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HAITIAN DEVELOPMENT FOUNDATION—TECHNICAL ASSISTANCE ROADMAP

BY: ROBIN BELL
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Development Alternatives, Inc.
USAID/Haiti Contract 521-0256-C-00-5059-00/521-C-00-95-00059-00

Office of Economic Growth

Program for the Recovery of the Economy in Transition (PRET)
Project Number 5124

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Haitian Development Foundation
Technical Assistance Roadmap

Prepared by: Robin Bell
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USAID

CHAPTER ONE: CREDIT OPERATIONS

The Haitian Development Foundation (HDF) is an organization with many years of experience in managing credit programs for micro and small entrepreneurs. In the Haitian context, HDF might be viewed as "the glass half full"; however, in the international context, "the glass is clearly half empty". In large part, this is due to the fact that HDF has never operated as an intermediary on a commercial basis; rather it operated as a donor dependent organization managing a series of "projects". This donor dependency pervades every aspect of the organization from the vision of senior management and the board to the credit methodology. The purpose of this report, is to point out specific areas of weaknesses so as to set the course of direction for technical assistance to be provided under the PRET project.

Loan Terms and Conditions

Loan Size: HDF's average loan amount is approximately G/. 27,000 (US$1,600+/-). This amount is relatively large in relation to Haiti's per capita GDP (est. <US$400) and would tend to indicate that poor microentrepreneurs, on the whole, do not have access to credit from HDF. Other microenterprise programs around the world typically have average loan to GDP ratios of less than 100%.

Loan Terms: HDF makes loans with average terms of 21.9 months. While the average term has been declining (the average of loans granted in 1995 was 17.6 months), when a client requests a 3 month loan working capital loan, they have been reportedly told that HDF does make loans for less than 12 months.

Repayment: The loan agreements state that repayments are to be made monthly. However, HDF has a practice of accepting partial payments, because they recognize that their product is not suited to the target clientele. Micro and small enterprises require continual access to short term working capital loans: HDF makes loans with long terms. The situation has evolved that the client has only been required to pay interest, but not principal No real concern was given to recovery of principal because donor funding was always perceived to be available, thereby obviating the need to manage cash flow Secondly, the donor did not appear to be concerned as long as the client was paying interest their primary concern was with getting money out there (growing the size of the portfolio).

> **RECOMMENDATION:** As HDF weans itself off of donor funding, it needs to give much greater focus to managing its level of risk in the portfolio. To reduce the risk of giving a first loan to a client with insufficient or unreliable business information and no collateral, DAI recommends that HDF adopts a strategy which will help the client build a positive credit history by starting with small, short-term loans. The term of HDF's new borrowers should be short — e g. three months — for several reasons. First, the built-in repayment incentives such as ongoing availability, rapid approval of subsequent loans, and increased subsequent loan amounts work more effectively on short-term loans. Second,

most microenterprises are involved in activities with rapid cash flow that allow them to pay back loans over relatively short terms. Working capital loans for repeat borrowers with good repayment histories could carry average terms of six months . Fixed-asset loans could be granted for an average term of 12 months.

Loan Operation Procedures

Loan Promotion: HDF's promotion efforts are fairly limited given their long history of existence: they now rely on word of mouth. Borrowers come to their offices.

Loan Analysis: HDF appears to use predominantly collateral and cash flow-based lending techniques, particularly in Port-au-Prince. Character-based techniques are used to a much lesser degree That said, some of the provinces with strong repayment records may in fact be using character based lending techniques, but this was not confirmed by the consultant during this visit (note: PRET is in the process of reviewing credit procedures in detail)

> **RECOMMENDATION**: Collateral based lending techniques should be replaced with character-based techniques. Project appraisals are too expensive, and the analysis does not enhance the quality of the decision because microenterprises rarely have written financial statements and never have audited ones. The main, if not only, financial analysis is likely to be of projected cash flows. Although collateral can, in principle, serve as an important incentive, and may reinforce the idea that the microenterprises' livelihood is at stake, it is of limited use in microlending. The cost of collateral recovery on microloans usually exceeds the value of the outstanding balance. Moreover, the lack of a functional legal and regulatory environment in Haiti makes enforcement of collateral next to impossible, a fact of which most clients are aware. Lastly, microenterprises rarely have assets that can serve as good collateral for loans.
>
> Successful microenterprise credit programs operate throughout the microloan size spectrum without any real guarantees, basing their low default rates character assessments, borrower incentives (e.g. a continual flow of high-quality credit services) and staff incentives (discussed below).

Loan Approval: Loan approval is decentralized at the branch level, but not necessarily at the operational level Loans are approved by a committee comprised of community members

> **RECOMMENDATION:** As HDF makes the transition to a high volume, accountable lender, its loan approval process will need to be decentralized to the relevant operational levels Community leaders obviously serve a useful purpose by providing character references However, branch managers should have the authority to approve loans recommended by the loan officer At the same time, however, the loan officers as well as their branch managers should be held directly responsible for the performance of the loans they make. Branch managers should oversee the performance of their individual loan officers and reinforce those whose performance falls below acceptable standards. Senior management should oversee the performance of the branch managers.

