Report to

Agency for International Development/Costa Rica Corporación Banex

June 1983

Evaluation of the Private Sector Productivity Project as Implemented Through the Corporación Banex

Arthur D. Little International, Inc.

Reference 89234

k

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

I. SUMMARY AND RECOMMENDATIONS

A. Introduction

The Corporacion Banex, S.A. (Banex) has evolved considerably since a group of Costa Rican businessmen established a small private export bank in 1980. The bank's founders saw a need for a private bank to provide an efficient alternative to the nationwide banking system as well as to provide financing for both traditional (particularly coffee) and non-traditional exports. The establishment of the bank, however, coincided with the onset of a major economic crisis in Costa Rica, characterized by a large foreign debt, a stagnant economy, high inflation, a rapid depreciation of the currency, and the critical impact of these problems at the firm level. This crisis greatly affected the bank by making it impossible to secure foreign commercial financing, and by increasing the importance of export development and the role of intermediary mechanisms such as Banex.

In discussions with the U.S. Agency for International Development (USAID), it became apparent that a continued relationship would be mutually beneficial. Banex would obtain much needed financing (a $10,000,000 loan) while USAID would be able to support a promising intermediary to help realize some of its development objectives (in this case export development). As a result of these discussions, as well as of studies sponsored by USAID to assess the situation, the shape and orientation of Banex began to change. This was brought about by a determination that in addition to credit and banking services, export development was being constrained by the lack of exporting expertise at the firm level. In order to have a greater development impact, it would be necessary for Banex to provide a range of services to assist producers in the export process.

The organization which emerged consisted of two principal components: the Banco Agro Industrial y de Exportaciones, providing export credit and banking services; and, Banex Trading, providing export management services. In September of 1981, USAID entered into a loan agreement with Banex and the first disbursement was made in December of that year. Banex Trading was not established until April 1982, since it was necessary to first design the implementation program for what was to be an entirely new concept for Costa Rica (and for USAID).

This report represents the first in-depth evaluation of the Banex project, as called for in the Loan Agreement. At its simplest level, the purpose of this evaluation has been to determine the extent to which the objectives set forth in the Project Paper and the conditions established in the Loan Agreement have been met, based on the performance of the first 15 months of operation since the agreement was signed. At another level, the study has also provided an opportunity for Banex and USAID to take a close look at the first year experience and make the appropriate adjustments in strategy, organization and implementation. Finally, this

9X

study has had particular significance for USAID, because it involves the evaluation of one of the Agency's first major initiatives to achieve development objectives with private sector intermediaries, and with export credit/trading companies in particular.

During a month of field work, the Arthur D. Little International, Inc. team focused its efforts on an interview program involving USAID officials, the top four levels of Banex management (in both the bank and the trading company), fifteen different Banex clients (10 bank and 10 trading clients), and the principal Banex contractor (the World Trade Institute), as well as on a thorough review of Banex files and all available written documentation. In order to enhance the usefulness of the evaluation process, extensive meetings were held with top level Banex and USAID mission management regarding conclusions and the strategic alternatives for the future. The consensus reached during these meetings as to the issues facing BAnex and the strategies required to deal with them, should greatly enhance their implementation by Banex and USAID.

B. Conclusions

Before entering into specific conclusions and recommendations, it should be noted that we recognize new enterprises experience "growing pains" during their first years of operation. The long-term success of a company usually depends on management's ability to adjust to changing conditions and to correct mistakes in the initial design. The principal thrust of this report is to assist Banex and USAID in assessing the performance of the first year and in making the appropriate adjustments.

In the case of Banex, the company began to operate in an environment of economic crisis and very rapid change, making the start-up period even more difficult. The decision to work with USAID, a public entity with limited experience in the private sector, represented another challenge for Banex. Furthermore, even before becoming firmly established as a bank, Banex agreed to develop a trading company, a business it knew nothing about. The Banex management has shown its capability and flexibility in operating in the face of these formidable obstacles, which suggests that this management should be able to effectively learn from its experience and insure the long-term development of Banex.

The banking and banking services component has generally performed well and developed into a professional and efficient bank. Some of the principal findings and conclusions regarding the bank are the following:

- o By providing an efficient alternative to the nationalized banking system, Banex has been able to realize one of its principal objectives -- the opening of the banking system. Interviews with Banex clients confirm this conclusion.

- o The bank's impact on the development of non-traditional exports has been less than initially expected. Most of the dollar lending has involved short-term credits for exports which probably would have been made anyway (with financing from other sources), while colon lending has gone largely to the recapitalization of companies affected by the devaluations of the currency.

- Dollar lending has been much lower than anticipated in the initial project paper. Not only were the actual disbursements from the USAID loan ($1.7 million as of December 31, 1982) 30% lower than the planned $2.5 million, but since most of the sub-loans involved short-term credit, the bank has had to be very aggressive just to re-lend the reflows. The problem has been that companies are highly averse to dollar denominated loans following the painful experience of many borrowers caught by Costa Rica's major devaluations with large foreign debts. The fear is so great that some firms will borrow in colones at much higher interest rates, even to purchase imported materials.

- Colon lending, which was not initially anticipated in the Project Paper, has more than compensated for the slow demand for dollars. The total portfolio is about $4.9 million (dollar equivalent) compared to the $3.3 million projected after the first year of operations. The bank has two sources for the colones: the sale of investment certificates to the general public; and, the USAID/Central Bank Loan Program (for balance of payments support).

- The bank's aggressiveness in promoting colon lending indicates a capable and flexible management adjusting to the market.

- Co-financing from foreign banks has been less than expected, but given the low demand for dollars, would have been a superfluous activity. Instead, the bank moved aggressively to capture local savings through the sale of certificates of investment, which again reflects an appropriate adjustment to a changing environment.

- Even though not directly related to exports, the loans for recapitalization and restructuring of liabilities (the principal use of colon funds) has had an important impact by allowing firms to continue to operate, thereby preserving jobs and production.

- Although banking services are now the most profitable, the bank's credit components are past breakeven and should increase their contribution to bank profitability.

- In the judgement of our banking experts, bank management is highly competent while operating practices are prudent and professional.

- **The bank is primarily commercial rather than developmental in orientation. Its lending criteria emphasize profitability and security while higher risk, long-term development loans have not** been pursued. The financing of export related investment projects, anticipated in the Project Paper, has generally not occurred (although two longer term loans were recently made). However, it was probably unreasonable to expect that the same bank officers could be both commercial and investment bankers at the same time. Each activity requires a different mentality, objectives and lending criteria. Given that Banex was initially established as a commercial bank, that its personnel were more experienced in this area and that commercial banking appeared more profitable and secure (at least over the short-term), it is not surprising that this area was emphasized.

In contrast to the bank, Banex Trading (BT) has not been able to accomplish its objectives during its first year of operation. As outlined in the project paper, BT's objectives included: providing producers with a wide range of export management services; assisting companies in developing the appropriate productive capacity for exporting; providing know-how by incorporating firms in the exporting process; and, providing procurement, financing, warehousing and other services. Since Banex had no expertise in this area, the project paper anticipated that implementation of the trading company concept would begin with the hiring of the World Trade Institute (WTI) to "initially provide the basic exporting and purchasing services" and to "provide the structuring and on-the-job training of the (BT) staff". The idea was that the contractor would design the strategy for the trading company, carry out the marketing services in the U.S., provide technical assistance in Costa Rica, and generally provide the training such that BT could begin to take over all activities after one year and be completely independent after the second year.

The results from the first year of operation have been disappointing and can be summarized as follows:

- The impact on export development has been negligible. The focus of BT's[1] activities has been on marketing surplus Costa Rican production in the U.S. This means that firms with surplus capacity, usually because of depressed local and Central American markets, would sell their surplus in the U.S., with BT acting as agent. The impact on export development is minimal because the exports are perceived by the firms as a temporary outlet which would largely be abandoned once the local market is restored to health. Furthermore, since most of these plants originated as import substitution industries it would be difficult for them to compete in export markets on the basis of quantity, quality

---

[1]Refers to the combined efforts of BT and WTI.

and price without a major effort to re-orient their production to meet market requirements. BT and WTI did very little to work together with producers to develop a production capability oriented primarily towards exports.

- The results in terms of revenues has been considerably lower than expected. During the first twelve months, BT generated export sales of about $251,600 (almost all trial orders) and earned about $7,800 in commissions (compared to the projected $250-500,000 in exports and $25,000 in commissions). The problem here was that BT often had to lower or forego its commission in order to make a sale and that many clients were reluctant to accept exclusive representation contracts for the U.S. market. Trial orders were placed for only 9 firms (instead of the 20 in the initial plan) while no material procurement activity took place ($10,000 in revenues had been expected).

