PD-AAU-980 98660

PRIVATE SECTOR EXPORT CREDIT, COFISA

515-0187 | USAID/COSTA RICA

4. EVALUATION REPORT ID (Enter the number maintained by the reporting unit e.g., Country or AID/W Administrative Code, Fiscal Year, Serial No. beginning with No. 1 each FY) 85-6

☐ REGULAR EVALUATION ☒ Final EVALUATION

5. KEY PROJECT IMPLEMENTATION DATES

A. First PRO-AG or Equivalent FY 82

B. Final Obligation Expected FY 83

C. Final Input Delivery FY 86

6. ESTIMATED PROJECT FUNDING

A. Total $ 25,000,000

B. U.S. $ 10,000,000

7. PERIOD COVERED BY EVALUATION

From (month/yr.) 9/1982

To (month/yr.) 7/1986

Date of Evaluation Review 10/27/86

8. ACTION DECISIONS APPROVED BY MISSION OR AID/W OFFICE DIRECTOR

A. List decisions and/or unresolved issues, cite those items needing further study. (NOTE: Mission decisions which anticipate AID/W or regional office action should specify type of document, e.g., cirgram, SPAR, PIO, which will present detailed request.)	B. NAME OF OFFICER RESPONSIBLE FOR ACTION	C. DATE ACTION TO BE COMPLETED
See Attachment for recommendations.		
1. CREDIT PROCESS		
a) Cofisa will submit to AID by March 31, 1987 a revised credit manual.	V. Schmack	3/31/87
b & c) New credit limits and delegation authorities will be established and submitted to AID.	V. Schmack	3/31/87
d, e, f, g) Cofisa will submit to AID a detailed written Portfolio monitoring and managing system which will include the recommendations made by evaluations.	V. Schmack	3/31/87
2. OPERATIONAL/ADMINISTRATIVE		
a) Cofisa has set up a profit center accounting system according to each income generating function. This system will be fully functional by the end of the 86/87 fiscal year.	V.Schmack	9/30/87
b) Already being implemented.	V.Schmack	
3. COFISA-AID STRATEGY		
See 1, (d, e, f, g)		
4. SPECIFIC RECOMMENDATIONS OF AID		
The only valid and acceptable recommendation for AID is to watch closely the 75%/25% requirement of long and short term loans, which will be monitored through the quarterly reports. The other recommendations under this heading are not valid, since the evaluator was not aware that reflows are not subject to AID procurement policies.	V. Schmack	Quarterly

9. INVENTORY OF DOCUMENTS TO BE REVISED PER ABOVE DECISIONS

☐ Project Paper ☐ Implementation Plan e.g., CPI Network ☐ Other (Specify)

☐ Financial Plan ☐ PIO/T

☐ Logical Framework ☐ PIO/C ☐ Other (Specify)

☐ Project Agreement ☐ PIO/P

10. ALTERNATIVE DECISIONS ON FUTURE OF PROJECT

A. ☒ Continue Project Without Change

B. ☐ Change Project Design and/or ☐ Change Implementation Plan

C. ☐ Discontinue Project

11. PROJECT OFFICER AND HOST COUNTRY OR OTHER RANKING PARTICIPANTS AS APPROPRIATE (Names and Titles)

Richard Rosenberg, Chief of Office of the Private Sector

Vinzenz Schmack, Project Manager

12. Mission/AID/W Office Director Approval

Signature

Typed Name: Daniel Chaij

Date

AID 1330-15 (3-78)

RECOMMENDATIONS FROM COFISA EVALUATION

(By Fernando and Alvaro Quirós, July 1986)

1. CREDIT PROCESS

a) On the credit process side, greater future effort should be allocated to institutionalization of the process gained so far by development of more standardized credit policies and procedures. A credit policy manual should be devised by management and approved by the board to provide guidance and written policies.

b) A sincere and realistic evaluation of institutional and Board of Director's attitudes towards delegation of loan approval is in order, as the delegation so far has been more theoretical than real.

c) Should COFISA opt for further credit delegation, levels for this should be analysed with respect to portfolio statistics volume of credit approvals, and senior management lending experience.

d) Greater institutional resources should now be allocated to administration of the credit portfolio, especially now that AID dollar lending is close to topping out. Maintenance of asset quality will be of vital importance to COFISA's future earning profiles, and close management of the portfolio will help achieve this goal.

e) These monitoring efforts, as well as credit policies and procedures, should be applied equally to the colon portfolio since at the present time there is very little information in the files on which to base an anticipatory posture with regard to future performance of the portfolio.

f) Renewal of the credit initiation phase with each credit, as new data is gathered to verify progress and determine continued credit worthiness (especially on the more commercially oriented part of the portfolio), should be done as standard policy.

g) The more defined responsibility over credits could be implemented by the designation of account officers, with an account load of about 20 to 25 accounts each (including accounts in the colon portfolio.)

2. OPERATIONAL/ADMINISTRATIVE

a) A budgeting process should be integrated into the new accounting system, establishing target loan and transaction volumes, and separating allocated and direct expenses, profit center earnings, returns on allocated equity, returns on assets, etc. to measure performance of each unit and each unit manager. Budget should then be reviewed quarterly for compliance, implementing new forecast procedures for adjustments to year and totals as necessary.

b) COFISA should show more initiative than it has up to now in taking charge of foreign exchange registration at the Central Bank and processing of its loans.

3. STRATEGIC RECOMMENDATIONS FOR AID AND COFISA

COFISA's future growth, while accomodating both institutions' objectives, should be tempered by the following observations:

a) COFISA should close to the client

COFISA credit staffers should become involved as actively as possible in the day to day activities of borrowing clients, with visits and quarterly follow ups on financial and operational performance (in some cases this is already being done to some degree.)

b) COFISA will have some portfolio problems on the AID loans

The strategy to deal with this situation should be threefold: (1) get as close to the clients as possible, (2) as a fail-safe measure, install a strong administrative system that places a premium on problem anticipation, and (3) growth and diversity.

c) COFISA has two fundamental options for future growth

COFISA should not neglect either project lending or short-term commercial business.

4. SPECIFIC RECOMMENDATIONS FOR AID

With respect to the loan agreement and future compliance, AID should consider the following:

- The reflow pool concept should be defined with COFISA. As the situation stands, AID funds may be free of AID restrictions after lending short term. This may or may not be acceptable to AID.

Priorities as to the relative importance of adherence to development orientation in loans verses procurement restrictions also need definition.

The 75%/25% requirement for tenures of 3 to 5 years should be watched closely since the portfolio has been reflecting the maximum short terms lending limit under the contract.

AID's requirements of receipts and documentation for new investment funds spent occupied a significant portion of credit personnel effort. In the future, as COFISA begins to handle a mix of AID funds, reflows from loan recoveries, and funds captured from the deposit market, such documenting of funds investment by clients could grow very complicated. Perhaps as COFISA matures, these investment documentation requirements can be substituted by simple monitoring of loans as to maintaining development orientation and conditions.

sa

PROJECT EVALUATION SUMMARY 86-6

PART II

The overall quality of the evaluation report was very good and the contractor showed that he knows and understands banking policies and procedures in general and local banking laws and regulations in particular. The contractor followed the scope of the work and the evaluation was useful for the Mission since it confirmed the Mission's belief that COFISA is becoming an effective development oriented financial institution.

The project has been successful and the contractors' recommendations were very general and were not for corrective actions, but rather suggestions for further operational and organizational improvements. Some suggestions were not accepted due to the contractor's lack of understanding of A.I.D. procurement procedures.

The Excecutive Summary was complete and summarized the findings and recommendations adequately.

The major "Lessons Learned" to be learned from the COFISA evaluation is that it is important to work with an entity like COFISA which has had a long and good track record as a successful financial institution. It has had a qualified staff at all levels and the manager has fully understood the objectives to be achieved. The other intermediate financial institutions in Costa Rica which received A.I.D. support (The Bank for Export and the Private Investment Corporation) started from scratch and first of all had to grow as financial organizations before being able to pursue their specific objectives.

The COFISA Project proves that a qualified, experienced staff at all levels is a prerequisite for a successful project and in future projects A.I.D. should reserve the right to approve not only the manager, but also the middle and lower level executives.

It is also important to keep in mind that an intermediate financial institution project does not end with the PACD, but rather needs constant supervision, especially after the PACD, to assure that the project sticks to the established objectives and uses loan reflows and net interest earnings for the same purpose as originally intended.

(Attachment to PES# 86-5)

EVALUATION COST DATA

USAID/ Costa Rica or Bureau/Officer _____

Form completed by Vincenz Schmack (Typed Name) | OPS (Office) | 10-27-86 (Date)

1. No. and Title of Project/Activity: Private Sector Export Credit Project
   (or Title of Evaluation Report) COFISA project # 515-0187

2. Date of Evaluation Report: August 1986
   Date of PES (if different): 10-27-86

3. Mission Staff Person Days involved in this Evaluation (estimated):
   - Professional Staff 3 Person Days
   - Support Staff n/a Person Days

4. AID/W Direct-Hire or IPA TDY support funded by Mission (or office) for this evaluation: N/A

Name	Period of TDY (Person-Days)	Dollar Cost: (Travel, Per Diem, etc)	Source of Funds*

5. Contractor Support, if any, for this evaluation:**

Name of Contractor	Contract #	Dollar Amount of Contract	Source of Funds*
Alvaro Quirós	Purchase order # 515-6362	Aprox the equivalent of $4,500 in L.C.	Local currency (From ESF)

*Indicate Project Budget, PD&S, Mission O.E. or Central/Regional Bureau funds

**IQC, RSSA, PASA, PSC, Purchase Order, Institutional Contract, Cooperative Agreement, etc.

AGENCIA PARA EL DESARROLLO INTERNACIONAL
MISION ECONOMICA DE LOS ESTADOS UNIDOS EN COSTA RICA

Apartado Postal 10053
1000 San José, Costa Rica
Teléfono 33-11-55
Telex 3550 AIDCR KB

STATEMENT OF WORK

A. BACKGROUND

The COFISA project consists of a $10,000,000 loan and a C223,500,000 local currency facility to develop and manage a carefully designed program of dollar and colon sublending to the private sector. The goal and purpose of the project is to assist with the resolution of the productive private sector liquidity crisis, to enhance the capacity of the productive private sector to earn foreign exchange and to reestablish COFISA as a development oriented financial institution.

B. OBJECTIVE

In order to assist the Mission to assess the overall performance of the Private Sector Export Credit Project (Known as the COFISA project), the Contractor will produce a comprehensive evaluation which will thoroughly analyze and assess each aspect of the Project's implementation. The evaluation will carefully consider borrower's performance, implementation context (i.e. changing external factors, such as overall economic conditions), appropriateness of Project design, achievement of targets, and contribution to the Mission's Development Strategy.

C. METHODOLOGY

The Contractor will become familiar with the details of the project's goal, objectives, components and relationship to the Mission's private sector strategy by reviewing background documents located in the files of the A.I.D. Mission in San Jose. These documents include: the Project Paper, the Loan Agreement, Implementation Letters, any related correspondence, and USAID planning documents. In addition, the consultants will interview the A.I.D. project managers, COFISA officials, local businessmen, and Costa Rican government officials as necessary.