A credit committee would continue to approve loans of relatively large amounts and act as a mechanism of internal evaluation and control of the quality of the approvals. However, ideally, the committee would include loan officers (on a rotating basis so that all can learn), a branch manager, and a regional or central office manager. Only for exceptionally large amounts should loan approvals be made by HDF's executive director, the board, or other community members.

Disbursement: HDF's loan disbursement period is excessively long at the moment due to liquidity problems.

RECOMMENDATION: A short disbursement period is key to attracting new clients and to retaining existing ones. It is also a key incentive to repayment on the part of the borrower. The loan approval/disbursement period should not exceed seven days for new loans and two days for repeat loans. To this end, HDF needs streamlined loan application procedures, a decentralized approval system, and effective financial management.

Monitoring: HDF has a database portfolio administration system. As will be discussed below, it is not linked with nor does it reconcile to the accounting system. While the system on the whole has many weaknesses, it can generate information on loans with past due payments (as of the date of the inquiry, but not as of a specified effective date).

RECOMMENDATION: Since microenterprise loans can be more risky than other loans, a **proactive,** up-to-date credit administration system that not only rapidly alerts loan officers and management to delinquencies, but also generates information on payments coming due in the next week, is essential.

Effective portfolio monitoring also requires that the field staff pay periodic visits to their customers, particularly those who are delinquent or who have a history of delinquency. Visits to delinquent borrowers should be required within one week of a missed payment to impress on them the fact that late payment is not an option (NOT to collect the payment). Collecting the payment sends the message to the client that there is no need for them to go to the office to make the payment on time, because the loan officer will come and collect the payment. This is not only costly in terms of the salary expenses of the individual collecting the payment, but in terms of increased risk of fraud

Management must also have information on relevant characteristics of each loan to isolate those that typify overdue loans for consideration in the future

Loan Recovery: Repayment is less a function of comprehensive loan analysis and hard collateral than of incentives to the borrowers Incentives that make repayment more likely are expectation of another loan, immediacy of the disbursement, and increasing loan amounts — in other words, the establishment of a banking relationship For these key incentives to work, it is essential that HDF not restrict credit, not disburse loans with lengthy terms, streamline its credit procedures to reduce the approval period for subsequent loans to a maximum of two days, and disburse subsequent loans nearly automatically

Appropriate terms and conditions also work as additional incentives to repayment. If borrowers want continued access to microfinance under certain terms and conditions, they probably do not have many alternatives. A provision of good credit services under appropriate terms and conditions would create for HDF a comparative advantage in the microenterprise market. The higher the value the borrower places on these services, the higher the chances of successful repayment.

Personnel Incentive System

In theory, HDF's loan officers are responsible for their portfolio. They recommend that the loans be approved and they are responsible for follow up and recovery. However, there is nothing which holds them accountable for performance -- no positive incentives or negative sanctions. For example, despite the very low productivity ratios and high delinquency rates (presented in more detail in Chapter Two), loan officers are not fired for non-performance.

RECOMMENDATION: An incentive system for credit personnel based on productivity and quality of the portfolio could substantially improve repayment. Nonmonetary incentives work to a certain extent; monetary incentives, however, are usually more transparent and work better in the longer term. Productivity-based incentives are not enough to ensure portfolio quality but do quantify management's expectations of the staff. When these incentives are in place, management can concentrate on supporting the field staff rather than on constantly communicating institutional expectations.

The incentive system for credit officers, for example, would take into consideration the variables listed in the table below.

INCENTIVE SYSTEM FOR CREDIT OFFICERS

Variable	**Incentive**
Number of new clients	Fixed bonus for each new client brought in
Number of repeated loans	Fixed bonus for each repeat loan
Number of loans granted	Fixed bonus
Outstanding portfolio	A sliding scale bonus tied to delinquency rates (This bonus should have the highest weight.)
Delinquency rate	A defined threshold level of delinquency above which no incentives are paid to ensure that overall quality of the portfolio is always maintained

These variables can be adjusted as to relative weight in the incentive formula, based on what management wants to emphasize at certain points and based on profitability of the portfolio above the break-even point Ideally, the remuneration of credit officers should come mainly from productivity plus a base salary If at some point credit officers fail to earn the incentive, they should be able to support themselves minimally with the base salary. The implementation of the incentive system will be closely monitored to ensure it generates the expected positive results or to correct unwanted distortions.

Those officers which do not respond to the incentives in the desired manner and consistently do not meet the objectives set out by management should be dismissed (e.g. if after a reasonable period of time and sufficient warning, loan officers with excessive delinquency rates should be fired.)

Administrative Structure

Field Staff: HDF's financial viability is not necessarily jeopardized by the salary levels or qualifications of its field staff. Credit officers typically have at least some technical school background, a level appropriate given HDF's average loan amounts. What is inappropriate is the mentality of loan officers: in Port-au-Prince, for example, the loan officers somehow feel that they should make field visits in chauffeured driven cars and have excessive administrative staff to help perform their functions. Given the average size of the loans and the number of clients managed by each loan officer, financial viability could never hoped to be achieved.