- Many of BT's clients have been disappointed by the poor results. Not only have companies been disturbed by the lack of results after optimistic forecasts were made, but they have also complained of the poor communications among the parties involved (buyer-WTI-Banex-producers). The focus of the services provided was almost entirely on U.S. marketing and the buyer; very little attention was given to working with the producer as a partner in a venture to develop exports.

- Institutional development has not occurred as expected. Part of the problem can be attributed to personnel turnover and a hiring freeze put on by Banex management when it began to have doubts about the direction being followed by BT. However, the remaining staff is not adequately equipped with the tools needed to operate a trading company.

The poor performance, summarized above and detailed in Chapter IV, can be assessed at two levels: the strategy itself and the implementation of the strategy. Unfortunately, there is no written statement of the BT/WTI strategy. The initial work program drawn up by WTI, which describes the tasks to be carried out, does not explicitly articulate a strategy. However, the implicit strategy, which can be deduced from the actual operations and the work program, involved the marketing in the U.S. of surplus production and an emphasis on marketing rather than production.

This implicit strategy limited from the start the possible success of BT. Costa Rica simply lacks the production capability for exporting in terms of quantity, quality and price. Furthermore, most existing manufacturers are largely oriented towards the domestic market and lack the necessary commitment to exporting. Instead of being oriented towards selling and the buyers, the strategy should have emphasized export production and working with producers committed to exports (for example, helping to finance and organize new export oriented projects).[1]

Serious problems can also be identified in the implementation of the strategy. Among the most serious has been the failure to work with clients on a partnership basis. The principal contact with firms involved transmitting communications from and to buyers. Another shortcoming has resulted from the failure to adequately assess whether a product could be really competitive in U.S. markets before beginning to identify buyers. A lot of effort and cost has been spent trying to make sales in cases where the limited potential would not have justified the investment. A third problem has been the lack of integration between the bank and the trading company. Providing export credit or financing for export related investments would have been invaluable in helping to stimulate export development, but this opportunity was not exploited. No loans were made by Banex to help develop BT generated export sales.

Some general conclusions can be made regarding the Banex project in addition to those specific to the bank or BT:

- The project, as designed in the Project Paper, may have been too ambitious. It proposed taking a small, newly established commercial bank and adding both an investment banking capability and a trading company providing a wide range of services.

- The design of the project may reflect the inexperience of USAID with private sector projects. The comprehensive program designed, incorporating a wide range of services, was primarily oriented towards achieving developmental objectives. Not only was a small new firm expected to enter into new and largely unrelated businesses, but it was expected to put as much attention into development goals and services as into the more profitable activities.

C. Recommendations

The principal thrust of a new strategy for Banex should be the development of the company's capability to serve the "producer end" of the export process. The entire Banex organization should thus work in an integrated fashion towards supporting existing or potential export producers by:

- Increasing the responsiveness of the banking side to the needs of producers for services and credit. This would involve continued flexibility in the bank to insure that the services offered are

---

[1] The Project Paper called for the trading company to provide both the marketing/U.S. capability and assistance to Costa Rican producers but does not explain how the latter would be accomplished. The WTI work program focuses mostly on the former component.

in line with user needs (loan officers should regularly visit clients to assess their needs); and, further emphasis on serving the key clients who are likely to use the full range of Banex services (a Banex account executive could be assigned to these clients to prepare and monitor a package of services for the client in coordination with the bank).

- o Developing a more venture-oriented investment/financing capability, under either BT or a new investment banking division. This new function would channel dollars (from the USAID loan or other sources) and/or colones into export-oriented investment projects through long-term lending or possibly equity participation.

- o Developing BT's capability to work with and for existing producers to improve their ability to meet new market demands. Such assistance may involve credit (for example, for new packaging machines or materials), product adaptation or redesign, and other services such as warehousing, cold-storage, freight consolidation and negotiation of advantageous freight rates.

- o Developing BT's ability to effectively promote joint ventures for export oriented industries, particularly in the agro-industrial and re-export industry areas.

By focusing on export production and the producers, the recommended strategic thrust is advantageous to Banex by providing a central focus for all of its operations and making better use of its resources, while also being more consistent with the needs of potential exporters. More specifically, the recommended thrust:

- o Emphasizes the use of Banex's principal resource — its financing capability.

- o Addresses the major constraint to export development, the lack of export production, such that the project is more likely to realize its development objectives.

- o Leads to export development in a way which is profitable to Banex, such that there is likely to be less conflict between development and profit objectives in the day-to-day operations.

- o Contributes to the integration of the bank and BT by providing a central focus for Banex as a whole.

- o Facilitates the development of a strong client base as a consequence of the emphasis on working with clients as partners.

- o Insures a meaningful and profitable activity for BT, in contrast to the current situation where it plays a marginal role. In fact, project financing and facilitation is likely to be the leading activity for Banex over the longer run, both in terms of its profitability and its generation of business for the banking and other trading services.

o Enhances the utilization of the USAID loan by emphasizing investment projects with a likely dollar component (for example, for imported equipment) and an export orientation (thus earning the foreign exchange to pay off the loan).

As a result of a strategy session with top level Banex and USAID management, aimed at reviewing the results of this study and its implications for Banex, the general consensus was that the strategic thrust described above would be the most appropriate for the corporation. Banex, with USAID concurrence, indicated its intention to begin to implement the new thrust immediately. We would recommend that the following factors be considered:

o A decision must be made regarding the structuring of the project investment/financing capability. The two principal choices are: setting up a separate investment banking department in the bank which closely coordinates its activities with BT; or to develop the project analysis capability in BT and establish mechanisms for channeling funds directly through this group. However, the important factor is to keep the commercial and investment banking functions separate (while maintaining close coordination) since each involves different objectives, loan or investment criteria and a different approach to risk.

o BT should carefully concentrate its efforts on a limited number of clients and projects. In addition to following through on the sales leads developed during the past year, it should work with a small number (about 3-4) of existing producers committed to developing exports and seek to develop and finance about 3-4 new projects per year.

o BT should work together with existing producers to prepare a program for export development. This should include: an assessment of what the producer will have to do in order to penetrate export markets (re-design products or packaging, streamline operations to reduce costs, expand certain lines, enter into a joint venture, etc.); determination of what services can be provided by BT (financing, assistance in identifying a joint venture partner, marketing and technical support, etc.); and, preparation of an action plan for executing the export development program.

o In developing new projects, BT or the investment banking department, should work with local or foreign investors to identify joint venture partners (when needed). Banex should then explore the possibility of an equity participation or of coordinating the project financing (with Banex and other bank participation). As these projects develop, Banex should aggressively pursue opportunities to provide additional banking and trading services.

- o BT will require additional staffing with expertise in project development and analysis and with some background in production management/industrial engineering, and project finance. One possibility would be to assign "account executives" to be responsible for working with specific clients. The "account executives" may need to contract with technical experts to assist in an advisory capacity in the assessment of the requirements for export development in specific enterprises (industry experts).[1] Some short-term assistance may also be required in the implementation of the new strategic thrust. However, Banex must take full responsibility for all its activities; the role of contractors is to provide specialized expertise and support.

- o The Banex Board should prepare and endorse a strategic plan detailing: specific goals and objectives (corporate, bank and BT); markets and services to be provided; criteria for measuring the performance of the different divisions; organization and staffing; and, an implementation plan.

- o Banex management should develop mechanisms for insuring close coordination between the banking and trading sides of the operation.

- o The New York office should be used as a base for: following up sales leads developed during the past year; helping to identify and contact joint venture partners; providing services to Costa Rican exporters in the U.S. (dealing with customs, USDA, FDA, negotiating advantageous shipping rates, etc.); supporting producers in their marketing efforts (with research, contacting of buyers, etc.).

USAID's role in implementing the new strategic thrust would be relatively limited. It would need to review and approve the strategic plan to be prepared by Banex management. Subsequently, USAID would monitor performance on a quarterly basis based on reports to be submitted by Banex. In addition, Banex and USAID should discuss the need for short-term technical assistance and agree on the best approach for financing and contracting this expertise.

---

[1] Maintaining a roster of local and foreign industry experts who could be retained by the client and/or BT could be an interesting new service for BT.

