphasized that preparation of the necessary application materials by the CF in no way guarantees the provision of financing, if the CFs have not already made this clear.

Upon qualification, the VFO will provide the CF with a standard loan application form (see Appendix 2). After completing the business plan and feasibility study (inclusive of supporting documentation, accounts, projections, and corporate documents), they will present them to TBC for review. The CF should sign the application form and submit it with the entire loan package. In the recommendations section of the form, the CF should include the proposed financial product, repayment terms, and collateral as appropriate.

The Write-Up
It is expected that the studies included in the package submitted for review will be well-designed and realistic; Appendix 3 discusses some of the items to be included. The preparation of the request package should be a collaborative effort between the CF and the customer, with the customer fully engaged in the planning process.

CFs must remember that the CF and TBC staff are team mates, not adversaries. The CF should feel free to consult with the VFO at any point in the preparation of the work-up. All information, whether positive or negative, must be shared between the partners if the customer is to be adequately served, and if risks are to be accurately assessed. The withholding of or the absence of relevant information can result in misdiagnoses or the use of an inappropriate financing product, structure or repayment plan. This will ultimately have a negative impact on the customer's ability to repay, and thus on the program's viability and the CF's compensation.

An important feature of the project write-up will be the identification of "compelling relationships" which can be used to secure payment in the event of payment problems. Getting repaid here often hinges on the use of a social relationship between the lender and borrower which virtually compels the client to repay. These sorts of informal relationships usually take many years to develop, and a lending program - in addition to having good ideas, good entrepreneurs, and good business support systems - must mimic this informal trait to be successful here. These relationships may be between the client (or spouse) and an influential family member, an ethnic leader, an influential or close business associate, or it may be in the identification of property which holds a special place in the client's heart. Whatever the source of leverage, a set of worst case collection strategies, i.e. Plan A, B, etc. should be developed around these.

Finally, the write-up must give an indication of the state of the client's - or critical personnel's - health. Due to the importance of key personnel in small enterprises coupled with the reality of AIDS and other health related problems, an intelligent project risk assessment must address these variables, however sensitive.

Formal Request Receipt and Review

Once the CFs have prepared a business plan and loan request meeting the VFO's standards (inclusive of supporting documentation, accounts, projections, corporate documents, and a set of tailored worst case collection strategies) and these have formally been presented to TBC for review, the VFO will conduct an independent review, including a site visit. It is expected that the VFO will review the package and conduct the site visit within five working days of receipt of the complete application. After discussions with the designated FAB official on the application's merits and demerits (e.g., sector risk, project soundness, potential for future commercial relationship, credit history, collateral issues, other FAB concerns, and the appropriate financial product), the VFO will either recommend approval to the trust's decision making body, the RMPS Board of Trustees (BT) or return the proposal and indicate its deficiencies in writing. The loan will normally not be rejected solely on the grounds of insufficient collateral or the absence of prior credit experience, and rejected loans can be revised and re-presented.

RMPS Board of Trustees Review and Decision

Once approved by the TBC VFO, financing requests will be submitted to a RMPS Board of Trustees (BT) - the RMPS Fund's decision making body - for final determination. The VFO will be responsible for providing each committee member a copy of the request and the VFO's evaluation at least three days before scheduled meetings.

The BT will have four members: USAID, TBC and the FAB will each choose one representative, with a local businessperson chosen by a unanimous vote of the other three members as the fourth member. The BT, which will meet monthly to consider investment requests, can decide to accept the request as submitted, accept the request conditionally or reject the request as not feasible. The FAB representative on the committee will have two votes rather than one. No investment can be approved with more than one no vote. This will effectively grant FAB veto power, as a final credit check.

Presentations to the BT will be made by the TBC VFO and will provide any information requested by commitee members.

The BT may, at its discretion, delegate to the FAB representative the power to act on behalf of the committee between meetings and to report such actions at the monthly meeting.

Notification of BT Decisions and Documentation

If the request is accepted conditionally, or if it is rejected, written explanations will be provided to the CF by TBC within three days of the determination. If it is accepted, a terms and conditions letter will be prepared by FAB (u.f.s. TBC) for the borrower to review. This letter will detail the basic agreement between the parties, including financing amount, repayment terms, a target return on investment (ROI) , interest rates, and fees. The letter will be signed by the borrower, FAB (on behalf of the BT), and TBC, with a copy sent to the CF. Loans approved by the BT will be forwarded to FAB for documentation and disbursal. All required documents will be prepared by FAB based on that agreement. Three original sets of the documents will be prepared, signed and distributed to the borrower, TBC and FAB. A copy will also be provided to the CF for their records. This will evidence the legally binding agreement between the borrower and the RMPS Trust.

