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HAITIAN DEVELOPMENT FOUNDATION INCENTIVE SYSTEM

BY ARELIS GOMEZ, PRET

Development Alternatives, Inc.

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Lauren Mitten
PRET Project Administrator
Development Alternatives, Inc.
7250 Woodmont Avenue, Suite 200
Bethesda, MD 20814
T: (301) 215-6651
F: (301) 718-7968

HAITIAN DEVELOPMENT FOUNDATION
INCENTIVE SYSTEM

1. OBJECTIVES AND DESCRIPTION

The proposed incentive system seeks to increase the portfolio quality, and staff productivity of the Haitian Development Foundation. The system is aimed at the field staff, specifically credit officers. It is based on a set of productivity and portfolio quality indicators which define management expectations during a specified period. The variables included in the system are summarized in table no.1.

Table no.1: Variables included in the Incentive System

Variable	Incentive
Outstanding portfolio	A sliding scale bonus tied to delinquency rate. The larger the portfolio and the lower its delinquency, the larger the bonus.
Delinquency rate	A defined threshold of delinquency above which no incentives are paid to ensure that overall quality of the portfolio is always maintained. A portfolio with a delinquency rate above 7% does not qualify for any incentives.
On time repayment rate	A defined threshold of repayment below which no incentives are paid to ensure that overall quality of the portfolio is always maintained. A portfolio with a repayment rate below 90% does not qualify for any incentives.
Portfolio at risk rate	A defined threshold of portfolio at risk below which no incentives are paid to ensure that overall quality of the portfolio is always maintained. A portfolio at risk rate above 20% does not qualify for any incentives.
Number of active clients	Fixed bonus tied to different numbers of active clients. The higher the number of active clients the larger the bonus. A portfolio with less than 150 active clients does not qualify for this incentive.
Number of new clients	A fixed bonus for each new client brought in

2. Stage I Bonus System

In the design of the bonus system several issues have been taken into consideration:

(a) The portfolio quality of the HDF is currently very low. Delinquency rates stand above --% for loans over thirty days past due. Portfolio at risk rate stands at 49.9%[1]. The HDF recently started a portfolio recovery plan. *A Stage I Bonus System* is designed to foster the plan effectiveness (table no.2). As the recovery plan keeps loan activity to a minimum, Stage I does not include portfolio size as a variable to be rewarded. Instead, the system concentrates on portfolio quality variables: delinquency rate, repayment rate and portfolio at risk rate. An additional bonus is given to the number of clients.

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[1]Robin Bell, HDF Technical Assistance Roadmap, March 1996.

(b) The HDF does not have a cost recovery structure. The cost per dollar stands around $0.40 of the portfolio while returns stand at $0.24. Under this structure, the program will not brake even until measures into that direction are taken (some possibilities are discussed later in this document). Therefore, the bonus system, at least during initial stages) will not be based on a "profit sharing" situation. In fact, it would add to the already high cost structure of the Foundation. Nonetheless, it could be expected that the revenue side would increase substantially (and upset the added costs) as a result of the implementation of the system, along with other measures proposed in section -- of this document.

The Stage I bonus system will be in place for a period no larger than 6 months. Prior or parallel to its implementation, management must have taken corrective measures to improve credit delivery, follow-up and recovery as those listed in next section. During the six month period of Stage I, those credit officers unable to show sustained improvement in the quality of their portfolios should be replaced. However, management must pay continuous attention to individual developments to ensure that credit officers receive all the support they need. Also, it should carefully evaluate non performing officers in search for justifiable situations. For instance, it is usually more difficult for the credit officers to recover loans from bad portfolios which use to belong to other officers. Similarly, it is more difficult to recovered very old delinquent loans than recent ones.

Bonuses are set high enough as to make it very attractive to the credit officer. This is, to be effective the bonuses must make a difference in the credit officer's income. The bonuses should be paid to the credit officers on a monthly basis. In that way, they would perceive it as part of their monthly income and as such will try harder not to loose it. If bonuses are paid bi-monthly or quarterly, collection efforts will concentrate at the end of the period.