II. EVOLUTION AND ORGANIZATION OF BANEX

A. Evolution of the Concept

Banex as a concept originated with a group of Costa Rican businessmen interested in establishing a private bank as an alternative to Costa Rica's state-owned banking enterprises. The bank as originally conceived had two principal goals: (1) to serve as an energizing force to open up the Costa Rican banking system, and (2) to provide credits for financing agricultural exports, particularly coffee. Coffee financing in Costa Rica, provided largely by a small group of foreign coffee buyers (primarily German), was rendered on terms which were considered unfavorable to Costa Rican producers. Growers believed they could obtain better prices for their coffee if the financing and purchase of coffee was separated. Furthermore, by providing Costa Rican financing, more of the final price of coffee would be retained in the national economy.

At the time that the concept of Banex was originally being developed in 1979-80, the Costa Rican economy was suffering from a severe credit squeeze. Only about 10% of available credit resources among state-owned banks was being channeled into the private sector, and there was a gap of about $300-400 million annually between the available supply of credit and the credit demands of Costa Rican agricultural and industrial enterprises for investment and working capital. Credit demands among Costa Rican coffee growers and manufacturers were found to be seasonally complementary, with agricultural credit demands peaking at the period of the year when manufacturing demands for working capital were at a low ebb and vice versa.

Thus the original goals of the bank were broadened to include the provision of a full range of banking services, as well as export-related services, to Costa Rican manufacturing and agriculture.

By January, 1981 Banex had obtained an initial capital subscription of about $1 million; the stockholder base was eventually expanded to 120, with paid-in capital of $2 million at the going exchange rates. A prestigious Board of Directors was formed bringing together diverse segments of Costa Rican agriculture and industry.

In order to leverage its equity, Banex management had originally counted on obtaining additional funds from three sources: international commercial or investment banks, purchased funds through time deposits from the Costa Rican general public, and lending from international financial institutions such as IBRD, IDB, or the IFC. However, the period of the bank's formation coincided with the severe deterioration of the Costa Rican economy and the devaluation of the colon in 1980-81. Foreign credit lines suddenly dried up, and Banex was unable to tap into foreign dollar lines of credit on which it had been counting to expand its $2 million of paid-up capital. Banex, in other words, was facing a test of survival, having barely gotten off the ground.

During the same period when the Banex concept was being formulated by members of the Costa Rican private sector, the USAID mission in Costa Rica recognized that macroeconomic conditions in Costa Rica had created a need for new, more efficient institutional mechanisms for meeting the export-related financial and management needs of Costa Rican industry and for stimulating the growth of non-traditional exports.

USAID recognized that the macro-economic crisis, characterized by drastic devaluation, contraction of imports and GDP, rising unemployment and high inflation, would require a vigorous effort to develop exports, and particularly non-traditional exports. Alleviating the crisis and developing exports would require efforts at various levels. At the policy level, it was believed that the Government was beginning to implement policies which would address the underlying structural economic problems and that it was making a committment to export development.

At the programmatic level, USAID noted the need for mechanisms aimed at promoting production for export and supporting firms in their export oriented activities. In particular, the need for an agile mechanism to attract foreign capital, channel much needed credit to productive enterprises, and provide a wide range of export-oriented services to the firms was identified.

As eventually crystallized in the Project Paper, USAID's purpose for its proposed project was to establish an integrated program of credit, export management assistance, and export-oriented banking services for the producers, manufacturers, and brokers of non-traditional exports to world markets. Project objectives included:

- A credit system making loans at market interest rates, with terms and conditions specifically tailored to the needs of eligible producers, manufacturers and brokers of exportable products;
- A privately operated export management organization;
- Basic export-oriented banking services; and,
- A viable, private banking institution which offers an additional private sector alternative for resolution of Costa Rica's banking problems (particularly the rigidity and inefficiency of the nationalized banking system).

The idea for a trading company linked to a private banking institution did not emerge immediately. Nor was the choice of Banex as an appropriate institutional vehicle for the project made overnight. Rather, both the idea and the decision to support Banex developed slowly over time once Banex surfaced to USAID as a worthy institution in need of financial support. The final project design incorporating credit, banking service and export management components evolved as a result of extensive discussions between Banex and USAID.

Banex was initially enthusiastic about USAID financing for the bank, particularly in light of its difficulties in obtaining other sources of financing. After some initial doubts, Banex was also enthusiastic about adding an export management component to the bank since this component would enhance the organization's ability to achieve its objective of contributing to economic development.

In the light of subsequent words and actions by the Banex Board of Directors, it appears clear that some members of the Board were not wholeheartedly committed to the concept of a trading company entity as part of the Banex operation. Some Board members appear to have been concerned about the capability of Banex to develop such a trading company operation from the ground up, as well as the possibility that efforts expended to develop the trading company would detract from initial efforts to insure the viability of the banking operation. Furthermore, some members apparently perceived the banking operations as being both the principal and most profitable component of the company, while the export management company would be more developmental and less profitable.

Even in the banking component, there also appears to have been a difference in emphasis between the goals for Banex as envisioned by its management and the goals for the project as articulated in the Project Paper. Specifically, Banex management placed solid emphasis on the development of a full-service, commercial, private banking operation which would act as a force to slowly open up the Costa Rican banking sector, but where profitability would be the primary objective. Thus, Banex management's self-described goals included:

o "an adequate ROI in colon or dollar terms; and,

o slow progress in opening up the banking system".

In practice, Banex in approving loans uses the following self-described criteria in order:

o serve customers on a first-come, first-serve basis;

o commercial viability of loan and funded project; and,

o contribution to development goals.

USAID, on the other hand, put much more emphasis on the developmental aspects of the proposed project. The Project Paper described Banex as "a private bank whose main focus is on export financing" and noted that "USAID's funds would be used to promote the export of non-traditional products to non-traditional markets" while Banex funds would be used for all exports including traditional products such as coffee". Sublending criteria indluced: the development or improvement of non-traditional export production and marketing systems; and, the overall diversification, export sales, profits and market penetration of individual sub-borrowers.

In summary, like most partnerships, the project which emerged from the USAID-Banex discussions reflected a symbiotic relationship where each party met some of the other party's specific needs while showing at least some of the same objectives and perception of the problem (although important differences remained). Thus, Banex secured needed financing and institutional support, while providing USAID with a mechanism for working towards its developmental goals. Even though Banex perceived profitability to be its primary objective, while USAID's mission was primarily developmental, there appeared to be enough overlap to permit a successful partnership. Finally, while Banex initially identified an opportunity in banking, it agreed with USAID that export management could provide an interesting activity for Banex, particularly from the developmental perspective. However, the differences in emphasis eventually may have had an impact on the project as will be further described in subsequent chapters.

B. Organization of the Corporation

In September of 1981, USAID entered into a loan agreement with Banex, SA. At that time the "Banex Group" consisted of Banex, SA and its subsidiary, BISA (Banex International - Panama). The loan agreement specifically required the creation of a trading company, the use of BISA for all dollar sub-lending, as well as agreement to and compliance with the loan covenants as specified in that agreement.

Upon implementation of the loan agreement by Banex, SA a series of obstacles emerged which were related to the organizational structure of the "Banex Group" at the time. Specifically, Costa Rican law (Article 73 of the National Banking System Law) does not allow a bank to establish a subsidiary which is involved in commercial activities. Also the uncertainty as to the application of the monetary law which regulates the contracts signed in dollars within the country, raised the possibility that since the USAID funds were channeled through Banex, SA then through BISA (its own subsidiary), before being passed on to the final borrowers, the sub-loan agreements with BISA could be viewed as agreements with Banex, SA in Costa Rica and subject to settlement at the official exchange rate by the final borrower. A third problem arose in that Article 154 of the National Banking System Law establishes that the net income of the bank is subject to certain deductions (5% Conape, 10% Fondo de Empleados) which would include the net income of BISA and the new trading company if they were formed as wholly-owned subsidiaries of Banex, SA. Other problems arose in that banking legislation requires that the Board of Directors of a private bank be appointed for relatively short time periods which would not have provided the "Banex Group" with a long-term, stable organization, as well as the fact that Banex, SA is capitalized and operates in colones, whereas BISA and Banex Trading Company were to operate in U.S. dollars.

At the time it was also felt that the banking side and the trading company, components should have different Boards of Directors in order to allow each organization to grow independently and to assure their success in the long run without being constrained by each others operations. After an analysis of the problem, it was decided that a holding company structure, with Banex, SA, BISA, and the trading company as an independent subsidiary with their own Boards would address the problems discussed above. The plan for reorganization which was approved in early 1982, resulted in the present-day organization of the Banex Group or what is now called Corporacion Banex (see Figure 1).

With the February, 1982 reorganization, the Banex Board of Directors was reconstituted into a nine-member Board of Directors for the Banex holding company. This Board includes participation by the President and executive vice-president, the latter who is also general manager of the bank and executive VP of the trading company. The holding company board meets once a month.