D. SCOPE OF WORK

1. Determination of the extent to which the Borrower has complied with the terms of the Project Loan Agreement and thoroughly describe any problems associated with compliance, making reference to the reasons for the delays in project implementation;

2. Determination of the extent to which the Project has made progress towards achievement of its specifically stated objectives as defined in the Project Paper and Loan Agreement;

3. Determination of the extent to which the Project has "developmental" impact as expected and expressed in the Project Paper, paying special attention to specific risk taking performance;

4. Determination of the extent to which the Project contributed to the Mission's overall development strategy;

5. A separate section on the lessons learned to date describing the causal relationship factors that have proved critical to Project success, including the political, policy, economic, social and bureaucreatic preconditions within the host country and AID. This should also include a discussion on the techniques or approaches which have proved most effective or bad to the changed and why;

6. Overall, general, and specific observations and recommendations regarding implementation, management design, and any other factors which the Contractor deems relevant. It is expected that specific recommendations will be made regarding project results and will include, but not be limited to:

   - The elimination of contraints to the successful implementation of similar projects;

   - actions which may be taken by the Mission and/or the Borrower that will contribute to more efficient Project management; and

   - improvements in the Mission's management approach.

The contractor will investigate the following areas for each of the project components.

1. Portfolio Characteristics:

   a. Analyze and interpret the characteristics of the COFISA loan and investment portfolio. The available data include: total number and dollar volume of subloans by economic activity, purposes and time terms of the subloans, and characteristics of subborrowers (annual sales, total assets, number of employees). Data analyzed as available should also include specific development impacts of subloans on expansion of nontraditional markets, and utilization of installed plant capacity;

b. Estimate the local value added of exports resulting from A.I.D. subloan financing by economic activity, net inflows of foreign exchange, and total employment and wages generated;

c. Review COFISA written subleending eligibility criteria and credit norms (including collateral requirements and specially the level of risk the institution is prepared, or willing, to take) and compare these with portfolio statistics. Interviews should be conducted with at least 10 subborrowers to assess COFISA adherence to credit norms and eligibility criteria, as well as to determine the expendiency, quality, and cost of the COFISA services;

d. Review at least 5 loan requests which were rejected by COFISA to determine if rejection was justified and interview clients and obtain additional information from other sources, if necessary;

e. Analyze and report on the characteristics of subloan delinquency arranged by economic activity and by time terms;

f. Interview credit department officials and assess the effectiveness of the promotion, analysis, approval process, closing, supervision, and collection of subloans;

g. Determine the average time required in the processing of a loan request, from the initial request to loan approval, and analyze if the average time is a reasonable time;

h. Determine if COFISA is able and prepared to assist clients to overcome difficult financial situations and structure the loans to specific financial needs; and

i. Discuss with clients what would have happened to project of financing through COFISA would not have been available.

2. <u>Organizational Development</u>:

a. Review changes in COFISA organizational structures since project implementation. Analyze the current structures including the roles and responsibilities of the Board of Directors, General Managers, Submanagers, and Department Heads;

b. Determine if the organizational structure enhances the banking services or if it is a constraint to it;

c. Analyze the financial statements and available internal financial reports of COFISH and comment on the financial status of the organization (e.g. profitability, contribution to earnings by profit center, structure of major cost items);

d. Determine the degree of COFISH's success in securing confinancing from sources other than A.I.D. and in effecting a recovery of investor/financier confidence in Costa Rica.

e. Determine what project benefits are likely to be sustained after AID funding ends.

f. Answer the questions: what local institutional capacities (management, technical staff financial) are being developed to continue project benefits? Will they be in place once AID financing ends? What policy conditions are required to facilitate continued long-term impact?

E. REQUIRED REPORTS

The Contractor will present 5 copies in English of a written report which covers all of the above points not later than May 23, 1986.

The report shall include:

1. An executive summary which will be a self-contained document and which will include the specific methodology used, findings, conclusions and recommendations. It will also include the sections on development impact and lessons learned.

2. A copy of the scope of work under which the evaluation was carried out. Any deviation from the scope shall be explained.

3. A listing of the evaluation team including host country personnel, their field of expertise and role they payed on the team.

4. A clear presentation of the evaluation recommendations in a separate section.

4. A paginated table of contents.

F. STAFF

The technical assistance is scheduled to begin on April 21, 1986 and the target date for the delivery of the final report is May 23, 1986. At least a two-person team of experts will be needed. The background expertise of the team members should include (but not limited to) the following:

1. Ability to conduct financial analysis of banking and trading institutions;

2. thorough and practical knowledge of financial institutions, including the management of credit and international banking services departments;

3. practical experience with the management of commercial foreign trade institutions;

4. knowledge of commercial channels and practices in the U.S., and other target areas for Costa Rican products; and

In addition, experience with previous evaluations of A.I.D. and/or other international donor development projects will be considered a plus.

XD-AAU-980-A
48661
86-6

COFISA - AID PROJECT LOAN AGREEMENT REVIEW

PURSUANT TO PROJECT NUMBER 515-0187

Alvaro Quiros

Fernando Quiros

San Jose, Costa Rica

25 June 1986

TABLE OF CONTENTS

		Page
I.	Executive Summary	1
II.	Introduction	8
	A. Background	8
	1. History	8
	2. Purpose of This Report	9
	B. Methodology	10
III.	Findings	12
	A. Cofisa Specific Findings	12
	1. Credit Policy Adherence	12
	2. Portfolio Characteristics	15
	3. Credit Process and Norms	17
	4. Cofisa Structural Changes	22
	5. Organization and Operations	2[illegible]
	6. Cofisa Financial Status	37
	B. Developmental Impact of the Cofisa Project	39
	C. Cofisa Operational Situation & Banking Alternative	44
IV.	Conclusions	5[illegible]
	A. Progress Towards General Objectives	5[illegible]
	B. Compliance with the Loan Agreement	51
	C. Contribution to the Mission Development Strategy	52
	D. Cofisa Operational Outlook and Banking Perspectives	53
V.	Recommendations	54
	A. For Cofisa - Administrative	54
	B. For AID - Strategic	59
	C. For AID - Specific	62
	D. Lessons Learned	63
VI.	Annexes	

I. EXECUTIVE SUMMARY

PURPOSE

The purpose of this report is to evaluate the extent of Cofisa's compliance with the terms of a loan agreement signed between it and AID on September 30, 1982 pursuant to AID project number 515-0187. The study has focused on measuring the extent to which the project has made progress towards achievement of the stated objectives, determination of the developmental impact of the project, and making other pertinent observations, in accordance with the scope of work for the review.

METHODOLOGY USED

The original project paper, the loan agreement, amendments to it, and implementation letters were reviewed and studied as the basis for the project. Cofisa compliance was judged in relation to stipulated requirements for eligibility criteria, observance of lending guidelines, and adaptation of mandated structural adjustments.

Credit portfolios and files were analyzed to measure compliance and to form opinions on the adequacy of Cofisa's credit process, organizational structure, and management systems. Financial statements, management information reports, and administrative listings were also examined.

Interviews and informal discussions were held with all key Cofisa

managers as well as two members of the board of directors. Discussions with eleven clients were also held, as well as one firm whose credit was not approved. Additionally, informal conversations with local and international bankers knowledgeable with Cofisa were sustained.

A review of the dollar portfolio at April 1986 was made to gauge the developmental impact of the Cofisa lending program. A spread sheet analysis has been prepared with the results of this review. A financial analysis and projection of the Cofisa balance sheet and income statement figures, focusing also on profit center analysis, was also performed.

FINDINGS

Certain findings have emerged, grouped as follows:

A. Cofisa Specific Findings

1. Credit Policy Adherence
2. Portfolio Characteristics
3. Credit Process and Norms
4. Cofisa Structural Changes
5. Organization and Operations
6. Cofisa Financial Status

B. Developmental Impact of the Cofisa Project

C. Cofisa Operational Situation & the Banking Alternative

Specific Findings

The loan agreement establishes eligibility criteria and certain lending limits and policies for lending components. Dollar

financing is primarily directed to non-traditional exporters, and Cofisa compliance in this area appears to be essentially correct. Other limitations include a sublimit of a maximum 35% lending to traditional exporters, a minimum 75% of the portfolio with a tenor between 3 and 5 years, maximum grace period of 2 years, maximim loan amount of US$ 500,000, and a mandate for lending at commercial rates. All of the above are being complied with, although the tenor limitation could be questioned on grounds of imprecisely structured loans, in a few cases, made to fit the tenor.

The dollar portfolio presents distribution characteristics consistent with the intent of the loan agreement, with 91.5% of credit approvals at April 1986 directed at non-traditional (vs. traditional) exporters. Of 27 dollar relationships reviewed, 8 could be classified as start ups, 4 turnarounds, 9 established firms, and 5 small business; but of the established firms, 2 of the financings were destined for new projects and only 1 were for strictly commercial financing. Of the totals, 75% of activity were for developmental (vs. commercial) financing. In the dollar portfolio, very few of the payments have yet fallen due because the loans are new and still on grace periods, and as a result there are as yet no real delinquency statistics.

In terms of the credit process, significant advancements were evident from the colon portfolio to the newer dollar portfolio, coinciding with the arrival of the new general manager. The advancements were in the nature of improved project and credit

analysis, and documentation of this process, with well focused quantitative and qualitative input. In general the efforts evident in bettering this credit initiation phase were good, although as with any relatively new unit that to some extent has been defining the process as they go, there is some room to improve some perceived process gaps. Very importantly, collateral policies were found to be fairly liberal, hence contributing to real development lending where loan structuring can be made in a flexible manner.

The emphasis so far in the relatively short period of time since the new credit regime has been in place has been in placing loans, i.e. the credit initiation phase. But more needs to be done in the area of credit administration to manage the portfolio in a manner that will provide control and an anticipatory posture which will allow early problem recognition. In general, Cofisa's clients were happy with the service and expressed satisfaction with the turnaround time on loan applications and with the relationship in general.

Cofisa mandated <u>structural changes</u> have involved the placing of preferred stock, obtention of a banking charter, establishment of a risk minimization fund and bad debt reserves, adjustment of accounting procedures, establishment of profit center reporting, establishment of a credit committee, modification of credit analysis tecniques, and staff development. Some of these have been accomplished, others are in process, and others are

difficult to measure whether compliance has been achieved because of lack of specifics.

One area requiring greater clarification is the bad debt reserve, where Cofisa has continued to book a contingency reserve as a segragation of retained earnings. However normal banking procedure is to reverse reserves against earnings and take the equivalent amount of loans off balance sheet.

Significant changes have been made in organization and operations on the credit side, but much remains to be done in terms of planning processes and bank operations to permit greater viability for Cofisa as a commercial bank once it receives its charter. The situation is aggravated by a general lack of commercial banking experience at senior levels of the Cofisa organization.

The Cofisa 3-31-82 financial situation depicts a remarkable turnaround from one year ago as debt negotiations with external commercial banks succeeded in preserving significant equity for the company. At this point, with a liabilities/capital ratio of about 1.55, Cofisa is underleveraged by a huge margin. Financially speaking, Cofisa's major challenge at this point is to obtain additional debt to leverage up their balance sheet, thereby permitting more normal financial institution patterns for returns on assets and equity.

Developmental Impact

The development impact spread sheet (attached to the pertinent section in the report) attempts to measure the effects within the Costa Rican economy of the Cofisa project by measuring net inflows, wages generated and people supported, as well as key credit and portfolio information. The numbers indicate a rough direct impact of about ₡ 2.4 billion once all of the projects are at full steam, generating about ₡ 1.1 billion in direct project wages, and supporting about 18000 people. These figures do not include a multiplier effect.