It is expected that some credit officers will be able to stabilize their portfolios more rapidly than others, and thereby qualify for Stage II.

Table no.2: Stage I Incentive System

Variable	Incentive
Delinquency rate (amount of overdue loans as a percentage of the outstanding portfolio)	A $---- (fixed)bonus per every point of reduction in the delinquency rate. In order to qualify for this bonus the credit officer (a) must have maintained a declining trend in the delinquency rate for the previous three months; (b) must have kept a repayment rate equal or higher than that of the previous month.
on time repayment rate	A $----(fixed) bonus per every point of increase in the on time repayment rate. In order to qualify for this bonus the credit officer (a) must have maintained a increasing trend in the on time repayment rate for the previous three months;
Portfolio at risk rate	A $----(fixed) bonus per every point of decline in the portfolio at risk rate. In order to qualify for this bonus the credit officer must have maintained a declining trend in the on time repayment rate for the previous three months;

Number of active clients	A $---- (fixed) bonus for a portfolio of 150 to or more active clients; $--- for 175 active clients, and $--- for 200 clients or more. To qualify for this bonus, the credit officer must have: (a) a portfolio with 150 active clients or more does not qualify for this incentive; (b) maintained a increasing trend in the on time repayment rate for the previous three months; (a) must have maintained a declining trend in the delinquency rate for the previous three months. (Only officers with qualify for bonuses 1 and 2 could qualify for this bonus.

Definitions:

Active clients: clients with outstanding loans and in between disbursement.

Delinquency rate: the amount of overdue loans as a percentage of the outstanding portfolio.

On time repayment rate: actual payments as a percentage of the payments due plus payments overdue for a specified period of time.

Portfolio at risk rate: the outstanding balance of all overdue loans as a percentage of the outstanding portfolio. For the purpose of the bonus system, only loans over 30 days past due.

3. Conditions for the system effectiveness

The implementation of an incentive system based on productivity and quality of the portfolio could substantially improve repayment. However, this is not a sufficient condition to ensure portfolio quality. The system simply increases and/or accelerates the effectiveness of existing or new credit and follow-up techniques, policies and procedures. It does not replace them. In the case of the HDF several issues need to be addressed and various conditions need to be met prior and or parallely to the implementation of any incentive system. They are summarized as follows:

- Loans over 365 days past due must be written off. In addition the HDF must define the measures to be taken to written off those loans over six months past due. HDF needs to establish adequate reserves for loan losses. The write offs must be carefully planned as to prevent a substantial and dangerous decapitalization of the HDF.

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- Interest rates need to be revised and set more accordingly to program costs. However, current operations are costly and inefficient. Support staff is excessively large and loan and managerial procedures are redundant and time consuming. Promotion efforts are too dispersed and expensive. Under this framework and prior to any interest rate adjustments, the foundation must revise and reduce the current cost structure. The foundation must avoid transferring its inefficiencies (costs) to the client.

x

- The current credit technology needs to be modified in order to make it more adequate to micro and small lending. Loans need to start small and increase as the client builds a credit history with the program. The HDF management may be reluctant to reduce the loan size by arguing that the program targets not the micro but mainly the small size enterprise. It also may argue that a loan smaller than what the client needs may be counterproductive. The HDF, however, needs to put equal emphasis on the repayment side. The prevalent misperception among entrepreneurs in Haiti is that repayment of "development" loans is at the most optional. In this regard, the HDF needs to be concerned about testing the client's willingness (character)to repay the loan. The best and quickest way to test the client is through small, scale-up loans. In this regard, the current credit technology used by the HDF has several weaknesses. First, it is far too expensive as every dollar in the portfolio cost US$0.40 (vs. an optimum of US0.20).

x

x Secondly, loan sizes are too large, terms are too long and guarantees receive too much weight in the loan approval process. The average loan of the HDF, currently at US$1,600, is far larger than the gross per capita income currently estimated at $250. The fact that most clients can not make full but partial payments indicates that loan sizes are too large for the type of clientele. An excessive average loan term of 16 months contributes to worsen the situation. Thirdly, loan approval is based on guarantees not on character. Promoters put excessive attention to guarantees. As a result, loan size and approval are determined by how much the guarantee could cover and how strong it is. Finally, continuos modifications due to declining portfolio conditions have resulted in excessive documentation and guarantee requirements. The burden of the problem has been put on the client and consequently access has become more difficult. Less efforts have been devoted to addressing severe weaknesses in the program management, follow-up and recovery.