Compensation and Disbursement

A total of between 6 to 9% in fees will be deducted from the loan proceeds and set aside at the time of the initial disbursal of funds. FAB, TBC, and the CF will each receive two percent (2%) of the face value of the loan for payment to the consultant firm for their advisory, documentation, and loan servicing work.[1] If the loan is the equivalent of U.S.$10,000 (Tsh. 6,200,000/=), 2% translates to the equivalent of $200 (Tsh 124,000/=). If the loan is for U.S.$50,000 (Tsh. 31,000,000/=), 2% is $1000 (currently equal Tsh 620,000/=).

CF payments will be conditioned by loan repayment status and submission of CF monitoring reports. Once the client begins making repayments on the loan/investment, the CF will be entitled to receive one quarter of their total

[1]when convertible discount notes are used, TBC will receive 5% rather than 2%.

payment (one-half percentage point) as a "paying client finder's fee" provided that they have submitted all monthly monitoring forms.

The remaining point balance would be payable semiannually on a *pro rata* basis as loan repayment occurred, again provided that CF monitoring forms have been submitted to TBC. If for any reason the client's payments are delayed or the client's loan is restructured, all payments to the CF will cease until the loan/investment is either fully current. If the loan has to be restructured at any point, the compensation to the CF will also be restructured accordingly.

The precise timing of payments for these services will be administratively determined by the RMPS Board of Trustees, and all payments to CFs will be made by FAB upon written instruction from TBC.

Once the loan documents have been prepared and signed, the FAB will disburse funds to the borrower in accordance with the terms of the agreement. FAB will issue payments directly to suppliers whenever possible and will verify receipt of payment and equipment delivery as a loan/investment condition. What CFs will be asked to do is to physically check the client's premises to see that the funds have indeed been used for their intended purpose and that things go as planned. If any doubts exist or problems develop, these should be reported immediately to the TBC VFO.

Monitoring

After approval and the signing of documents, CFs will begin monitoring customer performance. It is imperative that this begin with disbursement, to ensure - with FAB - that funds are used for the intended purpose, that the project begins as planned, and that commissioning of equipment take place properly and expeditiously. CFs are expected to visit their clients regularly and to submit monthly reviews of customer performance. Appendix 4 provides an example of the information to be included in the monthly report. In addition to providing for close followup of the activity being financed, the monitoring visits provide an opportunity for the CF to offer the client a variety of other services; payment for these ancillary services will be separately negotiated between the CF and the client.

FAB will provide a monthly report on the Fund's status to TBC and copied to the USAID designated representative. The information in the reports will include the Fund's current value, the collections and disbursements for the month, and the status of the investment portfolio, including non–performing assets (see Appendix 5). FAB should also provide a report on other banking products or services it sells to RMPS customers, including but not limited to additional loans and depository services.

Appendix 6 summarizes the responsibilities of the participants.

Problem Loans

FAB will be responsible for initiating communication with the VFO whenever any account experiences payment arrears of one or more days late or where payment problems are anticipated for any reason. FAB communication with the VFO on no-pays should be immediate (telephone backed up by official memo or note). The VFO would then be responsible for contacting the relevant CF and developing the appropriate response.

The CFs in coordination with TBC will have the primary responsibility for problem loan administration and collection. Specifically tailored strategies - both traditional and non-traditional - for debt collection in the event of payment problems will be required as part of the CF's write-up. In the event of non-payment, this proposed methodology - which essentially mimics successful informal sector lending - will use the "compelling relationships" identified in the initial project write-up to encourage the client to repay. When combined with a strong reference system, good project evaluation and effective networking within the indigenous business community, the incidence of non-performing loans should be significantly reduced.

In the event of delinquencies, these will be managed and accounted for according to Tanzanian law. However, investments will not be written off as losses unless it is decided that no reasonable chance of collection exists. If repayment is possible with some restructuring, the investment will be restructured. The aim is to make every effort to allow borrowers to fulfill their responsibilities under the investment agreement. If an investment is determined to be a loss, FAB will dispose of any collateral according to terms of the individual investment agreement and the Fund agreement. The write-off of unpaid principal will then be charged against the Fund's assets.

Project Termination and Handover

As stated in the introduction, the RMPS Fund aims to provide a bridging function for a 2-3 year period; after this point, private financial institutions are expected to substantively fill the void the RMPS Fund is aiming at. Nonetheless, to the extent that the Fund is able to successfully achieve its goals and remains a revolving fund, the question of its disposition at the end of this interim period must be addressed.