Five members of the holding company Board of Directors are joined by two other invited members to form the Board of Directors for the bank; this board meets once a week to review loan applications and approve all credits above $10,000 as required by law. Four other members of the holding company board are joined by three invited members to form the Board of Directors of the trading company. The bank and trading company boards function largely as management operating committees rather than policy boards.

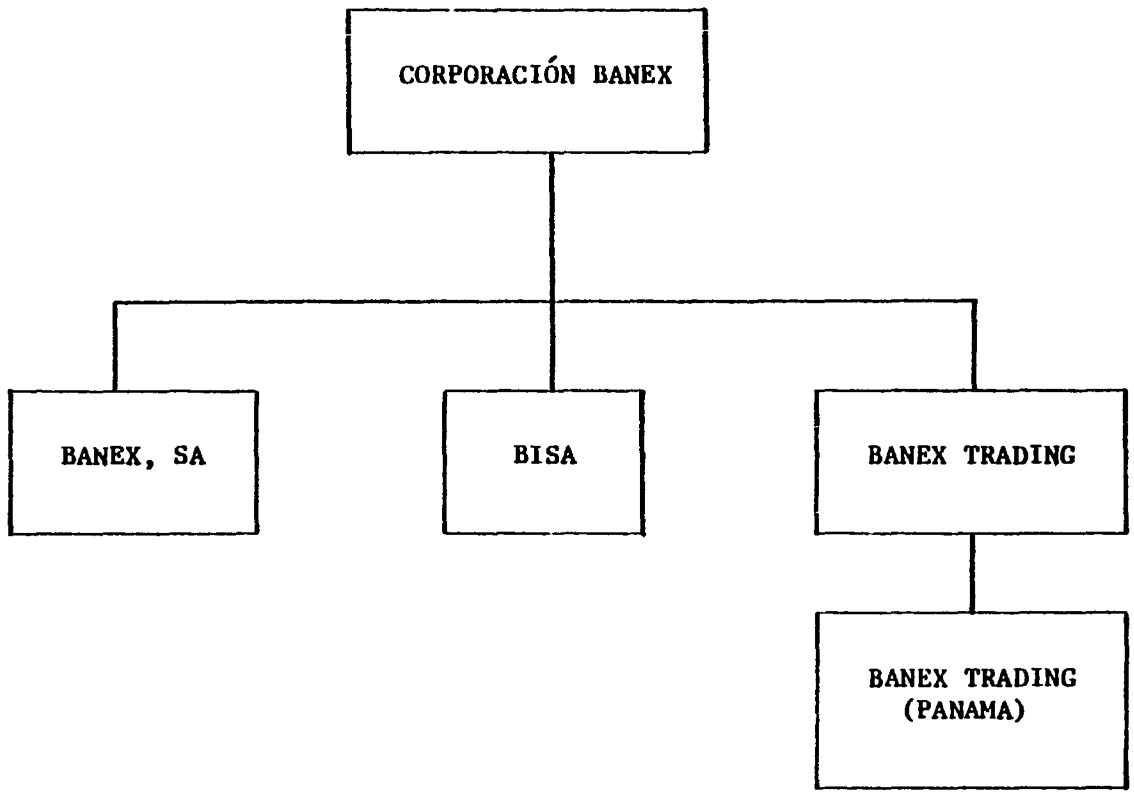
The internal structure of the bank has remained largely the same since the latter half of 1981. The operations or administrative manager is responsible for the accounting department, the internal auditor, and general services. The credit manager oversees both the credit department and the international department.

The internal structure of the trading company remains at a rudimentary stage of development. In addition to the general manager's position (recently filled following the departure of the first general manager), there are two trader positions (one currently vacant) in the Costa Rican trading company operation. The Director of the U.S. trading company arm is just in the process of establishing a New York office for Banex Trading consisting of himself and a secretary. There is, in addition, an administrative officer in the Costa Rican trading company.

Corporacion Banex was formed through a stock swap with Banex, SA at an exchange rate of sixty Corporacion Banex shares with a par value of U.S. $1.00 per share, for each share of Banex, SA which had a par value of 1,000 colones per share. That transaction led to the creation of goodwill in excess of $600,000 on Corporacion Banex's balance sheet reflecting the fact that Banex's market value exceeded its book value.

FIGURE II-1

ORGANIZATION OF CORPORACIÓN BANEX



As of December 31, 1982, Corporacion Banex held shares in its subsidiaries with a par value of 30 million colones for Banex, SA (increased from 20.8 million colones in December of 1982)[1], $250,000 in BISA, and $700,000 in BANTRA (Banex Trading Company). The $700,000 in BANTRA as well as the $250,000 in BISA were made possible through loans from Banex, SA to Corporacion Banex[2].

The organization as it now stands has given rise to a series of new problems and issues which the management of Corporacion Banex believes should be addressed in order to better protect the interests of USAID and Corporacion Banex. One of the first problems that has arisen as a result of the changes in the organizational structure, is that the interpretation of some of the loan covenants detailed in the loan agreement changes. This will be further addressed in the next chapter.

A second problem arising out of the new organizational structure relates to Articles 6 and 7 of the Monetary Law ("Ley de la Moneda") in which Banex, SA and BISA are still facing an exchange rate risk since the USAID funds channeled through Banex, SA, a Costa Rican company, to BISA before being lent to the final borrwer, could be interpreted as a loan originating in Costa Rica, causing settlement of the dollar debts at the official exchange rate rather than the market rate, by the final borrower. Recent jurisprudence suggests that the issue be addressed.

As a result of the reorganization, Banex, SA is also running a fiscal risk as specified in Article 11 of the Internal Revenue Code of Costa Rica. Recent jurisprudence suggests that strict interpretation of the Internal Revenue Code could result in Banex, SA being liable for taxes on the income differential between the 5% rate of interest it charges its related companies on USAID funds, and the legal interest rate of 12% (now under consideration for a possible increase to 25%).

Another area of concern relates to Article 85 of the "Ley de Organica del Banco Central" which specifies that the maximum credit risk per client cannot exceed 15% of the bank's capital and reserves. In the strictest sense, it is conceivable that the Central Bank auditor could interpret that the funds channeled from Banex, SA to Corporacion Banex and BISA are in fact a loan or credits from Banex, SA which exceed 15% of Banex, SA's capital and reserves and thus would violate the limitations set by Article 85.

For the above reasons, Banex has now raised the issue with USAID on re-defining the debtor of the Banex/USAID loan as BISA which would

---

[1] The increase was financed by Corporacion Banex through borrowings from some stockholders until Corporacion Banex raises more equity.

[2] The origin of the $700,000 in Banex Trading are the USAID funds provided in compliance with the loan agreement.

strengthen the organization's position should it be challenged by the authorities on any of the above areas of concern. Such a change would result in a clearer organizational relationship and would result in a decrease in the inflation of the individual company's financial statements as a result of the funds which are presently channeled through Banex, SA.

C. The Export Management Component

As has been noted, Banex was initially organized as an export oriented bank. USAID, however, was convinced that financing was only one of the constraints limiting export development. In addition, the Project Paper states that the lack of exporting expertise would require an export management capability incorporating a wide range of activities including, "but not limited to, foreign market development, moving papers in bureaucracy, and coordinating physical movement and transfer of goods ... (in addition to) feedback to the production activity about market requirements ..." Since USAID believed that the export management component was essential for achieving its developmental objectives, the establishment of an export management or trading company as part of Banex was made a condition for USAID assistance.

During the early stages of the conceptual process and development of the project paper, the trading company concept was not subject to a detailed feasibility analysis. USAID did bring in an outside consultant who owned and managed a trading company in New Orleans. His report, published in July, 1981 and entitled "Structural Design: Costa Rica Agro-Industrial Export Corporation (EXCO)", identified five key success factors in setting up a trading company: entrepreneurial talent; skilled staff capable of building and sustaining relationships of trust with customers; ability to provide transportation services; a focus on one or two product lines, usually a commodity, to generate initial revenues; a long-term development focus; and providing adequate time (3-5 years) to a trading company management before expecting profitable operations.

The consultant proposed the establishment of a Banex subsidiary export corporation (EXCO) which would function as a separate profit center from the bank operation and would be responsible for providing risk capital and trade-related management services to specialized product export companies (SPECO's), which in turn would be satellite export management concerns organized around specific industry or product groups (e.g., a furniture export management company, an apparel export management company, etc.). The SPECO's would be affiliated directly with the Banex export corporation through equity investment by the Banex export corporation and (in some cases) through overlapping management.