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- In order for the bonus system to work effectively the follow-up system of the HDF will need substantial improvement. Current follow-up is reactive as opposed to proactive. Visits to clients are based on arrears over 90 days. Under this practice, no client is paid a visit until the arrears situation becomes critical. Even in the worst cases, visits are conditioned to car and driver availability, climate and office schedule. For instance, most credit officers refuse to do visits in the afternoon allegedly due to the sun (!). Office hours end at 3:30pm after which they do not make visits either. In any instance, credit officers refuse to visit clients unless they have a chauffeur-driven car available. This situation is particularly true at the Port au Prince branch. In addition, the prevalent practice at HDF of rotating credit officers around different geographic areas has led to lack of continuity and accountability on client supervision. All these prevalent practices must be abolished or modified before any bonus system is implemented. All new measures must aimed at holding the credit officer accountable for his/her portfolio.

Key recommendations to improve follow-up include:

- Credit officers must prepare a weekly plan of client visits. This plan would be based on a list of clients which includes upcoming payments and arrears (formats and tools are included in the manual, annex A). The plan will be proactive as visits would pay not only to correct but to prevent arrears. Credit officers must impress on the client the idea that repayment is not optional. The results of the follow-up visits should be documented and evaluated by the regional managers.

x

- Credit officers must keep track and become fully accountable for their portfolio performance and arrears. In this regard, each promoter must prepare a (weekly) portfolio performance report to his/her supervisor. The report should include an action plan for clients in arrears.

x

- Credit officers should be provided with motorcycles (instead of the current chauffeur-driven cars). Motorcycles should be financed to the officers. The HDF would pay the officer a monthly fee which would include gas and maintenance.

x

- The HDF must define (in writing) the repayment policies

x

x The MIS system needs to provide accurate and timely information on portfolio performance by credit officer, including, portfolio, delinquency rate, portfolio by age, portfolio at risk rate, loan loss rate, repayment rate, average loan size, number of loans per credit officer.

x

- Promotion efforts and expansion strategies must be based on saturation of geographical areas. Once an area/zone reaches saturation or near saturation the program moves into new areas/zones. Regional Offices should only open in areas where there is potential for reaching self-sufficiency

x
x

4. Stage II Bonus System

Stage II Bonus System could only be implemented once the program is stabilized and key recommendations regarding portfolio management, follow-up, and loan terms and conditions are in place. It assumes that the current "freeze" on loan disbursements has been called off and, consequently, credit officers are able to increase their portfolios. It also assumes that the HDF has enough liquidity to respond to loan approvals. The later is particularly important to the success of the system. First, the system would have a counterproductive effect if after working hard to promote and approve loans (and thus qualify for the bonus on portfolio size)a credit officer is faced with lack of liquidity from the organization. Secondly, the client would be equally frustrated after being promised quick disbursement. Third, expectation of a next loan is one of the most important incentives to repayment. If a client suspects that his/her next loan will no be disbursed on time he/she would prefer to fall in arrears and hold on to the money to cover working capital needs. Again, liquidity is of utmost importance to the system.

Stage II includes all the variables used in Stage. In addition, the system includes two other variables: portfolio size and new loans. The reward system for most variables, however, differs from that on Stage I. For instance, instead of a fixed bonus on (reductions in) delinquency rates, this variable is directly linked to the size of the portfolio. The larger the portfolio at any given delinquency rate, the larger the bonus. Furthermore, bonuses are not given based on the improvement in the portfolio quality (e.g. reductions in delinquency rates, portfolio at risk rates, etc.) but on the quality of the portfolio itself. In this regard, a threshold of delinquency, portfolio at risk and repayment rates is set beyond which no bonuses are paid.