Structure: HDF has developed a network of 7 simple branch offices or annexes. A typical annex consists of one branch manager, 1-2 loan officers, and support staff.

Administration: The annexes are administered in a fairly **decentralized** manner to reduce borrower transaction costs, maintain a close and personal relationship with the local community targeted by the program, and reduce the operating expenses associated with such a network. This is appropriate since the nature of microenterprise lending requires institutions to confer a great deal of operational autonomy on the branch office staff who must gather information from the borrower's peer group. This "soft" information relates to borrower creditworthiness and is largely subjective in nature. The informal nature of this borrower-level information reduces the possibility that regional or head office intervention in credit decisions would have a beneficial impact because the information is only meaningful in a local context.

Staff Productivity: HDF has roughly a total of 45 employees: an executive director; a credit director, 8 annex managers/supervisors; 14 credit officers; and 21 administrative/general services staff The lack of management capacity, particularly in the area of finance is noted right away The excessive ratio of administrative staff is also noted, particularly when one takes into account that it only includes one accounting assistant and no internal audit operations

Total loans per HDF staff member are currently 45. Productivity ratios between the annexes highlight some of the inefficiencies. Loans per annex staff member range from a low of 36 in St-Marc (SMC) to a high of 81 in Jacmel (JAC). Moreover, three of the four annexes with the lowest productivity ratios have the highest portfolio-at-risk ratios (presented in Chapter Two)

Branch	Performing Loans		Non-Performing Loans		Total	
	# Loans	# Loans/ Annex Pers.	# Loans	# Loans/ Annex Pers.	# Loans	# Loans/ Annex Pers.
JER	183	61	40	13	223	74
JAC	227	76	16	5	243	81
SMC	234	78	4	1	238	79
Cayes	133	33	11	3	144	36
CDB	131	33	57	14	188	47
CAP	162	41	33	8	195	49
PAP	396	26	412	27	808	54

RECOMMENDATION: Given that salaries generally represent a high percentage of the total costs, profitability of HDF will be more a function of high staff productivity than of cost controls. HDF's challenge for the future is to bring its administrative structure in line with its credit personnel. It will also be challenged to improve its productivity ratios. Its total loan per staff member should be approximately 75 — that is, the credit officer should manage approximately 150 loans and the ratio of credit personnel to total staff should be in the range of 50%. Some programs do choose to have slightly higher levels of administrative staff so that the officers can manage even more clients. Such practice is acceptable as long as the overall productivity targets are achieved.

CHAPTER TWO: FINANCIAL PERFORMANCE

Capital Adequacy

Ability to Increase Capital: HDF's ability to increase its capital base from sources other than USAID in the short term appears to be rather limited. Capital sources generally fall into the following categories: contributions from other donors or founding members; private investments; or positive retained earnings (excluding donations).

- o Donations: Efforts to access to other donors have, in the past, reportedly been hampered to some extent by USAID. HDF is now in the position of trying to develop the necessary relationships to diversify its sources of funding, but such efforts take time to come to fruition.

- o Retained Earnings: HDF is not generating positive retained earnings in nominal terms let alone real terms: an accurate assessment of the extent of the shortfall could not be made as reliable financial statements (neither year-end or interim) for 1995 were not available.

- o Private Investors: HDF's current weak financial performance as well as its poor financial management will affect their capacity to raise private investment capital.

Financial Intermediation/Leverage: HDF is not yet intermediating commercial sources of funds. The extent of their liabilities is a mortgage loan from SOGEBEL and a subsidized loan (1% interest rate) from the IDB (Small Project Loan). As a result, HDF's leverage ratios are very low and their equity to risk weighted assets is high.

Sufficiency of Loss Reserves: It would appear that HDF maintains a reasonable level of provisions in relation to its past due portfolio. The issue is that they generally report as past due only those loans with interest in arrears. Using this method, at year end FY1994 they showed a past due portfolio of greater than 90 days totaling G/. 8,652,112 and a provision totaling G/. 8,450,140. This reserve has not yet been adjusted to reflect the past due portfolio at year end FY 1995 of approximately G/. 10.3 million. Principal in arrears is notably higher. As will be discussed under asset quality, HDF does not consistently write-off non-performing loans Specific write-off recommendations are made below

Asset Quality

Portfolio Quality: HDF's portfolio at risk greater than 90 days is substantially greater than has been previously reported. This is essentially because HDF typically reports its past due portfolio on the basis of past due **interest in arrears, not principal in arrears**. A significant percentage of HDF's borrowers will make partial payments of interest only. As long as interest payments are not more than 90 days past due, it is classified as a current loan despite the fact that required principal payments can be more than 6 months past due A comparison of the different methods of calculating portfolio at risk is presented below

PORTFOLIO AT RISK > 90 DAYS (PRINCIPAL IN ARREARS)
PRIOR TO WRITEOFFS

By Office (G/.)