The EXCO would have five principal sources of revenue: management and financial advisory fees to the SPECO's; fees for EXCO personnel assigned to the SPECO's; mark-up on imports handled by the import division; mark-up on exports handled by the U.S. procurement company, and financing spread on pre-export financing to coffee growers. In addition to the SPECO's, the EXCO was to be organized into three divisions: the coffee financing division; a U.S. purchasing company (for raw material and intermediate product imports), and an import/export division which would be primarily responsible for handling imports at the Costa Rican end of the chain. The EXCO itself would directly handle export transactions only under extraordinary circumstances.

The concept of the trading company evolved further in the spring of 1981 through discussions among USAID-Costa Rica officials, Banex management, and the World Trade Institute (WTI). USAID contracted WTI to assist in developing the trading company concept in the spring of 1981, about mid-way through the process of developing the Project Paper.

The final version of the planned export management component as reflected in the Project Paper integrated elements recommended by both consultants and featured:

- A wholly-owned Costa Rican-based trading company subsidiary;
- A wholly-owned U.S.-based trading company subsidiary and purchasing office;
- At least one joint venture export company specializing in a single product line involving Banex equity participation and participation by Costa Rican producers (similar to the SPECO concept).

The activities proposed for the trading company in the Project Paper, were very comprehensive in that they included almost all possible services which a trading or export management company might provide. The U.S. subsidiary was to provide market development and management services as well as materials procurement, and financing, warehousing, and transport and insurance. The Costa Rican component was to provide warehousing, production financing, equity investments, and other services and assistance to producers. The actual implementation of this design is discussed in Chapter IV.

III. BANKING AND BANKING SERVICES COMPONENTS

A. Compliance With Terms of the Project Loan Agreement

On December 29, 1981, USAID in its Implementation Letter #3, notified Banex that it had met all the conditions precedent to disbursement as stated in Section 5.1 of Article 5 of the Project Loan Agreement. That first disbursement amounted to $575,000 and, as of December 31, 1982, total USAID disbursements to Banex amounted to approximately $2.2 million, of which $700,000 was for the capitalization of Banex Trading Company.

In addition to the conditions precedent to disbursement as stated in Section 5.1 of Article 5 of the Project Loan Agreement, Section 5.2 through 5.6 outline the terms of the Project Loan Agreement, as do Sections 6.1 and 6.2 of Article 6 of that Agreement. As stated in the Scope of Work, the contractor has been asked to determine the extent to which the borrower has complied with the terms of the Project Loan Agreement, and this analysis is presented below. In performing this task, we have reviewed all of the terms of the Project Loan Agreement with the management of Corporacion Banex, as well as with USAID, and have raised in this section those issues resulting from changes in the original Project Loan Agreement or instances where Banex has received extensions in the time frame for complying with the conditions of the Project Loan Agreement.

Section 6.1(a) of Article 6, states that Banex "establish an evaluation program as part of the project." In Implementation Letter #1, dated December 16, 1981, USAID notified Banex that the evaluation program would be conducted by a contractor selected by USAID. This shifted the burden of the actual evaluation to the contractor, although Banex submits quarterly reports to USAID in which it reviews the major achievements of the quarter with respect to the project.

Section 6.1(m) of the Loan Agreement states that Banex "use reflows of sub-loan principal and interest in conformity with the purposes of the project." As stated earlier, Banex has drawn down approximately $2.2 million to the loan agreement, of which $700,000 was to capitalize Banex Trading Company. Of the remaining $1.5 million, approximately $795,000 is held in sub-loans directly funded by the money and approximately $700,000 in sub-loan reflows is held in investments, which amounts to over 45% of the net $1.5 million in USAID funding. This situation has occurred because in anticipation of a larger demand for U.S. dollar loans, Banex wanted to have the liquidity with which to make the loans. Since the demand has been so low, most of the reflows of sub-loan principal and interest were placed in investments, while disbursements of new sub-loans were funded through the USAID project. In September of 1982, Banex requested the last disbursement, and the total amount of funds held in investments has declined as the dollar sub-loan portfolio continues to grow.

The Loan Agreement does not specify a limit on the percentage of sub-loan reflows which can be placed in investments. At the same time, it allows for a faster disbursement of the USAID. Although a limit should be placed on the maximum percentage of the total USAID loan which can be placed in investments, this should be established at a level which provides Banex with enough liquidity with which to fund new sub-loans as its dollar portfolio grows. A maximum of 20% would probably be reasonable, provided it is measured as a protracted balance over a year's time, in order to allow for temporary "peaks" in sub-loan reflows.

As stated in Section 6.1(n) Banex must submit quarterly reports to USAID throughout the life of the Agreement. Banex has submitted these quarterly reports outlining its progress to date in each quarter, and these reports have been accepted by USAID even though the reports have not been as detailed and have not provided all of the information that USAID originally stated in the Loan Agreement. Specifically, USAID asked for "a breakdown of sub-projects, showing the types of industries, commitments and disbursements, terms and conditions of financing, uses of borrower and USAID funds, an aging of accounts and other comments as appropriate." Some of this information has been provided, however, other information, specifically terms and conditions of financing, an aging of accounts, as well as a breakdown of sub-projects showing types of industry, has not been provided on a consistent basis. This information is available at Banex and should be included in the quarterly reports, since this is the type of information which would facilitate monitoring by USAID as well as the Banex Board. Recently, Banex has begun to standardize the quarterly reports which it issues, and these should provide most of the information needed to monitor the project.

Should USAID feel that it needs additional information to adequately monitor the project, we are confident that Banex internal records could adequately produce this information with a minimum of additional effort. This issue should be negotiated to avoid penalizing Banex.

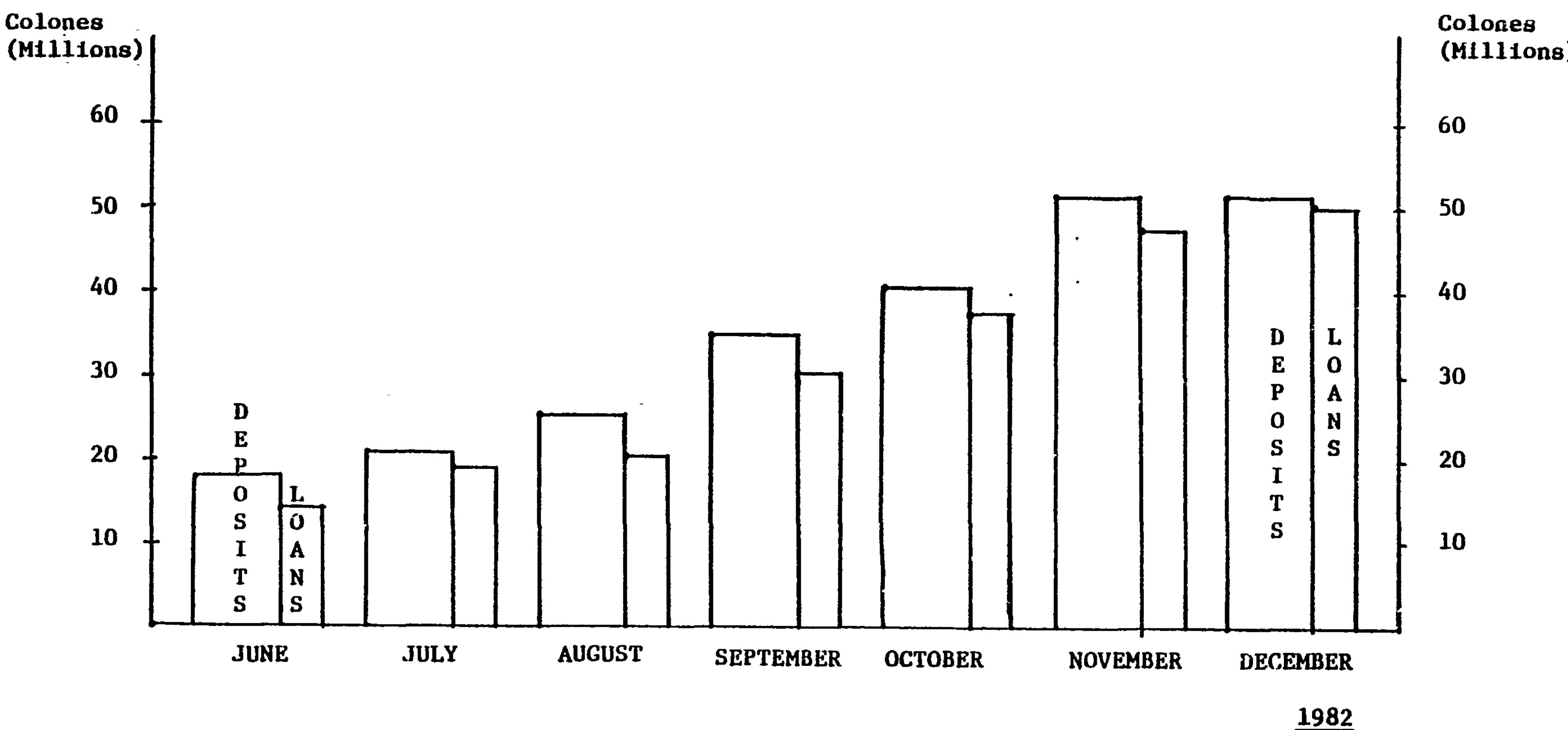
Throughout 1982, Banex pursued negotiations in order to establish co-financing arrangements in U.S. dollars as well as in colones. These actions are in direct response to Section 6.1(p) of the Loan Agreement.