Cofisa Operations and Banking Alternatives

There is a strong complementarity of the short term commercial banking function with Cofisa's present development orientation. The short term function helps balance the portfolio, not only in terms of tenor, but in terms of risk as well because the commercial component is normally associated with reduced risk. This option will also help achieve greater income diversification as well as permit offering of a more comprehensive banking services package to clients.

CONCLUSIONS

The primary objectives of the Cofisa loan project are to provide assistance to the productive private sector in Costa Rica, to enhance foreign exchange generation capacity of the sector, and to re-establish Cofisa financially. It appears that these objectives have been achieved, as measured in the economic impact study and as documented in the Findings section of this report.

Additionally, it appears that there has been essential compliance by Cofisa with the terms of the contract as higher risk development oriented loans have been booked, although there are some gray areas that have been identified. This essential compliance, almost by definition, has contributed to the AID Mission's overall development strategy of promoting the private sector and non-traditional exports.

RECOMMENDATIONS

In terms of Cofisa's posture to grow and develop as a Costa Rican private bank, the potential is considerable but significant adjustments still remain to be implemented to make future success even more likely. These adjustments are both administrative and strategic in nature, and pertain to credit process and organizational changes and enhancements, and to some operational adjustments to permit more flexibility with commercial banking operational needs.

II. INTRODUCTION

A. BACKGROUND

1. History

In September of 1982, AID approved a project paper for a private sector export credit program to channel funds to Costa Rica for re-establishment of dynamic growth of the economy. This project was in response to the Costa Rican debt and liquidity crisis, and to the effect of this crisis on Cofisa, an existing but financially troubled private sector finance company with which AID had in earlier years dealt successfully.

Cofisa's troubles were the result of external pressures in which their borrowers were hit hard by economic developments in Costa Rica, and where the country's Supreme Court ruled that obligations incurred in Costa Rica denominated in foreign currency could be payed at the official rate of exchange as determined by the legislature, which rate was then 20.0 CRC vs. the Central Bank and market rate upwards of 50.00 US$. This legal decision had the effect of totally undermining Cofisa's extensive dollar portfolio in the country.

The funds for this project were channelled through Cofisa to assist its borrowers and thereby help resolve the productive private sector liquidity crisis in the country. Onlending through Cofisa also would serve to enhance the capacity of this sector to earn foreign exchange by focusing on development oriented projects. A third purpose of the project was to re-establish

Cofisa as a development oriented financial institution, and to preserve its strong track record. The project came to be known as the Cofisa Project.

In the same month in which the project was approved, a loan agreement between AID and Cofisa was signed. The loan agreement was for US$ 10 million payable in 20 years, and an additional colon equivalent of US$ 5 million in AID funds was made available through CINDE and a special trust fund established with BANEX, a private sector Costa Rican bank. Several conditions precedent to disbursement were established, including a condition for increasing Cofisa capital by US$ 800,000, and a "flip flop" of ownership structure whereby Cofisa International, the Panama legal vehicle, would become the holding company for the Costa Rican legal vehicles.

Subsequent amendments to the loan agreement extended the Project Assistance Completion Date by fifteen months to 12-31-86, primarily to permit finalization of Cofisa debt renegotiations with foreign commercial banks. The amendments, among other things, called for an abandonment of the legal ownership "flip flop" requirement, a redefinition of some sublending guidelines, and a requirement that Cofisa request a banking license from the Costa Rican Central Bank.

2. Purpose of This Report

This review has been prepared pursuant to the loan agreement. The purpose of this review is to evaluate the extent of Cofisa's

compliance with the terms of the loan agreement, to measure the extent to which the project has made progress towards achievement of the stated objectives, to determine the developmental impact of the project, and to make other pertinent observations.

B. METHODOLOGY

Compliance on the part of Cofisa involves conformance to eligibility criteria for defining borrowers, observance of lending guidelines and constraints, and adaptation of agreed upon administrative, accounting, and structural adjustments. These terms are contained in the loan agreement, amendments, and implementation letters.

In order to measure this compliance and to form an opinion on the adequacy of Cofisa's credit process, organizational structure, and management systems, the credit portfolios and files were analyzed, focusing primarily on the dollar portfolio. Financial statements, management information systems, and administrative listings were also examined. Interviews and informal discussions were held with all key Cofisa managers as well as two members of the board of directors.

Discussions with outside people were also held. Eleven clients were contacted, as well as one firm whose credit was not approved. There was no list of companies in this latter category and hence it was not possible to speak with five as requested in the scope of work. Additionally, informal conversations with

local and international bankers knowledgeable with Cofisa were sustained.

A review of the dollar portfolio at April 1986 was made as mentioned above, and to gauge the developmental impact of the Cofisa lending program. A spread sheet analysis has been prepared with the results of this review, and reference will be made at greater length to the spread sheet in the sections that discuss the develoomental impact and credit norms.

A financial analysis of the Cofisa balance sheet and income statement figures was done, focusing on present numbers as a base from which to project 9-30-86 and full year results. An analysis by profit center is also presented, but the figures are estimates only, since the management information system from which the numbers were sourced are quite new and not yet developed.

III. FINDINGS

A. COFISA SPECIFIC FINDINGS

1. Credit Policy Adherence

The loan agreement and its modifications contemplate certain eligibility criteria, whereby the dollar component of the financing package will be directed to exporters and the local currency component primarily to firms serving the domestic market. Additionally, reflows from payback of loans are to be used essentially for the same respective purposes, or as otherwise agreed by AID.

In analyzing the AID portfolio, compliance in this area seems to be essentially correct. With a couple of exceptions that may be questioned the dollar portfolio is definitely export oriented, and heavily weighted to non-traditional exports as required. The exceptions involve a tourist related enterprise and a textile producer.

The propriety of the tourism loan, which is one of the smallest relationships, raises a question because the loan agreement focuses on producers and manufacturers, and is silent on tourist related enterprises. But since this firm is directed at tourism and generates dollar revenues, it conceptually fits into the exporter category although it is not technically a producer. Because of this, the appropriateness of the loan fits well within the spirit of the loan agreement.

Another dollar loan was made for the purpose of rebuilding a textile plant that was destroyed by a fire. Originally the loan was structured in dollars under the assumption that significant exports would be made as per a negotiated agreement with a U.S. retailer of specialty outdoor clothing products. However, as a result of the fire, the U.S. retailer arranged for purchase of raw materials eslewhere, leaving the Costa Rican borrower with a dollar loan unhedged by dollar exports. The local producer is attempting to arrange alternative exports, but at the present time nothing has been firmed up.

Also in terms of eligibility, Cofisa credit management has taken administrative steps to confirm client conformance to origin of equipment financed as detailed in the loan agreement, although one apparent discrepancy was found. This involves the same tourism loan as above, to Costa Rica Expeditions, which was made for the purpose of financing the purchase of [illegible] small buses in Panama to be used within the company's tourist services operations. However, the buses are Japanese in origin (Toyota), which poses a possible procurement violation since Japan is specifically excluded from the AID Geographic Code 941 list.

Cofisa management has justified this discrepancy on the basis that the loan was made with the proceeds of reflows from other dollar obligations that have been paid. However, the "reflow pool" concept is not sufficiently clear, and apparently not defined in the loan agreement. If it is considered that the portfolio is essentially longer term in nature, reflows would

result from repayment of this portfolio. But very little in long term debt has yet been repaid. It seems to be stretching the spirit of the loan agreement for Cofisa to lend short term with AID medium term project funds, and then relend these funds without restrictions as they are recuperated, thus "laundering" the original limitations out of them.

The loan agreement as modified establishes the following lending limits and policies:

1. the maximum financing available for traditional exporters is 35% of the dollar portfolio
2. at least 75% of the portfolio must be for a tenor between 3 and 5 years
3. grace periods cannot be longer than 2 years
4. the maximum loan amount is US$ 500,000
5. lending must be at commercial rates

In the dollar portfolio reviewed as of April 1986, only 9.1% of total approvals, and 2.8% of outstandings could be classified as to traditional exporters, well within the established 35% limits. At the same date, 25.6% of approvals but only 21.1% of outstandings were for a tenor of less than three years so that this 25%/75% constraint was very near the limit.

Some of the term loans to industrial enterprises were for purposes of "working capital," i.e. to finance current assets. Loans for these purposes are generally paid within the operating

cycle of the company, normally one year, but exceptions may be made in periods of exceptional growth to permit a more orderly conversion of current assets to sales revenues. This may be conceptually valid if the projected cash flow requires a greater tenor but the vulnerability of the argument is that perhaps loans that should be made for a shorter time frame could be made for three years or more simply to comply with the 25%/75% constraint.

As of the date of the portfolio review, no grace period was greater than 2 years, with the norm being 12 months for the term debt. None of the dollar loan approvals exceeded the $500,000 limit, although one of the implementation letters approved a waiver to allow approval of credit operations up to equivalent US$ 550,000 to one client. None of the colon outstandings ever approached this AID imposed limit, which is also very near in size to the Cofise Costa Rica legal lending limit of 20% of equity. As of 3-31-85, this limit was about ₡ 20.4 million, or US$ 450,000 at an exchange rate of ₡38/US$. All lending appeared to be at commercial rates, i.e. LIBOR + 3% p.a., plus commissions of 1% to 2%, for dollar loans.

2. Portfolio Characteristics

As of the date of the review, the dollar portfolio presented the distribution characteristics as depicted on the next page:

activity	approvals	% total	projected $ exports
flower/plants growers	$ 1286 M	19.4	$ 4.1 MM
spices/vegetables growers	301 M	4.6	0.4 MM
coffee/cacao producers	900 M	13.6	14.8 MM
fishing and extractive	135 M	2.0	0.6 MM
industry/construction	1150 M	17.4	2.3 MM
industry/processing	1950 M	29.5	14.6 MM
textiles/apparel	845 M	12.8	2.1 MM
tourism	52 M	0.8	0.3 MM
	$ 6619 M	100.0	$ 39.2 MM
traditional exporters	$ 500 M	7.5	$ 10.3 MM
non-traditional exporters	6119 M	92.5	28.9 MM
	$ 6619 M	100.0	$ 39.2 MM
start up (9)	$ 2136 M	32.3	
turnaround (4)	1200 M	18.1	
established firm (9)	2930 M	44.3	
small business (5)	353 M	5.3	
	$ 6619 M	100.0	
commercial financing	$ 1650 M	24.9	
developmental financing	5069 M	75.1	
	$ 6619 M	100.0	

The coffee activity above is traditional exporting and presents an exception under the 35% sublimit established in the loan agreement. Other than this category, all of the other activities are clearly non-traditional in terms of exports and in general present a fairly well diversified portfolio, without undue concentration in any particular economic sector. This is especially so because the largest category above, industry/processing with 29.5% of the portfolio is itself diversified with producers of candy, alcohol, cosmetics, recreational furniture, and polyethylene plastics.

Within the business classifications the numbers in parentheses indicate the number of firms. Of the nine established firms within the portfolio, the financing for two of these was destined for new projects, and only four of these firms were recipients of strictly commercial short term lending.

Because the great majority of this lending is term financing, generally with some grace period, and because most of the loan takedowns are recent (within the past 12 months), there have been few payments yet falling due. For this reason, there are as yet no delinquency statistics.