	PAR	Portfolio	%
PAP	14,916,517	21,054,690	70.85%
CAY	293,364	2,673,845	10.97%
JAC	512,238	2,798,873	18.30%
CDB	922,590	1,698,096	54.33%
SMC	24,793	2,705,903	0.92%
CPH	1,658,694	4,061,688	40.84%
JER	1,384,892	5,122,314	27.04%
TOTAL	19,713,088	40,115,409	49.14%

PORTFOLIO AT RISK > 90 DAYS (INTEREST IN ARREARS)
PRIOR TO WRITEOFFS

By Office (G/.)

	PAR	Portfolio	%
PAP	11,803,878	21,054,690	56.06%
CAY	73,484	2,673,845	2.75%
JAC	159,426	2,798,873	5.70%
CDB	397,253	1,698,096	23.39%
SMC	20,260	2,705,903	0.75%
CPH	360,909	4,061,688	8.89%
JER	1,718,629	5,122,314	33.55%
TOTAL	14,533,839	40,115,409	36.23%

PORTFOLIO AT RISK > 90 DAYS (PRINCIPAL IN ARREARS)
PRIOR TO WRITEOFFS

By Fund (G/.)

	PAR	Portfolio	%
PED	7,623,626	26,836,821	28.41%
AID 2	6,324,330	7,513,456	84.17%
PL480	511,212	511,212	100.00%
PPED	3,411,687	3,411,687	100.00%
IDB	1,842,233	1,842,233	100.00%
TOTAL	19,713,088	40,115,409	49.14%

PORTFOLIO AT RISK > 90 DAYS (INTEREST IN ARREARS)
PRIOR TO WRITEOFFS

By Fund (G/.)

	PAR	Portfolio	%
PED	4,501,492	26,836,821	16.77%
AID 2	4,389,750	7,513,456	58.43%
PL480	388,677	511,212	76.03%
PPED	3,411,687	3,411,687	100.00%
IDB	1,842,233	1,842,233	100.00%
TOTAL	14,533,839	40,115,409	36.23%

The portfolio at risk greater than 90 days using principal in arrears is 49.14% as shown by fund and branch below Using interest arrears only, the figure is 36.23%. It has been argued that only the PED fund has been used for the past few years, so that performance should be gaged primarily against that fund. Even using that argument, the portfolio-at-risk of 28.41% (alternatively 16.77%) is too high. In fact, since Sylvia Fletcher's consultancy (October, 1995) the portfolio-at-risk of the PED fund (interest arrears only) has increased from 8.1% In absolute terms, the portfolio grew by approximately G/. 6 million simultaneously the portfolio greater than 90 days past due increased more than G/ 4 million

It should be noted that the portfolio-at-risk figures include loans which should have been written off long ago. HDF attributes this to the donors which have treated the organization as a "project" not a financial intermediary, and thus have prevented them from writing off loans in a prudent manner In some cases, loans have had no payment activity for years (95 loans totaling G/ 1.7 million date back to 1991 or earlier)

> **RECOMMENDATION:** As of March, 1996 a total of 230 loans totaling G/ 3.9 million have had no payment activity in at least 1 year At a **minimum**, these loans should be written off In most other country contexts, it is recommended that all loans to the microenterprise sector more than six months past due be written off

The fact that a loan is written off doesn't imply that all reasonable measures be taken to collect a loan However, the cost-benefit of any collection efforts needs to be assessed Pragmatic, practical restructuring and/or collection efforts could also be effective (e.g. forgive all past due interest plus possibly even a percentage of the capital if they payoff now) Something is better than nothing money in the hand can be more productively invested in better performing clients

Adjusting for the minimum level of recommended writeoffs (G/ 3.9 million), the portfolio at risk decreases to 43.69%. If all of the loans under legal collections were to be written off (G/. 4.9 million), then the portfolio at risk would be 42 1% Clearly, these levels are too high also.

PORTFOLIO AT RISK > 90 DAYS (PRINCIPAL IN ARREARS)
AFTER WRITEOFFS OF LOANS (no payments > 1 year)

By Fund (G/.)

	PAR	Portfolio	%
PED	7,469,100	26,682,295	27.99%
AID 2	4,479,132	5,668,258	79.02%
PL480	413,233	413,233	100.00%
PPED	3,411,687	3,411,687	100.00%
IDB	58,316	58,316	100.00%
TOTAL	15,831,468	36,233,789	43.69%

PORTFOLIO AT RISK > 90 DAYS (PRINCIPAL IN ARREARS)
AFTER WRITEOFFS (loans under legal collection)

By Fund (G/.)

	PAR	Portfolio	%
PED	7,416,322	26,629,517	27.85%
AID 2	3,726,533	4,915,659	75.81%
PL480	273,499	273,499	100.00%
PPED	3,411,687	3,411,687	100.00%
IDB	6,597	6,597	100.00%
TOTAL	14,834,638	35,236,959	42.10%

The basic reasons for the high portfolio at risk are its image of the program and its methodology. Weaknesses in the system most likely have some effect, but to a lesser degree than the aforementioned.

o Image: Many of HDF's annexes do not really require their borrowers to make payments as agreed upon in their loan documents. They openly acknowledge that its acceptable practice to make partial payments of interest only. As a result, exceptions soon become the rule: only G/. 15 million (37.5%) pay more or less as agreed (principal less than 30 days past due). On time repayment is made by approximately 20% (principal)/25% (interest) of the portfolio.

o Methodology: The practice of accepting partial payments, to some extent, has its roots in the methodology. HDF offers a product which is clearly not suited to the target clientele Micro and small enterprises require continual access to short term working capital loans: HDF makes loans with an average loan term of 21.9 months. When a client requests a 3 month loan working capital loan, they have been reportedly told that HDF does make loans for less than 12 months. Thus, the situation has evolved that the client was only required to pay interest.