As of December 1982, Banex had been able to raise over 52 million colones through the use of investment certificates. These certificates range from six months to four years in term, at market competitive annual interest rates of approximately 26%. The growth in this colon gathering activity, along with the net loans which are funded by this activity, are shown in Figure III-1. This growth has continued into the first quarter of 1983. The net amount of approximately 52 million colones, as of December 1982, converts into a dollar amount equal to approximately $1.2 million U.S.

In addition to the colon deposits, Banex has received lines of credit in U.S. dollars of $0.5 million from BLADEX (Banco Latinoamericano

FIGURE III-1

SUMMARY OF COLON DEPOSIT ACTIVITY
AND RELATED LOANS



de Exportaciones S.A.), $250,000 from Deutsche-Sudamerikanische Bank A.G., $1.0 million from Bankers Trust and $0.5 million from the First National Bank of Boston[1]. Although Banex has been able to secure these commitments at commercial rates, because of the availability of U.S. dollars at low rates under the USAID Project Loan Agreement as well as the weak demand for U.S. dollars, Banex has not had to rely on these higher cost funds to finance its dollar portfolio.

Under the USAID/BCCR Loan Program, Banex has also been able to place an additional 130 million colones (approximately $2.9 million U.S.) as of December 31, 1982. Those funds, although not from "private" sources, along with the lines of credit in U.S. dollars and the colon investment certificates, amount to substantial co-financing agreements (in the generic sense) in excess of targets set for Banex at this time.

Given the weak demand for U.S. dollar loans, Banex's activities (and USAID's requirements) regarding the securing of U.S. dollar lines of credit appear to be somewhat superfluous. It would seem appropriate for USAID to soften or eliminate the co-financing covenant in view of both the likelihood that such lines of credit will probably not be utilized in the near term future and Banex's success in raising funds in the local market through investment certificates. As the market changes, and the demand for dollar loans increases beyond that which can be funded through the USAID project, Banex will be in a position to better undertake and benefit from these activities.

Section 6.1(q) states that Banex "establish and make payments into an escrow account on terms and conditions satisfactory to USAID... to provide assets which will be available to USAID as additional security against risk of loan default." As of December 31, 1982, Banex had yet to establish such an escrow account and in Implementation Letter #9, issued by USAID on January 1, 1983, an extension of 120 days was granted to Banex in order to comply with this portion of the Loan Agreement. In March of 1983, USAID had accepted a proposal submitted by Banex with regard to the escrow account, and compliance with this portion of the Loan Agreement was expected within the extension period granted by USAID.

The Loan Agreement also states in Section 6.1(r) that Banex increase the amount of newly issued stock available for public subscription by at least 10% annually. As of December 31, 1982, Banex had not been able to comply with this requirement for legal reasons, and in Implementation Letter #9 dated January 25, 1983, a 120-day extension was granted to facilitate compliance. In March of 1983, the management of Corporacion Banex presented to its Board a plan to increase the number of shares outstanding in Corporacion Banex from 1,242,640 shares to 2,000,000

---

[1]The last two were authorized and are contingent on a USAID letter of commitment facility.

shares, for an increase of 757,360 (61%) shares. The new shares to be issued will be offered to existing shareholders in amounts proportional to their present ownership in Corporacion Banex. As stated by Costa Rican law, if a shareholder rejects the option to purchase the additional shares, other shareholders have the right to purchase those shares before they are offered to the general public. In compliance with the USAID covenants, 10% of the new issue has been reserved and offered publicly to new investors. A portion of the stock issue will also be directed toward the employees of Corporacion Banex through a special stock financing program which has been developed by management.

The Loan Agreement also states in Section 6.1(s) that the interest income from the sub-loans made using USAID funds, less the interest expense, allowable operating expenses and other approved items, be used to establish and operate the export management component of the project. The Loan Agreement does not specifically state that the calculation must be done annually, but rather states that 100% of the net income, as defined above, in the first three years and 50% of the net income for as long as USAID feels is appropriate after the first three years, should be transferred to the trading company. For the first year of the project, the calculation has not as yet been completed initial calculations suggest that this amount would be negligible in the first year.

Section 6.1(u) states that at no time during the period of the Loan Agreement should the net worth of the trading company fall below $350,000. As of December 31, 1982, the consolidated statement for Banex trading and its Panamanian subsidiary reflected a net worth of $700,000. The net worth has remained equal to its paid-in capital because the operating expenses for the initial eleven months of trading company activities which ended in December of 1982, have been capitalized on the balance sheet and have not been expensed. The total amount of capitalized expenses amounts to approximately $349,000, and had they been expensed, would have reduced the net worth of the trading company to a point where it would come close to the minimum net worth limit set by the Loan Agreement. The specific reason stated by Banex for the capitalization of these expenses was in effect to defer the expenses to years where they will be better utilized for tax reduction purposes. As now planned these capitalized expenses will be amortized over a three year period beginning in January 1983.

The debt to equity, as stated in Section 6.1(y), is not allowed to exceed 6:1 during the first year, 7:1 during the second year, 8:1 during the third year, rising to 9:1 during the fourth year and 10:1 in years five through twenty of the Loan Agreement. As of December 31, 1982, the management of Corporacion Banex estimated that the debt to equity ratio for the banking subsidiaries (Banex, SA and BISA) was 4.8:1. This calculation was achieved by combining the liabilities of Banex, SA and BISA and eliminating the inter-company amounts (including an elimination of the $700,000 used to capitalize Banex Trading), as well as the funds raised through investment certificates.[1] This re-stated liability figure was then divided by the total equity arrived at by estimation. The total equity arrived at by estimation was computed subtracting the re-stated liabilities for the companies from the combined re-stated assets.

The problem in calculating the debt to equity ratio off the balance sheet of Banex, SA is that the assets and liabilities of the company are inflated by the fact that Banex presently serves as a borrower for almost all of the needs of the Corporacion Banex. In fact, as of December 31, 1982, the debt to equity ratio calculated off the colones balance sheet for Banex, SA, after subtracting out the funds raised through investment certificates from the liabilities figure, is 8.05:1.00, exceeding the 7:1 limit imposed for the second year of operations. However, for purposes of measuring the risk to USAID a better measure of the true debt to equity ratio of the Banex Group, would be to use the consolidated balance sheets for Corporacion Banex which reflects the total paid-in capital for the Group and which at this time is still primarily a bank holding company. A calculation of the debt to equity ratio off the consolidated dollar balance sheet for December of 1982 for Corporacion Banex reveals that after subtracting out the funds raised through investment certificates on the balance sheet, the debt to equity ratio is of 4.77:1 (5.69:1 if investment certificate funds are included). The substantial equity infusion scheduled for 1983 will continue to insure that the debt to equity ratio for Corporacion Banex remains under the limits imposed by the Loan Agreement, even though substantial growth in its loan portfolio will occur.

B. Characteristics of Banex Sub-Loan Portfolios

As of December 31, 1982, Banex had total outstanding loans of U.S. $4,885,000 (less a provision of $48,850). This total amount was held in three main portfolios; approximately $866,000 in dollar loans funded mostly by USAID; approximately $2,873,000 in colon loans (129,165,800 colones) funded through the USAID/BCCR program, and approximately $1,141,000 (51,341,000 colones) in colon loans funded by investment certificates.

Of the $865,763 in dollar loans outstanding, $794,763 was actually funded by the USAID dollar loan program, with the rest being funded by the equity in BISA. Approvals for disbursements totalling over $2 million had been granted to 18 Costa Rican companies through December of

---

[1] We were informed by Banex that USAID allowed the elimination of investment certificate funds from the debt to equity consideration. In most debt to equity calculations relating to financial institutions, these deposit type funds are included as part of the "debt", since these are indeed a liability of the bank.