3. Credit Process and Norms

In reviewing the Cofisa credits, 100% of the files for the dollar portfolio were examined. A selective review of the local currency credits was also performed, sampling 11 relationships of approximately 80, representing 38% of colon outstandings at that time. The following comments as to the credit process were sourced mainly from this review.

There has been a major change in the credit process at Cofisa since arrival of the new general manager. This is evident in documenting of the analytical process seen in the two portfolios. The dollar portfolio is well documented in terms of analysis and feasibility while the colon portfolio is, in general, poorly documented. The colon portfolio was largely compiled before the

change in management.

In terms of <u>credit initiation</u> the dollar portfolio evidenced a more than acceptable qualitative process as undertaken by the project analysis unit. The staff seems to have a good grasp of its target market definition, and has exerted considerable efforts in their analysis, focusing on demand, marketing, price, and other factors affecting the feasibility of the particular project. Analysts have also focused on the sensitivity of the numbers, using microcomputers for purpose of numbers and "what if" analysis. There was also evidence of trying to understand the critical factors of the client's business and the risks of the credit.

However, as with any relatively new unit, to some extent defining the process as they go, there are several process gaps that could be filled. These are listed because they can become more important in the ongoing loan administration phase as portfolios develop and the loan portfolio matures. Following are areas that could be strengthened.

- There could be greater focus in analyzing more deeply the purpose of each credit. In cases of generalized funds needs, so called "working capital" credits, there was insufficient analysis into what assets were being financed, for what purpose, and what would be the source of repayment. This can lead to confusion and improper structuring. It can also lead to granting a longer tenor than is necessary in order to

"fit" the loan within target parameters for a maximum 25% of the portfolio with a tenor less than 3 years.

- In some cases where the borrower is an established firm with a financial history, the numbers analysis has tended to be too balance sheet oriented with insufficient historical cash flow analysis from which to anticipate future events. However, on all term facilities projections were encountered, utilizing microcomputers to facilitate the process and permit sensitivity variations.

- In some credits, the analysis has tended to be too long, not getting to the main point or focusing enough on direct risk analysis. A more direct risk analysis would be helpful to the credit committee and board to facilitate grappling with the respective major issues of each credit.

- One area where very little analysis was detected was in attempting to measure the administrative and financial management capacity of the principals. This is a difficult task for any analyst or credit officer to perform, but it is important as an element of the risk equation, and to enable anticipation of where problems might arise in the future. This client weakness is one of the most common causes of problem loans, and the weakness of Cofisa's credit administration on this point is one of the areas where greatest effort for change is necessary.

Collateral policies have been fairly liberal, especially by Costa Rican standards. This flexibility factor has been critical to the feasibility of several projects that otherwise might not have been able to obtain sufficient financing. Indeed, several borrowers noted this as the most significant difference between this AID program and private commercial bank financing available locally and funded through a separate AID program. But several credits were fairly well collateralized, within levels of strictly commercial banking.

For the dollar portfolio the major effort during the past year has been to book loans, which has meant concentration in the credit initiation phase (defining target markets, collecting information, analyzing, structuring, approving, and documenting) of the credit process. And, as very few principal payments have yet fallen due because most of the dollar portfolio is still in grace periods, credit administration needs and efforts have been comparatively modest in the management of the dollar portfolio so far. However, with approximately 30 dollar relationships now on the books, and with 80 relationships in the colon portfolio, the credit administration needs now take on added significance.

This means tracking of items such as loan maturities (principal and interest payments), past due obligations, non-accrual loans (if any), annual revisions of credit facilities, receipt of quarterly (or frequency as agreed) financial statements or other operating information, term loan reviews, collateral inspections,

insurance policy maturities on properties taken in collateral, etc. in a comprehensive and centralized manner. Some of these ancillary functions are presently handled by the operations department, which directs the efforts of appraisers, agronomists, etc., and which apparently has been doing a satisfactory job.

In the portfolio review very little was seen in the credit files in terms of continued financial analysis after initial disbursement in the case of the short term outstandings. However, satisfactory control was evidenced over start-up projects where the progress of construction was followed by Cofisa's agronomists and appraisers.

Apparently, Cofisa management exerts control over the portfolio not so much through continued analysis as by structuring loans with monthly payments that permit close monthly follow ups. This is especially so in the color portfolio. Such a system has certain practical advantages, but does not permit the same "hands on" control or understanding of the portfolio as with continued qualitative and quantitative analysis.

In terms of processing a loan request, Cofisa's turnaround time of approximately one month (more or less depending on the credit and its complexity) is very reasonable. Certainly, compared to the national banks this is lightning speed, and compared to other private sector financial institutions in the country and outside the timing is also quite acceptable. In this regard, as in almost

all others, there were no complaints from Cofisa's customers.

Actually, Cofisa's clients expressed general "happiness" and satisfaction with the service provided. In a couple of cases clients also expressed satisfaction with Cofisa credit management's disposition to help in overcoming problems. One client in particular had problems with wind damage to greenhouses under construction, and it was Cofisa that approached him to offer additional assistance.

One area that was mentioned where service could be improved was in dealing with the Costa Rican Central Bank for registration of dollar loans and processing of requests for official dollars to pay interest and installments on those loans. The issue arises when borrowers receive a dollar check from Cofisa International that is deposited and registered with the Central Bank. It has taken up to several weeks for some borrowers to receive the equivalent in colones, yet they are presumably being charged interest on the dollar loan. On the loan repayment end, the Central Bank's "presa" (backlog of requests for dollars for imports and foreign loan repayments) delays obtention of funds for payments on dollar loans. Since many of Cofisa's clients are not financially sophisticated in terms of dealing with the Central Bank, they believe that Cofisa could be more effective than themselves in accelerating these financial transactions.

4. Cofisa Structural Changes

The loan agreement, amendments thereto, and implementation

letters mandate several administrative, accounting, and structural adjustments. These range from very specific to quite general. Several of these changes have already been accomplished or implemented, and others are still in process of compliance. They include:

a. the placing of US$ 800,000 equivalent in preferred stock
b. the requesting of permission to become a bank
c. establishment of a risk minimization fund
d. establishment of a minimum bad debt reserve of 2% of outstanding loans
e. adjustment of accounting procedures to reflect earnings by sources of funds
f. development and implementation of management information systems and credit monitoring procedures
g. establishment of a credit committee
h. modification of credit analysis techniques to consider more information and perform more in depth analysis
i. provision for staff development

a. Regarding the preferred stock issuance, as indicated in the loan documents, only a maximum of 50% of the shares could be purchased by existing Cofisa shareholders. This 50% has been fully subscribed. The remaining 50% will be issued through the Bolsa as recently approved by AID.

b. Cofisa has recently completed the application with the Banco Central de Costa Rica to become chartered as a private bank in

the country. Management expects issuance of the license soon, perhaps in July of this year.

c. With respect to the risk minimization fund, it has been established with First National Bank of Boston in Panama, as acknowledged by AID in the Implementation Letter No. 9.

d. The loan contract and its amendments requires a 2% bad debt reserve on dollar and colon outstandings under the Cofisa project. In accordance with normal banking procedures, reserves should be reversed against earnings and taken off balance sheet (i.e. decreasing loans). Cofisa has apparently been doing otherwise by segregating a portion of retained earnings within the net worth accounts under the contingency reserve, apparently with the blessing of its external auditor Peat, Marwick, Mitchell.

The Peat 9/30/85 consolidated Cofisa annual report on page 4 of the notes section, indicates that a net worth reserve for exchange rate fluctuations, bad loans, and other potential losses has been established for 0.5% of total investments (Ø74 million) and loans (692 million). This would result in a reserve of approximately Ø3.8 million, but on page 15 of the same report, the figure is listed as Ø19.8 million. The report is therefore inconsistent.

The loan contract is not clear on whether the mandated reserve should be established on the full balance sheet basis or only on

the AID funds. Given that the existing Cofisa portfolio already has a high proportion of problem loans on the balance sheet, the spirit of the agreement would seem to dictate establishment of reserves for the amount of AID funded loans, independent of prior loans that Cofisa may have on its books.

e. The requirement that Cofisa adjust its accounting procedures to reflect earnings by sources of funds is not clear or specific as to how this should be implemented. Further guidance in this regard may be helpful.

In any event, Cofisa's catalogue of accounts is set up with both assets and earnings classifications showing clear separation by source, including AID funds. In this basic sense there is conformity with AID requirements. But it should be recognized that the mandated adjustment to accounting procedures can achieve only limited benefits in terms of improving data presentation for management decisions because financial statements must be prepared by legal vehicle and must conform to certain requirements of the Auditoria de Bancos.

Profit center reporting is a separate but related matter (discussed below). It is certainly feasible to accomodate all of the accounting needs - AID reporting, profit center separation, Central Bank reporting, portfolio classification - into one system. But such an effort goes beyond mere accounting adjustments to the level of a complete accounting overhaul.

f. Cofisa has taken some steps to produce management profit reports, and the following profit centers have been isolated: Foreign Trade, Trust (Fideicomiso), Fiscal Warehousing, Bolsa Operations, Colon Lending - AID Funded, Colon Lending - Own Funds, Dollar Lending - AID Funded, and Dollar Lending - Own Funds. This is a good start, and further integration with management practices will be necessary.

Profit center numbers can be found in the financial analysis section of this report. However, the numbers are not reliable and do not close to the totals on the respective income statements. A great deal of polishing remains to be done in the development of these systems, as Cofisa management readily admits.

g. Cofisa has established a credit committee to structure and recommend credits to the board of directors. The board has also implemented credit delegations to the general manager to approve smaller credits. The delegations are up to US$ 25,000 for dollar credits or ₡ 1 million (approximately US$ 17,000 at ₡58/US$ rate of exchange) for local currency credits.

In practice the credit committee has displayed a keen sensitivity to acceptability of risk and target parameters, hence permitting the committee to serve as an effective screen for credits going to the board. On the other hand, it is questionable whether, in practical terms, the delegation has been genuine, since this limit has allowed credit committee approval of only two small

dollar loans, and most of the colon loans falling within the delegated limit were originally approved by the board before the delegations were implemented. In this area mandated change may be going against a prevailing mindset, in which case what we are seeing is a cosmetic delegation of lending authority used to give an appearance of credit modernization, but without relinquishing significant Board of Directors control of the credit process.

h. U.S. commercial bank style credit and project analysis, focusing on cash flow and projections as well as market and industry characteristics as inputs to the credit decision taking process, has been implemented. These are significant advances that strengthen Cofisa's viability as a developmental financial institution.

In the colon credit files there is very little credit information, and in some cases, no financial statements. There are very few credit memos with any analysis. The majority of these credits are older loans made before the advent of the new management.

Presumably the board based their credit decision to grant the credits based on identifiable criteria, but in most cases there was nothing in the file documenting the decision process or indicating the basis for granting the loans. Management is aware of this situation and has made an administrative decision not to direct scarce credit administration resources to the

documentation of old loans, concentrating on uniformity of the credit process for new loans as they are put on the books.

The new credit processes are well manifested in the dollar portfolio, where there is a great deal of effort evident to compile pertinent credit information such as financial statements and/or projections, price and demand data, market and product characteristics, distribution mode, etc. on which to base a credit decision. Analysis is generally good in these areas, although with unevenness of quality.

i. Staff development is another area where progress is difficult to measure. Certainly there has been considerable progress in how the credit staff looks at credit analysis and risk. The new general manager has been instrumental in implementing the new credit systems, which in their focus resemble those found in major international commercial banks. Judging by these standards, Cofisa must be among local financial institution leaders in purely project analytical aspects.