It is recommended that, in anticipation of a successful RMPS Fund management effort, Business Care Services assign a full-time counterpart to the TBC Venture Finance Officer. In this way, at the end of the project, not only is there an institutional basis for the continuation of the Fund - perhaps administered by Business Care Services in conjunction with First Adili Bank and USAID - but the counterpart, by participating from the beginning and throughout the 2-3 year life of the project, would develop critical skills in the areas of client evaluation, monitoring, and collection. Given the dismal track record to date in the country (as measured by the repayment records of the state-led financial institutions), there is plenty of room for improvement in these areas. To the extent that the Fund is able to develop methodologies which lead to repayment success, the skills developed leading to this result must be carried over and institutionalized.

Appendix 1: Characteristics of RMPS Financial Products

The RMPS product line will include:

- Amortizing Term Loans. Term loans will be repayable in regular installments over a period between twelve and twenty four months. Term loan agreements allow a grace period of up to six months before repayment commences. During the six–month grace period the borrower can either pay interest only or capitalize interest depending on its financial and operating condition.

- Discounted Notes. Under this type note, a rate of return will accrue over the life of the investment (up to one year), with the entire note balance due at maturity. Discounted notes allow the borrower to avoid using cash on debt repayment for an extended period. There will be a feature in the discounted notes that allows either collection of the entire note balance at maturity or conversion of all or part of the balance to an amortizing term loan. This product will carry a higher expected rate of return than the basic term loan product.

- Short–term Working Capital Loans. These will typically be available only with one of the other two products, and will be considered as a stand alone product on a case by case basis. This product is targeted toward potential borrowers in cash businesses, businesses that require little by way of fixed assets or which need a relatively constant supply of working capital to purchase inventory and carry accounts receivable, or one that has defined peaks and valleys allowing accurate projection of periodic short term needs. Short–term working capital loans can aid in fulfilling obligations under contracts with the government or a large company, in financing short–term needs of a recurring nature (not individual or random trading transactions), or for guaranteeing letters of credit for export/import
  These loans will carry a maximum term of 180 days and must be self liquidating. Any short term working capital loan must be paid to zero for at least one month before a renewal can be requested. If the short–term working capital loan is granted in conjunction with another RMPS product, no more than 3 renewals will be allowed. The proceeds of the short term working capital loan cannot be used to make payments on other loans, including loans made under the RMPS program.

Appendix 2 : What Is Expected In a Good Project Work-up

- Frank analysis. If a project is ill-conceived or is likely to be ill-managed, the CF must have the integrity and courage to tell the client this in no uncertain terms.
- Verification of basic facts and figures.
- Specifics of the planned activity and the proposed use of proceeds.
- Detailed analysis of market prospects. This should include the products and/or services offered by the company, the nature of demand for the product, primary customers and suppliers and new markets and expansion plans. Methods of production or service delivery should be noted as well as how they compare with others in the market.
- The competitive environment must be analyzed and detailed. Competition can be direct or indirect, existing or potential, domestic or foreign. It is not acceptable to say no competition currently exists. If the business or market that the prospect intends to enter is profitable, there will eventually be competition. It is important to address the issue ahead of time so that an adequate response to competition can be devised. This section should identify differences in cost of production, technology, product or service quality, prices, reputation, location and any other factors that provide the prospect a competitive advantage or causes a competitive disadvantage.
- Personal histories, background, relevant experience, and health status of key management personnel should be summarized.
- Discussion of critical non–financial factors affecting the borrower's ability to meet the repayment schedule. Issues could include infrastructure constraints (such as dependence on adequate and consistent power), skilled labor shortages, lack of access to foreign markets and other areas that might negatively affect the business' success and ability to repay the loan. There may also be positive critical issues such as a particular contract that will enhance repayment ability, other sources of income, or technological advantages that make the borrower's product or service vastly superior to market competitors.
- Historical details on sales revenue(turnover), expenses and profits, and the prospect's repayment ability based upon these; best efforts should be made to verify all information provided by the client.
- Inflation-adjusted cash flow projections, with all underlying assumptions made explicit, line item by line item. The assumptions must be reasonable and based on current economic and business realities.
- Sensitivity analysis of the projections examining all critical variables (e.g. exchange rate fluctuations).
- Primary and secondary sources of repayment.
- An assessment of the nature and quality of collateral, including best estimates of liquidation value.
- Tailored repayment strategies for the worst case scenario (including the identification of sources of compelling repayment leverage)
- A description of the existent accounting and documentation system.
- An assessment of client character and capacity incorporating information from the client's customers, suppliers and references.