RECOMMENDATION: If HDF expects to eventually intermediate commercial sources of funds and wean itself off of donor funds, then the methodology will need to adjusted as discussed above.

Productivity of Other Assets: In the past, HDF has maintained excessive levels of liquidity and has not optimized the use of its resources In a highly inflationary environments, it has maintained excessive cash balances (approximately 20% of total assets) in essentially non-interest bearing accounts

RECOMMENDATION: As HDF moves to become independent of donors and intermediate commercial sources of funds, it must make serious efforts to improve its cash management and optimize the use of its resources This will require not only developing internal capacity, but also the removal of potential constraints from USAID (e g the treatment of interest income on deposit accounts, dollar denominated accounts, and so forth)

Infrastructure: HDF maintains a reasonably acceptable level of fixed assets in relation to its total assets (approximately 15%) and given the inflationary environment, the investment in a reasonable level of physical infrastructure is probably prudent.

Management

Management Capacity: The depth of HDF's management capacity is extremely limited. The executive director would appear to have some managerial capacity, but it appears that his credit experience is limited to his prior involvement in HDF's board of directors. His area of expertise is clearly in the information systems area -- an area which he is trying to develop at HDF. Despite his intentions, to date, his efforts have not resulted in a functioning system There are still many bugs to be worked out

Financial management expertise within HDF is virtually nonexistent. This is not the executive director's area of expertise and there presently is no accountant or financial manager. An accountant/financial manager who comes highly recommended by the external auditors is slated to come on board in June. This should improve the situation somewhat.

> **RECOMMENDATION:** Technical assistance in this area should be considered as the accountant/financial manager does not have prior experience in managing a credit program

Credit management capacity is thin and also requires strengthening at both the senior level and at the annex manager level. Most of the technical assistance efforts -- past and present -- have focused on this area.

Human Resources: As noted above, HDF has roughly a total of 45 employees: an executive director; a credit director; 8 annex managers/supervisors; 14 credit officers; and 21 administrative/general services staff. Personnel policies and manuals are reportedly in place, but were not reviewed by the consultant. While there is reported discontent with salary levels, particularly among the credit personnel, the organization has not experienced excessive turnover levels.

> **RECOMMENDATION:** Adjustments to salary levels in the near-to-medium term should only be within the incentive/productivity structure discussed above

Internal Control/Audits: Financial statements for the PED (USAID project only) have been audited as of September, 1994 September 1995 statements should be audited commencing in July 1996 HDF's general accounts have not been audited due to the multitude of weaknesses noted in the audit reports Internal control and audit procedures are also practically nonexistent

> **RECOMMENDATION:** If HDF is to make the transition to an intermediator of commercial funds, it must address its weaknesses in this area Fraudulent behavior, while not openly acknowledged, surely exists throughout the organization There are too many opportunities for it to occur and no attempt to detect or control it

MIS: HDF's executive director is making efforts to improve its systems as he recognizes that efficient, timely, and comprehensive information services are critical to HDF's ability to expand its operations to reach scale and self-sustainability. To be efficient, the system must meet four qualifications: simplicity, pertinence, opportunity, and accuracy.

- o Simplicity focusing on a few key performance indicators;
- o Pertinence generating information that is relevant to decision-making;
- o Opportunity providing the needed information when required; and
- o Accuracy generating high-quality data.

However, computerized systems should be used as tools to increase productivity. Systems must be built on solid and proven processing procedures -- an area of weakness within HDF. The information produced by the systems must be disaggregated by loan officers, branches, and product types to enable managers to rate units' productivity, portfolio quality, and goals.

Accounting and financial information for FY 1995 (September year end) was not available as of March, 1996. The August, 1995 information which was made available had extensive errors and inconsistencies.

RECOMMENDATION: HDF needs to generate in a timely and accurate manner the following accounting/financial reports:

- o Financial statements balance sheets and profit and loss (monthly comparisons with budget and with prior periods);
- o Budget execution report by business unit loan officer, branch, and consolidated (monthly);
- o Disbursement projections by branch (weekly);
- o Expenses, revenues, and cash flow reports by branch (monthly);
- o Cost and profitability information by product, business unit, customer or customer group, and loan officer (monthly/quarterly);
- o Projected performance to end of year (monthly/quarterly);
- o Self-sufficiency rates (monthly); and
- o Bad loans and write-offs.

The management information system must also focus on information that allows for effective management and assessment of the risk of the portfolio and for control of its delinquency, i.e. generate a portfolio performance report by loan officer, branch, and type of activity (daily list of payments due, daily list of payments overdue, and weekly client list). The performance report should include the following indicators:

- o Total active loans;
- o New loans;
- o Repeat loans;
- o Loan disbursement;
- o Loan recovery;

- o Outstanding portfolio;
- o Delinquency (amounts and rates by age);
- o Portfolio at risk (amounts and rates by age); and
- o Loan losses (amounts and rates).