It appears that this Cofisa credit organizational structure has thus far developed to a significant extent on an extemporaneous basis, with the Cofisa general manager also acting as the credit department unit head. This is not necessarily inappropriate, and it has apparently worked to infuse a more bottoms up analytical style and informal hierarchical structure. It has also provided an apparently enthusiastic atmosphere among the credit staffers since they have a direct input into the process, and has brought

a certain flexibility in which credits can be processed fairly quickly, especially as more expertise has been gained by analysts and credit officers alike.

In this area, Cofisa has recently completed and submitted to AID a staff training plan, which has been accepted by AID. This training plan outlines plans for strengthening the trade services department and Bolsa operations, and comments on changes made in the credit department to transform it into a unit for project analysis. The plan also sets up a budget for specific training during 1986, allocating ₡ 866,000 (US$ 15,000) to training. It would be appropriate to tie the amount of this budget to a benchmark, such as a specified percentage of profits. The amount above constitutes about 3% of consolidated six month 7-31-84 net income.

The issue of staff development is closely associated with how Cofisa is organized and what changes may be necessary. These points will be covered at greater length in the next section.

5. Organization and Operations

Cofisa's organizational structure reflects the Costa Rican pattern of a Board of Directors active in day to day matters of running the institution, a strong general managership that depends heavily on an assistant manager, and, after that, a vertical drop in responsibility and authority levels. This is in contrast to a U.S. style bank where the board delegates

management responsibility to a general manager or chief executive officer, to whom separate areas report directly in a more horizontal structure.

- On the credit side, the situation has been significantly improved with the creation of a project development and analysis unit and a credit committee to analyze and screen credits. On the operations side, effective control of the institution resides, by default, in the accounting department.

Planning Processes are in an incipient stage at Cofisa. This is the first year that the institution is operating under a planning budget. In banking institutions, the budgeting process is the principal catalyst for getting all the departments to fix revenue, service and cost goals for a future period, and to make commitments to achieving these goals. In view of Cofisa's operational paralysis of the last few years, lack of past budgeting is understandable. It will be management's challenge to get the process to work as a fundamental planning tool in future years.

Bank operations may be defined as the systems of paperwork and data processing implemented to get things done - principally to move money - while maintaining security and control and minimizing risk of loss from factors such as human error, telecommunications failures, and currency price fluctuations. Accounting is a fundamental component of operations, but must be counterbalanced by the need for speed and efficiency in serving

clients.

Because of Cofisa's historic term lending orientation, a delay of a day or two in producing a check was not important. The loans weren't tied to specific transactions within the client's cashflow, and would be paid back over a period of years. And, what client could complain if Cofisa had approved the loan in one month while the National Banking System took six months. Thus the need for operational speed and efficiency did not counterbalance internal accounting needs in the evolution of Cofisa's systems.

The Cofisa accounting system is designed by and for accountants, with limited operational effectiveness or management information value. An example of this is booking of loan write-offs within general and administrative expenses of Cofisa Internacional. The write-offs distort the general and administrative category, especially since they comprise more than half of the totals.

The accounting department also dominates operations, so that personnel in some departments seem to work more for accounting than for clients. For example, letter of credit and collection files contain large amounts of detailed accounting receipts which are nonessential to the administration of the documentary operations.

Cofisa suffers from <u>lack of commercial banking experience</u>, profitably exploited, among its personnel. Working experience at

private commercial banks is non existent among upper level management and this acts as a constraint to delegation of responsibility. At the level of clerical personnel, commercial banking experience is limited and insignificant in terms of input into systems and operations.

Reorganization has been on an ad hoc basis and concentrated on those aspects directly related to putting loans on the books. Departments and affiliates that will be crucial once Cofisa becomes a bank (Bolsa, foreign department) have been absent from the market in recent years due to Cofisa's crisis. After being reduced to nothing or nearly nothing, they have been revived and are being run by new people (Bolsa Operations - 5 months in job, foreign department - one month). These newcomers have not yet been integrated into an overall reorganization process, but may prove to be a valuable source of input if the system can be opened up to accomodate their ideas and experience.

The institution is still gunshy as a result of past problems. For example, processing of colones into dollars for repayment of interest and principal under loans disbursed is left in the hands of clients. This is more work for the client that wants to pay, and provides a too convenient excuse for delayed payment by the client that doesn't. Yet Cofisa has not found a way to provide this service for clients, and thus take charge of the process, out of fear that a receipt will be generated that will allow the client to discharge a dollar obligation by payment in colones at the official rate, even though the client's check must be written

in favor of the Central Bank.

It is true that no other Costa Rican private financial institution was hurt as badly by colon payment of dollar obligations as Cofisa, and that only Cofisa has dollar term loans (which get different treatment in dollar processing by the Central Bank) as the principal portion of its portfolio. Still, it is hard to imagine Cofisa's private Costa Rican banking competition tolerating a situation of dollar processing for loan repayment totally left up to the client, without taking action.

6. Cofisa Financial Status

Financially, Cofisa has made a phoenix-like recovery after final resolution last year of negotiations with foreign commercial banks over previous dollar debt, and after entering into the contract with AID. Cofisa went from a negative net worth of approximately equivalent US$ 4.5 million at 9-30-84 to a positive level of approximately US$ 8.5 million at 9-30-85, primarily as a result of the arrangement reached with the foreign banks which essentially forgave accumulated interest debt on the principal amounts of loans.

This development has resulted in present consolidated leverage of about 1.55, a figure which is more appropriate for an industrial enterprise than for a bank or other financial institution. The typical leverage (total liabilities / equity) for a private sector commercial bank in Costa Rica is close to 10. One of

Cofisa's financial challenges after taking on the AID debt will be to find other sources of funds to "leverage up" their balance sheet to achieve greater growth, increased returns on equity, and a more appropriate financial structure.

The attached spread sheet presents a consolidating and consolidated picture of Cofisa six month figures at 3-31-86, alongside projected full year 9-30-86 results. The numbers for 3-31-86 are sourced from Cofisa, but the projection is our own based on projected earnings for the AID dollar portfolio in the second half of the year superimposed over essentially annualized six month figures. Balance sheet levels were maintained at similar levels as those existing at 3-31-86, except for adjustments to loans for the increase in the AID portfolio and adjustments to capital to reflect the pending US$ 400,000 increase.

The first column of the spread sheet lists the numbers, in dollars, for Cofisa Internacional, while the next column restates the figures in colones at an arbitrary rate of ₡58/US$. Columns three and four depict the Cofisa Costa Rica and Almacenes Cofisa numbers, respectively. All of these figures were taken from the regularly prepared individual financial statements of each company.

The sixth column contains the consolidated data especially prepared for this study by the Cofisa accounting department. It is noteworthy that consolidated Cofisa numbers are normally not

prepared, either on a monthly, quarterly, or semiannual basis. Cofisa management does not operate for its own purposes with consolidated numbers. The consolidation is done only at fiscal year end.

The fifth column is therefore a balancing column that sums columns two, three, and four and then makes the total fit with the consolidated totals. Contained within the column are: (1) eliminations (which are relatively few, reflecting the low volume of intercompany transactions), (2) differences in accounting classifications between those seen on the sheet and Cofisa's own (e.g. Cofisa classifies some marketable securities within "loans and investments" whereas in this study these have been reclassified into quick assets), (3) differences in exchange rates used to convert Cofisa Internacional dollar figures into colones, and (4) the figures for Cofasa, the legal entity for the trust arrangement, which because of their immateriality (total assets of approximately US$ 6000) have been ignored in this study.

Present and projected 9-30-86 indeces for return on assets (ROA), return on risk assets (RORA), and return on equity (ROE) indicate an exceptionally high return on the former two, and a modest ROE, especially in comparison to other Costa Rican private sector financial institutions. However, the high return on asset figures should be discounted because these simply reflect the underleveraged balance sheet position wherein earnings are

compared to relatively small assets in relation to capital. Conversely, the low ROE is also the logical consequence of overcapitalization in relation to assets as additional income generation from an otherwise greater asset pool is not available to contribute to greater earnings.

In terms of projecting full year earnings on present operations once the AID loans are fully taken down, we can anticipate consolidated earnings approximately as follows:

* gross revenues (at ₡/58/US$)	₡ 240 million
* general and administrative expenses (including writeoffs for Cofisa Internacional)	₡ 100 million
* financial expenses (at similar rates)	₡ 50 million
* income tax	₡ 15 million
* net earnings	₡ 75 million

This would allow a significant capital formation rate (i.e. growth in equity) of 15% at present levels which would have the effect of reducing leverage ever further if loan or other asset levels are not increased at the same or faster rates. Therefore, in order for Cofisa to increase leverage to a material extent, assets must be increased by a much greater margin of growth than equity.

Cofisa's present consolidated level of annual operating costs (salaries & wages, premises, telecommunications, maintenance, supplies, legal, etc. is approximately as follows:

Cofisa Internacional	US$ 125,000	=	₡ 7,500,000
Cofisa Costa Rica			48,000,000
Almacenes Cofisa			25,000,000
			₡ 80,500,000

Compared to gross revenues of ₡ 240 million above, Cofisa would register a 3.0 coverage ratio for operating expenses. Compared to other private sector financial institutions in Costa Rica, the Cofisa index is probably somewhat low, indicating less efficiency of operations. However, a more rigorous line by line comparison would be useful for greater precision, and presumably Cofisa has higher maintenece and management costs on repossessed assets than do competitors, as a result of Cofisa's past problems. Also, it may be too early for these comparisons since Cofisa operations have functioned at these "normal" levels for only a relatively short period of time. The figure probably therefore deserves some adjustment factor in favor of Cofisa.

Revenues by earnings streams are identifiable in the financial statements only in terms of the three legal vehicles themselves. However, the incipient management information systems indicate the following breakdown, which compares relatively closely with the consolidated six month 3-31-86 figures found on the spread sheet. However, as warned by Cofisa management, the figures below are still only provisional, especially the cost allocation and expense totals, and thus may vary considerably from actuals. The figures are therefore not depicted with purposes of precision, but only to indicate very general cost relationships.

3-31-86; 000's of colones	revenues	expenses
Cofisa Internacional		
own asset sources (at ₡58/$)	22136	12194
AID asset sources (at ₡58/$)	12444	11930
Cofisa Costa Rica		
foreign trade services	1149	1463
trust	6485	1139
own ₡ asset sourced	10509	5574
AID ₡ portfolio sourced	23524	7623
Almacenes Cofisa		
warehousing operations	31057	32666
Bolsa operations	3178	2877
Total	110482	88634
3-31-86 consolidated figures	105946	78291

From the above we can see that there is some diversification of funds inflows. It is also evident that Cofisa Internacional's own funds sources still have a considerable impact in terms of earnings, although this is the portion of the portfolio most susceptible to continuing write offs. According to the above numbers, at the 3-31-86 cutoff date AID dollar sourced [illegible] had not yet picked up, although the associated costs [illegible] funds were reportedly high. The cost figure here does not appear to be correct.

Within the Cofisa Costa Rica legal vehicle, we can appreciate that the foreign trade services unit is not material in terms of revenue generation, and is also reporting losses. The trust segment, however, is reporting healthy earnings and has the largest relationship of revenues to expenses. At this date the AID sourced colon portfolio was producing major earnings, posting the single highest profit center earnings (PCE).