3?

1982. However, at that time only 10 companies had taken advantage of the dollar facility and these companies had accounted for approximately $1,700,000 in total disbursements as of that date. A breakdown of the key characteristics of the 18 companies is provided in Figure III-2.

As can be seen in Figure III-2, all of the loan approvals, as well as the actual use of these loans, has been for short-term credit in either export financing or for working capital and import financing related to exports. This reflects the difficulty in placing long-term dollar loans in the marketplace. All dollar loans have been placed at market rates.

Between January 1 and March 13, 1983, an additional 11 dollar loans totalling $1.18 million were approved. Although most of the loans continued to be short term in nature, two longer term (five year) loans were made for investment projects (agro-industry and hotel projects).

The colon portfolio, financed through the USAID/BCCR program, represents approximately two-thirds of the total colon amounts disbursed through that program in 1982. Twenty loans were made to 18 companies or their owners (most of which are different than those receiving U.S. dollar financing) of which the majority were long-term loans for recapitalization or for the restructuring of liabilities. The breakdown on the characteristics of the 18 companies which received these loans is shown in Figure III-3.

These companies, which are generally smaller than those that have received approval under the dollar loan program, will benefit tremendously from the additional capital which has been injected into them. Almost all of those companies have been under-capitalized or have held a precarious debt schedule. All loans under this program have been made at a rate of 25% except for one company which is paying a rate of 28.5%.

The third loan portfolio, colon loans funded by deposits, is by the nature of the funding, made up of short-term (six months) colon loans made only to highly liquid "A" rated companies for which little or no analysis is required. These companies, either multi-national corporations or local companies with substantial assets, pay rates of approximately 33% per year plus a 1% fee per semester.

Loans funded by investment certificates, yield the bank a very low interest rate spread which requires that the loans be of a very low risk and have a low associated administrative cost.

The quality of all of the sub-loans in Banex's loan portfolio appears to be high, and consequently they have not suffered any loan losses. A reserve of 1% is maintained against all of the sub-loans, as required in the USAID Loan Agreement. The analysis of these loans and the files kept on the borrowers reflects the concern on Banex's part with

FIGURE III-2

CHARACTERISTICS OF SUB-BORROWERS
USAID DOLLAR PROGRAM[1]

Purpose of the Loan	Number of Companies
Export Financing	10
Import Financing	5
Working Capital (pre-export)	3
TOTAL	18

Asset Size (millions colones)	
0 - 100	8
100 - 250	4
250 - over	5
TOTAL	18

Sales (millions of colones)	
0 - 100	8
100 - 250	6
250 - over	4
TOTAL	18

Number of Employees	
0 - 100	6
100 - 250	7
250 - over	5
TOTAL	18

[1] As of December 31, 1982.

FIGURE III-3

CHARACTERISTICS OF SUB-BORROWERS
USAID/BCCR COLON PROGRAM

Purpose of the Loan	Number of Companies
Working Capital (short-term)	1
Restructure Liabilities (long-term)	6
Recapitalizations (long-term)	11
TOTAL	18
Asset Size (millions colones)	
0 - 100	12
100 - 250	2
250 - over	4
TOTAL	18
Sales (millions of colones)	
0 - 100	11
100 - 250	5
250 - over	2
TOTAL	18
Number of Employees	
0 - 100	8
100 - 250	4
250 - over	6
TOTAL	18

the possibility of placing a bad loan early in the life of this project. A bad loan causing a write-off could hamper the financial strength of Banex and it would affect its ability to continue placing loans in the market place because of the relative large size of a small number of loans.

C. Achievement of Objectives and Financial Analysis

The financial projections outlined in the project paper, estimated that by the end of the first two years Banex, SA would have placed U.S. $2,275,000 in loans. These financial projections also estimated that by the end of the second year of the project, Banex's sub-loan portfolio would grow to U.S. $9,400,000, increasing again to U.S. $19,213,000 by the end of year 3. In terms of dollar equivalents, as of December 31, 1982, Banex had exceeded the first year loan volume projection by approximately U.S. $1,600,000. However, the composition of the actual loan portfolio at year end was very different from that which was forecasted almost two years ago.

Interviews with a sample of Banex clients suggests that the main reason for the difference in the composition of the loans arises out of the almost complete collapse in the demand for dollar loans that has occurred in the country in reaction to the monetary crisis which occurred during the start-up period of the bank. Many firms indicated that dollar loans were clearly out of the question, despite the large differential in interest rates between dollar and colon financing. The financial projections in the Project Paper had estimated that by the end of year 1, the expected loan portfolio of U.S. $3,275,000 would be made up exclusively of dollar lending, of which U.S. $2,500,000 was to be funded through the USAID loan program while U.S. $775,000 would be funded by the capital in the bank. The actual figures, with a total dollar equivalent in the loan portfolio of U.S. $4,885,000, have been achieved largely through colon lending, with only 18% of the portfolio held in direct dollar loans.

It is doubtful that at the time that the projections were made, it would have been possible to foresee the impact of the country's economic crisis on the demand for U.S. dollar financing. However, Banex's management has maintained the necessary flexibility in order to adjust to these conditions, and has been able to step up its colon financing activities in order to exceed the target projections in U.S. dollar equivalents.

The projected pro forma profit and loss statements show that for the first year of operations, Banex was expected to generate U.S. $392,000 in interest income against interest and bad debt expense of U.S. $130,000, resulting in a net interest margin of U.S. $262,000. The actual interest income for the year ending December 31, 1982, for the consolidated statements of Corporacion Banex[1] was U.S. $563,307, less expenses of U.S. $263,840, leaving a net interest margin of U.S. $299,467 (see Figure III-4). Actual fee income (banking services) reached U.S. $176,000 against a projected level of U.S. $296,000 and total operating income was approximately U.S. $475,000 versus the projected operating income for the first year of U.S. $558,000. Total actual administrative expenses were U.S. $357,000 versus a projected general and administrative expense figure of U.S. $320,000. The actual net income for the period of U.S. $154,000 (after adding in additional income and subtracting taxes) compares favorably with the projected net income for the first operating year of U.S. $101,000. Although the figures vary from the initial projections because of unanticipated changes in the operating environment, the final result compares favorably with the projected statements.

As can be seen in Figure III-4, 80% of the bank's total assets are in earning asset categories, and the goodwill component accounts for 7.4% of the assets on the balance sheet. On the liabilities side, almost 60% of the total liabilities and equity are from loans from other financial institutions (including USAID). Deposits account for almost 14% of the total liabilities and equity.

This goodwill component arose when the ownership of Banex, SA was transferred to Corporacion Banex. The accounting transaction (researched and calculated by the bank's external auditors) arose because at the time of the ownership transfer, the market value of many of Banex's assets exceeded the book value of those assets. Specifically, Banex, SA had written off its organizational costs completely in 1981 and the book value of Banex, SA's fixed assets did not reflect the true market value of those assets. Also the colon book value of the dollar assets held by Banex, SA also understated the market value of those assets.

A profit center analysis was undertaken by Banex, SA's management at our request for the banking activities in order to better understand the income and expenses associated with the different services offered.

Three profit centers were used; colon banking, dollar banking, and banking services, for the year ending December 31, 1982. The profit center analysis is shown in Figure III-5 and a detailed review of the assumptions used in calculating this analysis was conducted by ADL. We found the profit center analyses to be well researched and the assumptions used to be reasonable.

---

[1] The financial statements of Corporacion Banex have been used since these consolidated statements cancel out all inter-company transactions and because the primary business of Corporacion Banex continues to be banking.

FIGURE III-4

COMPARISON OF PROJECTED AND ANNUAL FINANCIAL STATEMENTS

Profit and Loss Statement
(U.S. Dollars)

	Actual Corporacion Banex Year Ended Dec. 1982		Projected Banex Project Year 1	
Interest Income	$413,472	100.0%	$392,000	100.0%
Interest Expense	266,173	64.4	130,000	33.2
Net Interest Margin	147,299	35.6	262,000	66.8
Other Income[1]	412,181	99.7	296,000	75.5
General and Operating Expense	354,559	85.8	320,000	81.6
Other Expenses and Deductions	13,010	3.1	36,000	9.2
Income Before Tax	191,911	46.4	202,000	51.5
Income Tax	37,740	9.1	101,000	25.8
Minority Interest	7	-	-	-
Net Income (less minority interest)	154,178	27.4	101,000	25.8
Return on Average Assets		3.2		4.0

[1] Banking Services, commissions on loans and net gain on foreign exchange transactions.