Earnings

Accurately assessing the degree of the credit program's profitability was not possible as there are costs funded by AID which have not entered into their accounting system. This is true not only for fixed assets, but also for operational costs. For example, AID pays the operating costs of new branches for a year. In the audited statements of 1993-94 it was specifically noted that the costs for the Jeremie branch were not included This practice continued throughout most of FY 1995. Since the level of such operational costs could not be determined, they were obviously not included in the analysis As a result, the profitability in the analysis below is overstated.

Income and expenses from the audited statements are expressed as a percentage of the average portfolio. They have also been annualized (divided by 2) since the statements were for the two years combined and did not break out 1993 and 1994 figures separately. The figures have also been expressed both as percentages of the gross portfolio and the net portfolio since there is such a high non-performing portfolio Monetary corrections (inflation adjustments) were made to the fixed asset, equity and quasi-equity (IDB subsidized loan) accounts. (financial statements presented in Annex)

This analysis shows that HDF's credit operation in 1993-1994 yielded a negative net operating ratio before inflation — this in a period of high inflation (27.2% FY1994 and 55% FY1995). Thus, on an inflation adjusted basis, HDF's operations were extremely unprofitable/subsidized as the real interest rates were negative.

INCOME RATIOS	1993-1994 Net	1993-1994 Net (Annualized)	1995 Net	1995 Net (Annualized)
Yield on Portfolio	46.58%	23.29%	23.63%	25.78%
Less: Financing Cost Ratio	3.37%	1.69%	0.94%	1.03%
Financial Margin	43.20%	21.60%	22.69%	24.75%
Less. Operating Cost Ratio	111.37%	55.69%	37.05%	40.42%
Net Operating Margin	-68.17%	-34.09%	-14.36%	-15.67%
Less: Monetary Correction Ratio	118 14%	59.07%	0.00%	0.00%
Adjusted Net Operating Ratio	-186 31%	-93 15%	-14.36%	-15.67%

INCOME RATIOS	1993-1994 Gross	1993-1994 Gross (Annualized)	1995 Gross	1995 Gross (Annualized)
Yield on Portfolio	28 91%	14.46%	16.50%	18.00%
Less: Financing Cost Ratio	2.09%	1.05%	0.66%	0.72%
Financial Margin	26.82%	13.41%	15.84%	17.28%
Less Operating Cost Ratio	69.14%	34.57%	25.87%	28.23%
Net Operating Margin	-42 32%	-21.16%	-10.03%	-10.94%
Less Monetary Correction Ratio	73.34%	36.67%	0.00%	0.00%
Adjusted Net Operating Ratio	-115 66%	-57 83%	-10 03%	-10.94%

Assessing 1995's operations was even more challenging. HDF has had a series of problems with accounting systems — the result is that they have interim statements as of August 1995 (year end is September). The interim statements have many errors and require extensive cleanup. Interest accrual policies changed as well — all loans, regardless of how much they are past due, accrue interest. As a result, a cursory analysis was made using only interest received (cash). The expenses reflected on the statements provided to the consultant were not corrected. The same problem with the recording of operational costs as noted above also pertains here. The loss provisions/reserves as they have not yet been adjusted to reflect the portfolio quality as of August, 1995. This analysis will be repeated once their new accountant comes on board in June and has a chance to clean up the statements.

- o Yield: The interest yield on the *net* portfolio increased from 20.02% (cash basis) — 21.06% on an accrual basis as reflected in the audited statements — to 23.05% (cash basis) primarily due to the increase in the interest rate from 18-20% (1993-1994) to 22% in 1995. The yield on the *gross* portfolio is substantially lower given HDF's high delinquent/ non-performing portfolio. In short, there is a substantial margin between the effective interest rate charged and the effective interest earned (e.g. approximately 7% or 30-35%of the total charged). This ratio improved during FY1995 indicating slightly better portfolio performance. However, as noted above, the quality of the current portfolio in FY 1996 has deteriorated markedly. Commissions earned as a percentage of total portfolio remained fairly constant.

- o Financing Cost Ratio: This ratio is declining as HDF's debt financing (the IDB loan and its mortgage loan) shrinks in relation to its growing portfolio.

- o Operating Cost Ratio: The operating cost ratio (before loss provisions and other operating expenses) as a percent of the *net* portfolio has remained fairly constant on an annualized basis —30.12% and 30.07% respectively. Other operating expenses in 1993-1994 are those which were paid by USAID project and accounted for in HDF's accounting as "institutional support". These costs have not yet been captured in the 1995 statements, thus it is difficult to make an valid comparisons, e.g. assess if there has been much improvement in the operating cost ratio before loss provisions (40 36% vs. 30.07%).