With respect to Almacenes Cofisa, the numbers indicate losses on operations. The actual financial statements indicate a profit of ₡ 2.4 million, net of ₡ 3.3 million in administrative costs paid to Cofisa. However, we are unsure of what eliminations if any have taken place on the revenue side as these are not detailed on the income statement.

B. DEVELOPMENT IMPACT OF THE COFISA PROJECT

By definition, the purpose of the Cofisa project has been to promote developmental credit, and lending guidelines to this end were established by AID. Therefore the focus of lending activities has been toward development projects as defined in the project paper. But beyond the development focus, this section attempts to measure the extent of the potential development impact.

The attached Annex presents a spread diagram of Cofisa's AID funded dollar portfolio as of April 1986. This spread sheet attempts to capture the impact of this portfolio by measuring effects within the economy, such as net funds inflows, wages generated, and people supported. The chart also notes other portfolio information such as tenor and grace periods, total assets, and client categories.

At the 4/86 cutoff time, total approvals were US$ 7.1 million, with outstandings of US$ 5.0 million (the spread sheet indicates

approvals of US$ 6.6 million only since an approved but undisbursed credit for US$ 500,000 was cancelled by Cofisa after grave doubts about the principal's character arose). Since then, total approvals have nearly reached the US$ 10 million total. Assuming that the new approvals share the characteristics of the 28 relationships existing at 4/86 and reviewed for this report, prorating of the numbers will probably approximate the total impact of the dollar segment of the Cofisa project.

The numbers generated are direct numbers that do not take into consideration any additional jobs generated due to a multiplier effect within the economy, so that in terms of overall impact, the figures may be considered conservative. Assuming a multiplier of 1.5 to 2.0 as in the project paper, the people supported figure would increase to the range of 25,000 to 37,000.

It should be noted that by nature the numbers in this exercise are soft, since they are based in many cases on projected export sales of projects that are still in the building stage, i.e. what the completed project is expected to produce when operational. The numbers are also imprecise since many of the assumptions made to arrive at the numbers are themselves only estimates of certain cost, production, and financial relationships. Therefore, the figures should not be given too much weight, although the numbers are useful in providing a base figure, or general estimate of the overall impact of the dollar portfolio.

It should also be noted that some well established firms could have obtained financing elsewhere so that for a significant part of the portfolio the wages generated figure cannot be attributed solely to the Cofisa project. However, in all cases, the availability of the Cofisa loans contributed significantly to the overall viability of the respective projects financed, especially considering commercial financing alternatives with typically heavier collateral requirements.

Looking at the numbers, the statistics for the prorated dollar portfolio indicate aggregate annual sales of ₡ 4.1 billion (US$ 71 million assuming an exchange rate of ₡58/US$) generated by ₡4.2 billion in assets, achieving estimated inflows of ₡ 2.4 billion (US$ 41 million). These inflows are net numbers, applying the value added percentage estimate to sales. The numbers are stated in colones because in many cases the borrower has a combined colon/dollar cash generation, and because many of the figures were sourced from colon projections.

The figures appearing for number of employees of some firms, particularly industrial processors, have been arbitrarily adjusted by the percentage export factor to avoid distortion of numbers, under the assumption that Cofisa financing was directed at the respective company's export operations and not for domestic production. For example, Gallito Industrial's total employees are approximately 750, yet only 225 are reflected on the spread sheet to account for the 30% export sales.

Wages generated of ₡ 1.1 billion are calculated by multiplying the sales figure by an estimated labor expense content, which varies by industry. For example, the figure used for the flower and plants industry is 25% of sales. These industry numbers have been derived from some of the principals themselves.

The figure for number of people supported is derived from the assumption that each worker supports him/herself plus four others, as assumed in the original project paper. This implicitly assumes that even single workers contribute to the support of siblings and other family members.

In further refining the concept of development impact, we can appreciate that most of the dollar portfolio is structured on a term basis, with five years the most common tenor (13 of 28 borrowers). By allowing for a longer use of funds, the borrower has greater flexibility and each particular project can be better structured to match cash outflows with maturity of operations. The grace periods also permit adequate building or consolidation of operations before commencing repayment of principal.

Another major determinant of the developmental nature of the portfolio, but one not reflected on the spread sheet, is the ratio between the value of tangible collateral and loan amounts. This relationship, probably more than any other, separates developmental from commercial lending, and insufficiency of collateral by commercial standards is probably the greatest

single impediment to financing for any start up project in Costa Rica. In reviewing the dollar portfolio case by case, the author concludes that a ratio of about 70% to 80% is average in many cases, with a few individual credits significantly below this level, and with a few credits (the ones more commercial in nature) based solely on corporate and/or personal guarantees. This profile of collateral to loan value means that Cofisa credit approvals have been fairly liberal in this key consideration, and therefore more genuinely geared to developmental financing.

Interest rates of Libor + 3% p.a. charged on the dollar portfolio in accordance with the loan agreement are commercial (vs. developmental) in nature. Under the terms of the loan agreement, then, the benefit of the development rate is not passed on to the end user. This is wise to prevent windfall profits to project owners, or subsidizing of otherwise uneconomical projects. This also serves to permit Cofisa to improve its capital formation rate, by virtue of the enormous spread (presently about 8% p.a.; LIBOR of 7% + 3% spread - 2% cost of funds) plus commissions on its dollar portfolio, thereby contributing about US$ 800,000/year to Cofisa's net interest revenue, and consequently, to the goal of re-establishing Cofisa's financial strength.

These present rates of LIBOR + 3% p.a. are similar to those that foreign commercial banks used to offer to normal Costa Rican credit risks before the onslaught of the Latin American Debt Crisis. However, this commercial financing is no longer offered by foreign commercial banks (they have either withdrawn from the

market or are constrained from lending to Costa Rica in dollars because of the "substandard" classification of credit risk for Costa Rica by U.S. bank regulators), and LIBOR is presently at very low levels (about 7% p.a.). Therefore the dollar rate of about 10% can be extremely attractive to generators of foreign currency, as compared to local currency interest rates (up to approximately 36%).

C. COFISA OPERATIONAL SITUATION AND THE BANKING ALTERNATIVE

The Cofisa project loan paper made Cofisa's application for a banking license a condition for AID's loan approval. The chief consideration behind this requirement was twofold: under Costa Rican banking law, certain commercial operations, principally collection of dollar proceeds for exports, which generates comissions and is a key service for exporting clients, is limited to banks; and, certain funding sources, both medium and long term, are chanelled only through banks.

The negative aspect of becoming a bank is that regulation by the Central Bank is much more of an administrative burden than that imposed by the relatively simpler financiera reporting requirements. Nevertheless, the dominance of the private banks over the financieras in the crucial foreign trade sector is ample evidence that in the Costa Rican private banking market much more can be done, both in variety of services and in generating income, through a bank legal vehicle.

Cofisa management has manifested that approval of the banking licence by the Central Bank of Costa Rica is expected soon, perhaps as early as July 1986. Given the imminence of this very major step in Cofisa's recovery and future development, we feel that the following observations are appropriate.

Complementarity. The importance and complementarity of the short term commercial banking function is apparently not appreciated by many people within Cofisa, both employees and directors, nor by AID. There is a prevailing mentality that Cofisa's role as a development oriented financial institution will be compromised by a strong short term commercial emphasis. This view, in our opinion, could prove costly in terms of lost opportunities and prestige in the market, if it results in Cofisa's not doing all it can and should to compete and carve out a strong position in short term foreign trade financing. Among the principal arguments in favor of this point of view are:

Portfolio Balance. Financial institutions must not only balance tenors of assets and liabilities (long term loans from long term sources, short term loans from short term sources). A healthy portfolio also requires a solid basis of short term, revolving. working capital loan business as an offset to term loans, not only for purposes of risk diversification and minimization, but for liquidity as well.

The economic calculation for the two types of loans is basically

different. An individual or a company will very carefully analyze present and projected economic conditions before committing to a term loan, especially in dollars in a weak currency economy like Costa Rica. But a going concern lives or dies by its ability to channel inputs into its productive process. The market for working capital credit is therefore permanent and much less affected by economic expectations. With this type of credit, the question is not whether companies will use it, but how much, from what institution, and on what terms.

As long as Cofisa remains basically a term lending organization, its growth will be driven not by the dynamism of the productive sector, but by its ability to obtain longer term funding. And the institution's credit and foreign exchange risk will lack an ofsetting advantage that Cofisa could obtain through commercial operations.

Clients will be much more inclined to pay their term loans if they are tied to the same institution for their working capital requirements. And the Central Bank may, at any time, have different dollar allocation priorities for payment of dollar inputs to current production than for payment of loans disbursed years before. In a given situation, which has already ocurred in Costa Rica, well run companies that try to manage risk may be uninterested in term loans (especially in dollars) but simultaneously short of working capital financing.

For all these reasons, the stronger Cofisa's market penetration

in short term commercial banking, the better equipped the institution will be to maintain strength and vitality as a Costa Rican financial force, both short and long term.

Source of Income. It is commonly perceived that the growth of the Costa Rican trade financing oriented private banks in Costa Rica has been the result of their filling the vacuum left when the multinational commercial banks withdrew. This is one of the two principal factors.

The other, much less understood, is that, as the Costa Rican colon collapsed from 8.6 to 65 to the dollar, then down and now back up to 56, comission business on foreign trade operations (letters of credit and collections) became proportionally more attractive in local currency terms. This is because the comission rates for these operations, varying from 1/4% to 1% for the various types, or repetitive business that turns over in one to three months, are fixed by the Central Bank and based on the dollar value of the import or export. From 8.6 to 56 colones to the dollar, we are talking about comission increases, in local currency terms, of over 500%. As a result of this, the emphasis of the agressive private banks has been precisely on this type of operation. With the Costa Rican nationalized banks noncompetitive from a service standpoint, these private banks today derive 30% to over 40% of their revenues from these operations.

Service to Clients. A centerpiece of Cofisa's development lending

strategy is that the funds be lent to agricultural and industrial clients - export oriented producers. Almost by definition, we are talking about a client base that will make heavy use of foreign trade banking services. And, with the high proportion of start up clients Cofisa has, much of the customer base is unsophisticated in banking and foreign trade. If Cofisa is not competitive in the quality of its commercial banking services, these clients will either have to suffer with inferior service or go elsewhere.

Equity in Collateral. Another aspect of import and export financing operations that makes them so attractive to commercial banks is that they generate their own collateral. Frequently, they generate double collateral - documents that give title to the merchandise being financed, and cash in the form of client deposits or assignment of payment, to which the financing bank has title as the Central Bank's agent within the process of controlled exchange between colones and dollars.

A major component of Cofisa's development lending orientation has been flexibility in collateral requirements, and the capability to offer loan tenors beyond local commercial banking standards. If Cofisa is not competitive in foreign trade operations, the institution will be in the unenviable position of accepting risks of lower collateralization and longer lending terms on the development portfolio which the commercial banks have avoided, while its clients go to the competition with their lucrative, short term, highly collateralized, lower risk foreign trade business.

New, Complementary Services. Apart from the rise of foreign trade financing as a primary private banking business in Costa Rica, a parallel development has been the flowering of the Costa Rican Securities Exchange (Bolsa Nacional de Valores) as a major factor on the local financial scene. For purposes of this analysis, two aspects are outstanding with respect to the Bolsa. First, it is an extremely effective method for listed firms to raise short term funds by issuance of CD's. And second, it has made aggressive management of short term funds possible for large to medium sized companies.