Appendix 3: Sample RMPS Fund Application Form

Date ____________________
Client Name ____________________
CF Name ____________________
Assigned Consultant ____________________
Project Title ____________________
Location ____________________
Project Summary ____________________

Appended Studies ____________________
(please list)

Client's Principal ____________________
Business ____________________

Other Businesses ____________________

Major Personal Assets

References ____________________

Other Pertinent Information

Recommendations
- Amount ____________
- Percentage of Overall Financing Package ____________
- Proposed Payment Terms
  - Grace Period ____________
  - Term ____________
- Financial Product ____________________
- Collateral ____________________
- Proposed Worst Case Collection Strategies

CF Signature

____

Appendix 4: Sample CF Reportage Requirements
(submit one form for each outstanding client loan)

Name of CF ______________________________

Month ______________

# of Approved RMPS Fund Client Loans Outstanding ______

Client Name ______________________________

Project ______________________________

Assigned Consultant ______________________________

Project Stage
- Approved but not fully disbursed ________
- Fully disbursed ________

Payment Status
- Within Grace Period ________
- Current ________
- Late ________

<u>If Within Grace period or Current Account</u>

Last Visitation Date ________

Status of project (comments)

____
____
____
____

<u>If Late</u>

Account Name ______________________________
Days late ______
Specific problem(s)

____
____
____
____

Is this the first time payment has been late?
- Yes ______
- No ______

If no, previous occurrences ______________________

Specifics of CF interventions to date

Results

Has restructuring been attempted?
Yes ________
No ________

If Yes, what is the status?

Status of collateral

Recommendations

Appendix 5: FAB Reportage Requirements

Month

Fund's current value
- Tsh
- U.S.$

Fund Value Breakdown
- Non-entrepreneur investments by type
  - Summary of earnings year to date
- Entrepreneurial loans/investments by type

Entrepreneurial Collections and Disbursements for the Month (broken down by credit)

Total outstanding loans/investments to date
- Payment status of which: Current
  - Late

Late accounts:
- Account Name
- VFO Notification Date
- Loan/Investment Specifics
  - Type
  - Amount
  - Term
  - Interest Rate/Target ROI
  - Purpose
- Is the loan fully disbursed?
- # Days late
- Is this the first time payment has been late?
  - Yes
  - No
- If no, # of previous occurrences
- Has restructuring been attempted?
- If so, what is the status?
- Nature of collateral

Summary of Write-offs, year to date

Other FAB Banking Products or Services Sold to RMPS Customers

Appendix 6: Participant Responsibilities

The Business Center

1.) Selects and trains CFs
2.) Refers prospects to and liaises with CFs
3.) VFO reviews and evaluates investment request packages
4.) Submits packages to BT, communicates outcomes to CFs
5.) Managing Director serves on the RMPS Board of Trustees
6.) Reviews periodic reports by CFs
7.) Monitors CF performance in areas of its responsibilities (assigned consultants and tasks eligible, quality control)
8.) Reviews FAB loan reports, coordinates appropriate response w/CF
9.) Reviews FAB trust management, coordinates
10.) Monitors CF and FAB Compensation
11.) Reports on program status to AID

Consulting Firms

1.) Attend TBC training events
2.) Prospect identification and outreach (emphasizing quality control, references, and character assessment)
3.) Preliminary liaison with TBC VFO
4.) If positive, preparation of quality package and presentation to VFO;
If negative, communication of denial and basis; possible rework
5.) If VFO recommendation of formal package positive, await outcome of RMPS Board of Trustees meeting;
If negative, communication of denial and basis; possible rework.
6.) If BT determination positive, monitor disbursement and project initiation
7.) Review of customer performance and oversight on loan servicing
8.) Problem loan administration and resolution
9.) Non-performing loan collection (with TBC)

First Adili Bancorp

1.) Manage Trust and Fund assets on behalf of the Board of Trustees
2.) Preliminary review of loan requests with TBC VFO; final review of loan requests as member of Board of Trustees
3.) Books approved loans to TBC Clients, prepares loan documents
4.) Disbursement control and normal loan servicing
5.) Reporting on performance and status of Trust and the Fund
6.) Reporting on status of loans
7.) Communication with VFO on past due loans

U. S. Agency for International Development

1.) Negotiate and structure Trust and Fund Agreements
2.) Provide funds to establish the Trust
3.) Participate as Member of Board of Trustee or designate a representative
4.) Monitor progress of the Trust and the Fund

Clients

1.) Contract CF Advisory Services

2.) Meet program criteria
3.) Provide required monitoring data
4.) Repay Fund