  RECOMMENDATION: Successful microenterprise finance programs in a multitude of country contexts which make average loans of US$500 or less have achieved operating cost ratios (including loan loss provisions) as a percent of the performing portfolio of less than 25% HDF's challenge will be to bring its loan losses in line with international standards and to increase its operational efficiency so as to bring down its operating cost ratio before loss provisions to no more than 20%. If HDF were to lower its average loan from $1,500± to $500, an personnel/administrative cost ratio of 25% would be acceptable

Liquidity

Liquidity management is an important and decisive area in any financial institution, because there must be adequate management of assets and liabilities to effectively meet the needs of the institution, particularly its credit demand. The surest way to undermine a credit program is to suspend credit disbursements because of a liquidity crisis On the other hand, excess liquidity negatively affects profitability as well as outreach, given that the funds can be more productively used by investing them in a *performing* portfolio.

HDF has taken a very passive approach to managing its liquidity, as it has always had surplus and steady funding from USAID. As noted earlier, no attempts have been made to optimize the use of excess resources. Of course, the situation has since changed -- USAID has slowed its funding and there are no longer excess resources. Despite this, no formalized procedures are in place to prepare cash flow projections. Cash requirement forms submitted by the branches are in all practical respects a game. The head office is not in a position to fund loan requests approved by the branches--approved loans can take months to disburse given the current cash situation. No alternative sources of funding (e.g. overdraft accounts) have been negotiated with banks to improve cash management, nor has credibility in the banking system been established HDF's only loan from the formal financial sector is a mortgage loan.

> **RECOMMENDATION:** HDF must take serious steps to improving its liquidity management-- an element critical to the success of the MSE credit methodology. Cash management should be consolidated at the head office to the greatest extent possible (e.g. excess funds should be swept from the branches to a central high yielding investment account); bank accounts/relationships should be rationalized and/or streamlined; cash flow projections should be instituted, and overdraft and or bank lines of credit should be negotiated

HDF
INCOME STATEMENT
(Current G/.)

	92	% of Ave. Portfolio	93-94	% of Ave. Portfolio (Annualized)	95	% of Ave. Portfolio (Annualized)
Interest	2,122,316	19.80%	5,353,116	21.06%	4,120,082	23.05%
Commissions	380,400	3.55%	466,764	1.84%	346,533	1.94%
Investments	0	0.00%	0	0.00%	0	0.00%
Other	0	0.00%	100,476	0.40%	140,733	0.79%
Total Operating Income	2,502,716	23.34%	5,920,356	23.29%	4,607,348	25.78%
Financial Costs	30,304	0.28%	428,820	1.69%	183,616	1.03%
Financial Margin	2,472,412	23.06%	5,491,536	21.60%	4,423,732	24.75%
Personnel	1,441,278	13.44%	3,536,856	13.91%	2,837,733	15.88%
Administration	853,897	7.96%	3,187,017	12.54%	1,850,847	10.36%
Depreciation	157,364	1.47%	932,458	3.67%	685,493	3.84%
Other Operating Expenses	0	0.00%	2,604,691	10.25%	0	0.00%
Loss Provisions	2,119,016	19.77%	3,895,342	15.32%	1,849,860	10.35%
Total Operating Costs	4,571,555	42.64%	14,156,364	55.69%	7,223,933	40.42%
Net Income from Operations	(2,099,143)	-19.58%	(8,664,828)	-34.09%	(2,800,201)	-15.67%
Other Income (Donations)	1,988,274	18.55%	33,548,901	131.97%	2,600,618	14.55%
Other Expenses	0	0.00%	12,542,827	49.34%	0	0.00%
Net Income	(110,869)	-1.03%	12,341,246	48.55%	(199,583)	-1.12%
Monetary Corrections						
Average Equity * Inf.	2,678,213	24.98%	15,975,868	62.84%	0	0.00%
Average Subsidized Loans *(Inf.-1%)	462,276	4.31%	1,838,082	7.23%	0	0.00%
Fixed Assets * Inf.	(293,431)	-2.74%	(2,797,848)	-11.01%	0	0.00%
Total Montetary Corrections	2,847,058	26.56%	15,016,102	59.07%	0	0.00%
Adjusted Net Income from Operations	(4,946,201)	-46.14%	(23,680,930)	-93.15%	0	0.00%
Adjusted Net Income	(2,957,927)	-27.59%	(2,674,856)	-10.52%	0	0.00%

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HDF
BALANCE SHEET
(Current G/.)