A recent variation of this trend has been the association of most of the major private banks with a seat on the securities exchange, either by owning one outright or through affiliation or contracted working arrangements. Cofisa is a founding member of the Bolsa. As such, it already has the legal vehicle to become competitive in this area, which will become more crucial as its client base grows in size and sophistication.

III. CONCLUSIONS

A. PROGRESS TOWARDS GENERAL OBJECTIVES

The primary objectives of the Cofisa loan project are three:

1) to provide assistance to the Costa Rican productive private sector to face the country's liquidity crisis
2) to enhance the capacity of the Costa Rican private sector to generate foreign exchange
3) to re-establish Cofisa as a developmental oriented financial institution in Costa Rica

So far, it appears that these objectives are being met as, in general, Cofisa loans have been made for the productive purposes intended, resulting in a noticeable impact within the country's private productive sector. This impact has been achieved both through the colon and dollar lending components. However, in the case of the colon portfolio, verification of the loan purpose from the credit files was generally not possible since these contain skimpy credit information and little documented analysis.

The foreign exchange generation capacity of the private sector has been enhanced as a result of the Cofisa program since lending (the dollar portion) has been directed mainly at export generation projects. These projects, as required by the loan agreement, are directed at non-traditional exports. As implemented through Cofisa lending policies the projects generate a high value added production content to achieve considerable net foreign exchange generation, especially in comparison to the

amount invested by AID.

With respect to Cofisa's development, it has reaquired financial vigor as a result of this AID program and last year's successful resolution of prior dollar debt negotiations with foreign commercial banks. These events have contributed to a presently strong consolidated balance sheet with productive assets generating considerable interest and commission earnings that contribute to strong capital formation.

B. COMPLIANCE WITH THE LOAN AGREEMENT

The main purpose of this report has been to evaluate Cofisa's compliance with the terms and objectives of AID's loan project. Certainly, from the point of view of putting loans on the books, and for the type of credit and risk acceptance specified by AID, the efforts of Cofisa and the new administration must be judged as more than satisfactory. And in terms of evolution into a development oriented financial institution, significant strides have been made in a very short time.

In reviewing the dollar credit portfolio, in general we conclude that the target market adherence is quite good, and that deviations from non-traditional lending are within established sublimits. In terms of risk, due to the developmental nature of the portfolio and the long average tenor, the risk within the portfolio is inherently higher than a normal commercial portfolio, as expected given the purpose of the project.

But once the funds are all placed, two major areas of focus will become paramount for Cofisa. These are the ongoing management and administration of the portfolio to assure repayment of outstandings in accordance with established or renegotiated repayment schedules, and the reorganization and commercial banking aspects of the business.

The asset quality and earnings stream generated from the portfolio, together with growth through operational and funding diversification will be essential to propel Cofisa from a narrow development oriented base to a more broadened and balanced commercial base. Such a broadened commercial base will serve to insulate Cofisa from the inherent weakness of dependence on narrow "spread" earnings of a higher risk portfolio.

To accomplish this, we submit that Cofisa is at a juncture in which some fundamental assumptions should be revised. The reorganization process, which up to now has been concentrated in those aspects directly related to placing the development loans, must be broadened to encompass the entire institution. This will be much more difficult.

C. CONTRIBUTION TO MISSION DEVELOPMENT STRATEGY

The Mission's overall development strategy in Costa Rica is geared to promotion of the private sector, creation of employment, and promotion of non-traditional exports. Pursuant to

this end, and for the purposes already mentioned, the Cofisa project was devised and implemented. Since there has been essential compliance with the terms of the loan agreement as described, and since there has been a measurable development impact from the project, we conclude that the Cofisa project has contributed to further AID interest and objectives in Costa Rica.

D. COFISA OPERATIONAL OUTLOOK AND BANKING PERSPECTIVES

Cofisa's commercial banking potential is considerable. The operational structures of the most successful commercial banks in Costa Rica can be duplicated by Cofisa through organization, accounting changes, training and people - all factors within reach. And what Cofisa has in its well developed medium to long term development lending capability, most private commercial banks either cannot or will not develop.

It is reasonable to assume that, among banking institutions in which the short term operational and lending services are comparable, clients will prefer to work with the institution from which they can also hope to get longer term loans unavailable elsewhere. And, in a small economy like Costa Rica, with companies interrelated by ownership participation in several companies, today's medium term start up loan can result in tomorrow's shifting of short term business from a related company to Cofisa - if the service is superior.

IV. RECOMMENDATIONS

A. RECOMMENDATIONS FOR COFISA - ADMINISTRATIVE

Some of the administrative recommendations involve further implementation of changes envisioned within the loan contract as part of the overall project structure. Other recommendations involve some changes that the new Cofisa management has already identified as necessary, in one way or another. Still other recommendations may be fresh to both Cofisa and AID.

Some of these are made with full awareness that everythying can't be done at once, and that some of the areas cited are as they are simply because of lack of time and human resources to act upon them. These recommendations should therefore be viewed as an indicative list of areas upon which management priorities and effort should be focused. The recommendations may be grouped in three areas: the credit process, organizational structure, and operational-administrative, although there is considerable overlap.

On the <u>credit process</u> side, greater future effort should be allocated to institutionalization of the process gains so far by development of more standardized credit policies and procedures. A credit policy manual should be devised by management and approved by the board to provide guidance and written policies for lending operations.

The benefit of preparing such a document is in forcing management

and the board to consider and anticipate the details of how credits should be targeted, analyzed, structured, approved, documented, disbursed, and managed. Guidelines can then be established for use by the credit and project analysis staff, and this will permit greater delegation of the credit function (not necessarily of credit approvals) as basic policies could be understood in a more precise manner down to the analyst level. Standard and informative formats should be followed for presenting information and for documenting approvals or actions to be taken.

A sincere and realistic evaluation of institutional and Board of Directors' attitudes towards delegation of loan approval is in order. That delegation so far has been more theoretical than real may be indicative of a basic reluctance by directors to delegate decisions for which they can, legally, be held personally responsible. The real attitudes on this crucial issue should be brought into the open so that appropriate action and structuring may follow.

There is wisdom in having heavy input into credit decisions from a manageable number of businessmen who know the economy and the people in it intimately. Streamlining of the credit approval process may be in order, but a reduction in knowledgeable input is not. The previously mentioned restructuring may fulfill the need for a more specific and effective credit process, without necessarily implying further delegation of loan approval powers. Should Cofisa opt for further credit delegation, levels for this

should be analysed with respect to portfolio statistics volume of credit approvals, and senior management lending experience.

Greater institutional resources should now de allocated to administration of the credit portfolio, especially now that AID dollar lending is close to topping out. Mainteneance of asset quality will be of vital importance to Cofisa's future earnings profiles, and close management of the portfolio will help achieve this goal.

These monitoring efforts, as well as credit policies and procedures, should be applied equally to the colon portfolio since at the present time there is very little information in the files on which to base an anticipatory posture. This ongoing monitoring process will become even more important if Cofisa obtains its bank charter since the level of local currency operations could be increased considerably, and since a logical departure point for such an increase is the existing credit portfolio.

Renewal of the credit initiation phase with each credit, as new data is gathered to verify progress and determine continued credit worthiness (especially on the more commercially oriented part of the portfolio), should be done as standard policy. This means a revision of credit facilities at least anually, to be approved by the board, or as an alternative, by a credit deputy authorized by the board for this purpose.

On the credit organizational side, a more formal structure will probably be necessary, and sooner rather than later. The present structure has worked satisfactorily for Cofisa in their recent transitional stage, but it is now reaching the point where clear definition of responsibility for individual relationships is needed. This involves performance of annual revisions of credit facilities, or term loan reviews, and maintenance of contact with the principals, i.e. managing the relationship from analysis to disbursal to loan recovery. This will be especially important as some problems develop in credits (this is inevitable in a development oriented portfolio) and more credit management time is needed to manage the situation and help the client work out his problems.

The Cofisa board should seriously consider bringing in an experienced credit person to head the credit department (the project paper itself mentioned the perceived need at that time for three senior credit people within the credit staff) and manage and oversee the evolution of the structural change. This would free up the general manager to cover other areas (conversion to a bank, pursuing other sources of funds, development of management information and profit reporting systems, possible reorganization of management structure, pursuing alternative earnings streams, etc.) while permitting the credit department to function more deliberately and autonomously, as well as with the additional portfolio and administrative controls that will be necessary to permit effective management

(vs. putting loans on the books) of the portfolio.

The more defined responsibility over credits could be implemented by the designation of account officers, with an account load of about 20 to 25 accounts each (including accounts in the colon portfolio). Such structuring would also permit greater and more advantageous expertise deployment as different people could specialize in different industries. Cofisa, with its superior analysis and credit personnel, has a good beginning towards the development of a loan officer corps with the mix of skills necessary for an effective partnership relationship with its clients.

On the operational-administrative side, and in terms of managing the portfolio from an ongoing profitability and efficiency perspective, greater development of the profit (or cost) center units will be necessary. Budgets should be established for target loan and transaction volumes, allocated and direct expenses, profit center earnings, returns on allocated equity, returns on assets, etc. to measure performance of each unit and each unit manager. Budgets should then be reviewed quarterly for compliance, implementing new forecast figures for adjustments to year end totals as necessary. In this manner, the board of directors can focus greater energies on policy and strategic decisions and leave greater latitude for implementation of these policies by management, since there can be direct and quantitative measures of performance.

As another step to achieve greater control, Cofisa should show more initiative than it has up to now in taking charge of foreign exchange registration and processing of its loans. The fact that the Central Bank chooses to register operations in the borrower's name should not disuade Cofisa from taking custody of all documentation and taking charge of all processing, under the client's signature.

B. RECOMMENDATIONS FOR AID - STRATEGIC

How much Cofisa reorganizes and changes depends on strategic decisions of where Cofisa wants to go. AID as an interested party that has been instrumental in restoring Cofisa as a going concern, should have input into Cofisa's future orientation. Where Cofisa and AID want to go in turn depends on strategic goals and expectations for the future.

These goals and expectations should be tempered by the following observations:

<u>Cofisa should stay close to the client.</u>

Cofisa credit staffers should become involved as actively as possible in the day to day activities of its clients with client visits and quarterly follow ups on financial and operational performance (in some cases this is already being done to some degree). This is because structuring loans with monthly payments is not enough. The fact that many clients are unsophisticated in

accounting, finance and dealing with the Central Bank can be made to work to Cofisa's advantage. To the extent that Cofisa can structure or provide these services for clients, the relationship with them will grow closer and greater control will be obtained to assure the client's, and Cofisa's, financial health. As the only institution with significant presence in the market making medium term development loans, Cofisa is already "in bed" with its clients to a greater degree than any short term lender. Cofisa should become equipped to demand commitment from the client that reciprocates Cofisa's commitment to the client.

Cofisa will have some portfolio problems on the AID loans. Despite the care in initial analysis and the deliberate weigning of structuring vs. risk in the AID portfolio, some problem loans are statistically likely. This is due to the developmental nature of the loan portfolio, with a significant number of start up and turnaround loans, some of which are breaking new ground in the Costa Rican economy.