Tables nos. 3 to 6 present the bonus for the Stage II. In table 3, all credit officers with a portfolio of at least $80,000, a delinquency rate below 7%, a portfolio at risk rate below 30% will receive a bonus accordingly to the size of their portfolio and its level of delinquency.

A second bonus is paid to those officers with a repayment rate equal or larger than 90%.

Other considerations:

All field staff will participate in the bonus system. The Regional Manager will receive a bonus equal to 20% of the aggregated bonus received by the credit officers under his/her supervision. In order to qualify for the bonus, 51% or more of the credit officers under his/her supervision must have qualified for bonuses. Field administrative assistants would receive 5% of the aggregated bonuses. In order to qualify for the bonus, 51% or more of the credit officers he/she supports must have qualified for bonuses

No recommendations are given regarding "documentalists" and other support field staff until the HDF had done analysis on operations redundancies and overlapping. It could be expected that some of these support positions will disappear.

It is recommended that new staff work for at least 90 days prior to qualify for the bonus system. As in the Stage I system, bonuses in Stage II must be paid on a monthly basis.

The variables, bonus values or percentages could adjusted to different goals and management expectations. As aforementioned, the proposed systems are oriented to improve quality of the portfolio and increase productivity. If goals change, for instance achieving self-sufficiency becomes a primary goal, thus, variables must be adjusted accordingly. Under this scenario, loan disbursements, average loan, among other, could be included as variables. The size of the portfolio would have the highest weight in the system. Under a second scenario, and assuming a primary goal is to scale up operations (e.g. reaching 20,000 clients) then portfolio size would become less important. Number of new clients and number of active clients would have a higher weight. If under a third scenario the goal is to reach the smallest or poorest entrepreneurs then average loan size would carry the higher value. Under all scenarios, however, portfolio quality variables (egg delinquency rate, portfolio at risk rate) must be present.

Appendix G
Bonus Structure

Average starting portfolio per Credit Officer estimated at $60,000
Which is 50% of what on the average each Credit Officer is now carrying

(36,970,113/16 25)/14=Sheet 162505 99121

d 24% interest rate per year.
Interest Rate 2% mes

Portefeuille	60000	65000	70000	75000	80000	85000	90000	95000
Delinquency								
0%	1200	1300	1400	1500	1600	1700	1800	1900
1%	1188	1287	1386	1485	1584	1683	1782	1881
2%	1176	1274	1372	1470	1568	1666	1764	1862
3%	1164	1261	1358	1455	1552	1649	1746	1843
4%	1152	1248	1344	1440	1536	1632	1728	1824
5%	1140	1235	1330	1425	1520	1615	1710	1805
6%	1128	1222	1316	1410	1504	1598	1692	1786
7%	1116	1209	1302	1395	1488	1581	1674	1767

Net profit of the operation per levels of portfolio and delinquency
Currently the cost/dollar in the portfolio is .04
Best case scenario: Cost/dolar in the portfolio 0.0166666667

Portolio	60000	65000	70000	75000	80000	85000	90000	95000
Delinquency								
0%	200	217	233	250	267	283	300	317
1%	188	204	219	235	251	266	282	298
2%	176	191	205	220	235	249	264	279
3%	164	178	191	205	219	232	246	260
4%	152	165	177	190	203	215	228	241
5%	140	152	163	175	187	198	210	222
6%	128	139	149	160	171	181	192	203
7%	116	126	135	145	155	164	174	184

Bonus per portfolio and delinquency			10%					
Portfolio	60000	65000	70000	75000	80000	85000	90000	95000
Delinquency								
0%	20	22	23	25	27	28	30	32
1%	19	20	22	23	25	27	28	30
2%	18	19	21	22	23	25	26	28
3%	16	18	19	20	22	23	25	26
4%	15	16	18	19	20	22	23	24
5%	14	15	16	17	19	20	21	22
6%	13	14	15	16	17	18	19	20
7%	12	13	14	14	15	16	17	18
10	5							
Number of clients								
150	10							
160	15							
170	20							
180	25							
190	30							
200	35							
210	40							
220	45							
						Promotor		Responsable
							25	
							50	
							80	