	-------92-------		-------93-94-------		-------95-------	
Cash, Deposit Accounts	4,494,601	24.02%	6,732,987	21.06%	8,400,950	21.28%
Portfolio	15,934,576	85.17%	25,016,234	78.24%	33,493,630	84.83%
Loan Loss Reserve	(7,079,555)	-37.84%	(8,450,140)	-26.43%	(10,300,000)	-26.09%
Net Portfolio	8,855,021	47.33%	16,566,094	51.81%	23,193,630	58.75%
Interest Receivable	115,829	0.62%	334,583	1.05%	119,346	0.30%
Accounts Receivable	960,872	5.14%	3,387,195	10.59%	1,129,405	2.86%
Total Current Assets	14,426,323	77.11%	27,020,859	84.51%	32,843,331	83.19%
Fixed Assets	2,133,025	11.40%	4,673,794	14.62%	6,419,443	16.26%
Other Assets	2,150,008	11.49%	278,680	0.87%	218,645	0.55%
Total Assets	18,709,356	100.00%	31,973,333	100.00%	39,481,419	100.00%
Bank Loans	0	0.00%	0	0.00%	0	0.00%
Accounts Payable	233,866	1.25%	700,668	2.19%	444,386	1.13%
Accrued Expenses	0	0.00%	0	0.00%	240,562	0.61%
Total Current Liabilities	233,866	1.25%	700,668	2.19%	684,948	1.73%
Long-Term Debt-Subsidized	2,375,000	12.69%	2,208,333	6.91%	2,153,366	5.45%
Long-Term Debt-Commercial	998,454	5.34%	976,813	3.06%	976,813	2.47%
Unearned Income (Donor Advances)	1,812,600	9.69%	2,509,640	7.85%	125,695	0.32%
Total Long Term Liabilities	5,186,054	27.72%	5,694,786	17.81%	3,255,874	8.25%
Total Liabilities	5,419,920	28.97%	6,395,454	20.00%	3,940,822	9.98%
Total Equity	13,289,436	71.03%	25,577,879	80.00%	35,540,597	90.02%
Total Liabilities & Equity	18,709,356	100.00%	31,973,333	100.00%	39,481,419	100.00%

HDF INCOME STATEMENT	(Constant G/.)			(US$)		
	92	93-94	95	92	93-94	95
	1.66	0.84	1.00	10.18	15.10	15.24
Interest (A)	3,522,038	4,505,591	4,120,082	208,479	354,588	270,347
Commissions	631,284	392,864	346,533	37,367	30,918	22,738
Investments	0	0	0	0	0	0
Other	0	84,568	140,733	0	6,655	9,234
Total Operating Income	4,153,321	4,983,024	4,607,348	245,846	392,162	302,319
Financial Costs	50,290	360,928	183,616	2,977	28,405	12,048
Financial Margin	4,103,031	4,622,096	4,423,732	242,870	363,757	290,271
Personnel	2,391,838	2,976,888	2,837,733	141,579	234,280	186,203
Administration	1,417,064	2,682,437	1,850,847	83,880	211,107	121,447
Depreciation	261,150	784,828	685,493	15,458	61,766	44,980
Other Operating Expenses	0	2,192,307	0	0	172,534	0
Loss Provisions	3,516,561	3,278,617	1,849,860	208,155	258,026	121,382
Total Operating Costs	7,586,613	11,915,077	7,223,933	449,072	937,712	474,011
Net Income from Operations	(3,483,582)	(7,292,981)	(2,800,201)	(206,203)	(573,955)	(183,740)
Other Income (Donations)	3,299,592	28,237,317	2,600,618	195,312	2,222,267	170,644
Other Expenses	0	10,557,001	0	0	830,832	0
Net Income	(183,990)	10,387,335	(199,583)	(10,891)	817,480	(13,096)

HDF BALANCE SHEET	(Constant G/.)			(US$)		
	92	**93-94**	**95**	**92**	**93-94**	**95**
	1.66	0.84	1.00	10.18	15.10	15.24
Cash, Deposit Accounts	7,458,906	5,666,996	8,400,950	441,513	445,991	551,243
Portfolio	26,443,837	21,055,573	33,493,630	1,565,283	1,657,066	2,197,745
Loan Loss Reserve	(11,748,703)	(7,112,283)	(10,300,000)	(695,438)	(559,734)	(675,853)
Net Portfolio	14,695,134	13,943,290	23,193,630	869,845	1,097,332	1,521,892
Interest Receivable	192,221	281,611	119,346	11,378	22,163	7,831
Accounts Receivable	1,594,592	2,850,922	1,129,405	94,388	224,367	74,108
Total Current Assets	23,940,853	22,742,818	32,843,331	1,417,124	1,789,852	2,155,074
Fixed Assets	3,539,810	3,933,822	6,419,443	209,531	309,590	421,223
Other Assets	3,567,993	234,558	218,645	211,199	18,460	14,347
Total Assets	31,048,656	26,911,199	39,481,419	1,837,854	2,117,902	2,590,644
Bank Loans	0	0	0			0
Accounts Payable	388,107	589,736	444,386	22,973	46,412	29,159
Accrued Expenses	0	0	240,562			15,785
Total Current Liabilities	388,107	589,736	684,948	22,973	46,412	44,944
Long-Term Debt-Subsidized	3,941,373	1,858,702	2,153,366	233,301	146,279	141,297
Long-Term Debt-Commercial	1,656,960	822,160	976,813	98,080	64,704	64,095
Unearned Income (Donor Advances)	3,008,056	2,112,305	125,695	178,055	166,238	8,248
Total Long Term Liabilities	8,606,390	4,793,167	3,255,874	509,436	377,221	213,640
Total Liabilities	8,994,496	5,382,902	3,940,822	532,409	423,633	258,584
Total Equity	22,054,160	21,528,296	35,540,597	1,305,446	1,694,270	2,332,060
Total Liabilities & Equity	31,048,656	26,911,199	39,481,419	1,837,854	2,117,902	2,590,644