This probability is compensated to a degree by the exceptional interest spread that Cofisa enjoys on AID funds, but this advantage should not give a false sense of security. The strategy to deal with this situation should be threefold: (1) get as close to the clients as possible, (2) as a fail-safe measure install a strong credit administrative system that places a premium on problem anticipation, and (3) grow and diversify. By following this approach, Cofisa will maximize both its ability to avert write offs and its ability to absorb them when they occur.

The Need for Change.

Although progress in reactivating Cofisa has been excellent for the first year, it should be remembered that money is the easiest product to sell. Cofisa still carries baggage from its past in the form of lack of significant commercial and operational banking experience, and systems unequipped for the agility and speed required by competitive commercial banking.

The danger is not that Cofisa cannot compete commercially. With its well developed term lending capability, Cofisa would have a decided edge over the competition if a first class commercial banking operation were set up parallel to it. But such a set-up is easier said than done. It involves fundamentally changing outlooks and systems, and bringing in new people and giving them input into the system.

A precious intangible brought to Cofisa by AID's funding and the new management has been momentum for change. The major challenge ahead is to keep that momentum going and channel it effectively to achieve banking viability independent of concessional rate funding.

B. SPECIFIC RECOMMENDATIONS FOR AID

With respect to the loan agreement and future compliance, AID should consider the following:

- The reflow pool concept should be defined with Cofisa. It

does not seem appropriate that funds should be free of AID restrictions after lending short term if the funds have never been loaned long term. If this is permitted, it is a significant loophole for Cofisa.

- The 75%/25% requirement for tenors of 3 to 5 years should be watched closely since the portfolio has been reflecting the maximum shorter term lending limit under the contract.

- AID's requirements of receipts and documentation on how investment funds were spent occupied a significant portion of credit personnel effort. In the future, as COFISA begins to handle a mix of AID funds, reflows from loan recoveries, and funds captured from the deposit market, such documenting of funds investment by clients could grow very complicated. Perhaps as Cofisa matures, these investment documentation requirements can be relaxed.

C. LESSONS LEARNED

In funding COFISA and indicating a specific, specialized lending role within the market, AID has provided the institution with a specific mission - getting the loans on the books for develoment oriented lending - that has generated an initial taste of success. Cofisa's mission for this initial year was difficult but feasible and has basically been fulfilled. But in terms of re-establishing Cofisa as a viable, competitive financial force in the market, it is still too early to draw conclusions.

ANNEX 1: COFISA FINANCIAL STATUS

COFISA CONSOLIDATED FINANCIAL STATEMENTS AT 3-31-86 AND PROJECTED TO 9-30-86

in thousands exchange rate = C.58/US$	Cofisa Int'l-$	Cofisa Int'l-C.	Cofisa C.R.-C.	Almacenes Cofisa-C.	balancing + elim	Consol-idated	Projected 9-30-86
Balance Sheet							
cash & banks	1101	63858	4052	7002	-4359	70553	70000
quick assets	2296	133168	133175	28261	-13602	281002	285000
loans, net	6936	402288	208254	78102	-28439	660205	950000
long term investments	1350	78300	39557	4000	-31172	90685	90000
property taken	1065	61770	47170	181	-4314	104807	100000
premises	0	0	56582	3856	141	60579	60000
other	761	44138	58039	1600	-61507	42270	40000
Total Assets	13509	783522	546329	123002	-143252	1310101	1595000
notes & other short term	963	55854	131765	69779	-55343	202055	200000
AID long term	5057	293306	223500	0	-20462	496344	720000
foreign banks & other LT	0	0	59467	33309	5000	97776	95000
Total Liabilities	6020	349160	414732	103088	-70805	796175	1015000
capital	2000	116000	96500	5000	-121000	96500	120000
reserves	673	39034	27542	6431	-35252	37755	44000
retained earnings	4816	279328	8055	8483	63805	379671	416000
Total Equity	7489	434362	132097	19914	-72447	513926	580000
Liabilities + Equity	13509	783522	546329	123002	-143252	1310101	1595000
loans / total assets	0.51	0.51	0.38	0.63		0.50	0.60
cash + quick / ST liab	3.53	3.53	1.04	0.51		1.74	1.78
AID LT / total liab	0.84	0.84	0.54	0.00		0.62	0.71
AID LT / total assets	0.37	0.37	0.41	0.00		0.38	0.45
liabilities / equity	0.80	0.80	3.14	5.18		1.55	1.75
equity / total assets	0.55	0.55	0.24	0.16		0.39	0.36
Profit and Loss							
interest earned	636	36888	25112	4391	9814	76235	170000
commission & other	-7	-406	23795	29844	-23592	29641	60000
gross earnings	629	36482	48907	34235	-13778	105846	230000
general & admin expenses	236	13688	23678	18100	-5375	49591	100000
financial expenses	92	5336	9281	11315	-4327	21605	46000
income tax	0	0	4685	2410	0	7095	14000
net income	301	17458	11263	2410	-3576	27555	70000
earnings / total assets %	2.23	2.23	2.06	1.96		4.21 *	4.39
earnings / risk assets %	2.43	2.43	2.08	2.08		4.45 *	4.59
earnings / net worth %	4.02	4.02	8.53	12.10		10.72 *	12.07

* annualized

ANNEX 2: DEVELOPMENTAL IMPACT SPREAD SHEET

COFISA DOLLAR PORTFOLIO - 4/86	APRVD $ AMT	% OF TOTAL	DATE APRVD	O/S $ AMT	% OF TOTAL	TENOR/ GRACE	SALES C. MM	XPRT %	ASSET C. MM	NO. EMP	VAL ADD	CLIENT CATEGORY	INFLD C. MM	WAGES C. MM	PEOPL SUPRT
Flowers/Plants															
Arbol Grande	235750	3.56	12/85	235750	4.89	6 - 24	17	100	4	10	80	START UP	14	4	50
Bromelia	500000	7.55	8/85	300000	6.23	5 - 12	85	100	30	45	80	START UP	68	21	225
Fincas Nabori	250000	3.78	2/86	250000	5.19	5 - 12	36	100	25	55	80	START UP	29	9	275
Flores Intercont	300000	4.53	6/85	300000	6.23	5 - 12	100	100	27	15	80	START UP	80	25	75
SUBTOTAL	1285750	19.43		1085750	22.54		238	100	86	125			190	60	625
Spices/Vegetables															
Agro Aromas	100000	1.51	12/85	100000	2.08	5 - 12	10	100	5	22	90	SMALL FARM	9	4	110
Erkelens y Cia.	145000	2.19	1/86	135000	2.80	3 - 0	8	100	8	20	90	SMALL FARM	7	3	100
Prod CR Aceit/Esp	56000	0.85	11/85	56000	1.16	5 - 36	3	100	20	125	90	SMALL FARM	3	1	625
SUBTOTAL	301000	4.55		291000	6.04		21		33	167			19	8	835
Coffee/Cacao															
Benef El General	250000	3.78	1/86	0	0.00	S T	300	100	200	60	90	TRADIT EXP	270	75	300
Benef Montealegre	250000	3.78	1/86	0	0.00	S T	300	100	220	50	90	TRADIT EXP	270	75	250
El Comendador	150000	2.27	1/85	134000	2.78	5 - 12	60	100	33	100	90	REACTIVAT	54	15	500
El Dorado	250000	3.78	11/85	250000	5.19	5 - 12	200	25	126	57	90	ESTAB IND	45	50	285
SUBTOTAL	900000	13.60		384000	7.97		860		579	267			639	215	1335
Fishing/Extractive															
Industrias Martec	25000	0.33	3/86	15000	0.31	S T	33	80	16	37	90	START UP	24	17	185
Deriv Calcareo	110000	1.66	PENDING	0	0.00	5 - 6	17	50	20	12	90	START UP	8	4	60
SUBTOTAL	135000	2.04		15000	0.31		50		36	49			31	21	245
Industry/Construc															
Dise/Constr Naval	150000	2.27	1/86	0	0.00	S T	35	100	12	33	70	RECENT IND	25	11	165
** Inversiones Zeta	500000	7.55	3/86	250000	5.19	5 - 12	16	100	390	40 *	90	CONSTRUC	14	5	200
Portico	500000	7.55	7/85	500000	10.38	5 - 12	81	100	135	165	95	TURNAROUND	77	24	825
SUBTOTAL	1150000	17.37		750000	15.57		132		537	238			116	40	1190
Industry/Processing															
Gallito Indust	500000	7.55	1/85	500000	10.38	2 - 12	231	30	302	225	90	ESTAB IND	62	56	1125
** LAICA (Tabogal	500000	7.55	6/85	500000	10.38	7 - 24	313	100	220	600	90	SUGAR COOP	282	78	3000
Lordan	150000	2.27	1/86	150000	3.11	S T	110	60	83	96	30	ESTAB IND	26	28	480
Ser Gen Oeste	300000	4.53	11/85	300000	6.23	5 - 12	200	100	85	124	40	RECENT IND	80	50	620
Yanber	500000	7.55	7/85	350000	7.27	S T	357	50	544	190	30	ESTAB IND	54	89	950
SUBTOTAL	1950000	29.46		1800000	37.37		1211		1234	1235			504	303	6175
Textiles/Apparel															
Confec H y H	30000	0.45	3/86	0	0.00	3 - 4	12	100	11	110	90	DRAW BACK	11	10	550
Fuertejidos	440000	6.65	2/86	340000	7.06	5 - 24	50	10	107	7	50	REACTIVAT	3	20	35
OS Textiles	265000	4.00	2/86	100000	2.08	3 - 6	130	80	160	140	50	START UP	52	52	700
Textiles Flex	110000	1.66	2/85	0	0.00	5 - 12	10	40	16	72	50	TURNAROUND	3	4	360
SUBTOTAL	845000	12.77		440000	9.13		202		294	329			68	86	1645
Tourism															
Bandana Republic	12000	0.18	11/85	11000	0.23	3 - 0	1	50	0	2	90	START UP	0	1	10
CR Expeditions	40000	0.60	1/86	40000	0.83	3 - 0	20	95	5	24	90	SERVICES	17	10	120
SUBTOTAL	52000	0.79		51000	1.06		21		5	26			18	11	130
TOTAL PORTFOLIO	6618750	100.00		4816750	100.00		2735		2804	2436			1585	742	12180
PRORATED PORTFOLIO	10000000						4132		4236	3680			2375	1121	18402

* approximately 200 employees for 1 year divided by 5 year tenor

** figures for project financed only

ANNEX 3

LIST OF INTERVIEWS

Cofisa Clients

Howard Salomon	Costa Rica Expeditions
Fabio Valverde	Portico
Dave Hall	Flores Intercontinentales
Jorge Zuñiga	El Gallito Industrial
Sidney Fehrens	Sociedad General del Oeste
Rodolfo Cortez	El Dorado
Larry Huntington	Diseño y Construcciones Navales
Peter Fox	Bromelia
Jim Stanley	Fuertejidos
Carmen Padilla	Corrugados de Belen
Ozco Ruiz	Granja Avicola Monica

Cofisa Board and Management

Mario Urbina	Board Member
Harry Friedlander	Board Member
William Phelps	General Manager
Guillermo Serrano	Manager
Jorge Brenes	Assistant Manager
Manuel Ossenbach	Head of Project Analysis Unit
German Castro	Head of Foreign Trade Unit
Alvaro Coto	General Manager of Almacenes Cofisa
Hernan Morales	Head of Bolsa Unit