FIGURE III-4 (continued)

COMPARISON OF PROJECTED AND ACTUAL FINANCIAL STATEMENTS

Corporacion Banex
Balance Sheets Structure

	U.S. Dollars	% of Total Assets
Cash and Banks	462,930	5.5%
Investments	1,912,817	22.6
Loans, Net of Reserve	4,834,904	57.2
Accounts Receivable	80,113	0.9
Interest and Commission Due	63,319	0.7
Equipment and Furniture	81,458	1.0
Leasehold Improvements	23,525	0.3
Capitalized Expenses	348,824	4.1
Goodwill[1]	627,405	7.4
Other Assets	19,017	0.2
TOTAL ASSETS	8,454,312	100.0
Overdrafts	174,726	2.1
Loans - Financial Institutions	5,058,351	59.8
Loans - Others	206,800	2.4
Deposits	1,162,344	13.7
Other Liabilities	587,993	7.0
TOTAL LIABILITIES	7,190,214	85.0
Paid-In Capital (Net of Treasury Stock)	1,241,861	14.7
Legal Reserves	11,043	0.1
Retained Earnings[2]	11,194	0.1
TOTAL EQUITY	1,264,088	15.0
TOTAL LIABILITIES AND EQUITY	8,454,312	100.0

[1]Goodwill resulted from the transfer of Banex, SA ownership to Corporacion Banex and reflects the difference between the market and book value of Banex assets at the time of the transfer.

[2]Retained Earnings of $143,135 less an adjustment for currency conversion of $131,941.

517

FIGURE III-5

PROFIT CENTER ANALYSIS

(U.S. Dollars)

	January-June 1982			July - December 1982			12 Months 1982		
INCOME	Colon Credit Operations	Dollar Credit Operations	Banking Services	Colon Credit Operations	Dollar Credit Operations	Banking Services	Colon Credit Operations	Dollar Credit Operations	Banking Services
Interest Income	47,785	51,940	-	302,691	88,978	-	350,476	140,918	-
Interest Expense	28,598	16,391	-	201,359	39,024	-	229,957	55,415	-
Interest Margin	19,187	35,549	-	101,332	49,954	-	120,519	85,503	-
Banking Services	-	-	133,435	-	-	144,321	-	-	277,756
Total Income	19,187	35,549	133,435	101,332	49,954	144,321	120,519	85,503	277,756
EXPENSES									
Personnel	9,768	9,768	21,165	19,186	19,186	38,372	28,954	28,954	59,537
Building	3,461	3,461	3,461	3,920	3,920	3,920	7,381	7,381	7,381
Promotion	262	498	1,862	1,986	1,532	2,157	2,248	2,030	4,019
General	7,056	21,920	27,085	59,762	35,771	10,281	66,818	57,691	37,366
Directors	285	542	2,024	1,932	1,490	2,098	2,217	2,032	4,122
Service Corp.	728	1,383	5,167	2,845	2,195	3,089	3,573	3,573	8,256
Operating Margin	(2,373)	(2,023)	72,671	11,701	(14,140)	84,404	9,328	(16,163)	157,075
Other Income	2,259	248	15,156	10,556	44,464	15,332	12,815	44,712	30,488
Other Expenses	24	-	160	250	-	101	274	-	261
Profit Before Tax	(138)	(1,775)	87,667	22,007	30,324	99,635	21,869	28,549	187,302

The figures reflect the fact that the banking services component of Banex, SA continues to be the most profitable area of the bank, but the credit components are now past the breakeven point and will increase their contribution to the bank in 1983.

An assessment of Banex's achievement of its other non-quantitative goals and objectives, however, is not as straightforward and more difficult to assess. The purpose of the overall project was to "establish an integrated program of credit, export oriented banking services and export management assistance for the producers, manufacturers and brokers of non-traditional exports to world markets." The project was to provide an alternative to the nationalized banking system and through its offerings of a wide variety of export-related services, it was to directly contribute to increasing the country's exports. Through interviews with private sector users of Banex services, we have been able to verify that Banex has indeed been able to provide, at least for them, a serious and better alternative to the national banking system. It was generally perceived that the bank was one of the more efficient grantors of credit and providers of banking services, and several clients indicated that they hoped to increase their banking relationship with Banex in the future.

The development impact of the project through its sub-loan portfolio, varies by sub-loan portfolio. The USAID dollar-funded program has probably, at this time, had the least development impact. Most of these credits have been short-term, working capital (import/export) loans or lines of credit for which many of the borrowers had an alternative, albeit not as efficient, as borrowing from Banex. In fact, several firms did not draw upon their credit. The bank could have had a greater economic impact by seeking out new export oriented projects to participate in, instead of focusing largely on existing firms with cash flow or debt problems. The latter are the least likely to be interested in dollar loans while new investment projects would generate additional jobs and exports and be more in line with the development objectives established in the Project Paper. The first two longer term loans to help finance new investments, were approved in early 1983 such that the economic impacts cannot yet be measured.

The colon financing program (USAID/BCCR) on the other hand has probably had a much larger development impact on the country. As an efficient bank, Banex was able to respond quickly to meet the needs of the private sector. Consequently, the first two-thirds of the total monies disbursed through this program were channeled through Banex, SA. The loans, for recapitalization and restructuring of debt at long-term (ten year) market rates, have been essential in helping many of these companies reorganize financially and even survive. Thus, the impact of this program has been in saving jobs and production capability, which would seem as important as the creation of new opportunities as anticipated in the Project Paper. To some extent the colon loans have also been used to finance expansion and the purchase of new equipment.

The fact that Banex was able to competitively place such a large portion of the funds offered through this program suggests that had the Banex alternative not existed, many of these loans might not have been made or the overall loan approval process would have been much slower with an adverse effect on many of these companies.

The fact that in some cases companies borrowed colones to finance dollar purchases indicates the reluctance of firms to incur a dollar debt, despite the large differential in rates. Since the dollar loans were to be used for export projects, this reluctance also indicates a lack of conviction that sufficient exports could be generated to pay off the debt. However, Banex is now aware that it must aggressively market the dollar funds in those cases where it is justified, in order to overcome the psychological hurdle and identify appropriate new projects. As has been noted, Banex has recently been able to place two long-term dollar loans, one to a project which will export vanilla and the second to a hotel, both of which are dollar earners. Also, in the first quarter of 1983, Banex undertook an analysis of the country's exporters in which it identified 270 exporters (of which 87% were non-traditional exporters) and found that of those non-traditional exporters, 38 were already clients of the bank in one way or another, and an additional 38 had been visited with an attempt to cultivate a banking relationship. The analysis did identify a list of potential customers, for which the credit department has designed an aggressive work program which requires each loan officer to visit at least four companies per month.

Despite Banex's efforts to push its dollar loan portfolio, it is doubtful that Banex will be able to change the resistance of many private companies to dollar borrowing, since the memory of the devaluations is still very strong. However, Banex must identify and take advantage of opportunities where dollar lending can be fully hedged. One possibility would be for Banex to prepare and disseminate material outlining the risks in dollar lending and suggesting ways to manage these risks. Perhaps then, a better educated borrower may be willing to borrow in U.S. dollars when in need of dollar "tagged" funds. Even more importantly, Banex should identify new export projects in need of financing. These new ventures may be less burdened by recent events and a high debt, and by being entirely export-oriented, may be less averse to dollar borrowing. Ventures with foreign participation may play an important role here.

D. Management and Procedures

The management of Banex (banking and banking services) was interviewed extensively and in all cases the highest degree of competence and commitment to the project was found. This commitment can be seen throughout the bank in the operating standards and procedures which are used in the credit files and in the overall efficiency with which the bank operates. Interviews with Banex's clients reinforced our findings, with management receiving very high marks in terms of the confidence instilled in the client.

On the credit side, we reviewed the credit procedures of the bank, the company files which are maintained, the analysis of the companies within those files, as well as the follow-up procedures, promotion efforts and collections. In all cases we found Banex to be very well organized, always protecting the interests of the bank. For example, a careful review of several of the credit files revealed excellent documentation, a thorough evaluation of the customers and a strong adherence to the credit policies of the bank which meet USAID's requirements. Most of the suggestions which we came up with in order to improve the credit files had, in fact, been acknowledged and were already being implemented.

An ongoing training program, conducted throughout the first quarter of 1983, has been established for the loan officers. These officers have strong financial backgrounds, although limited banking credit experience. The program focuses on exposing these officers to the other services offered through the bank and, in effect, will increase their capabilities for cross-selling all of the services which Banex has to offer.

Some of the other management systems are somewhat weaker. The problems identified include: the lack of formal coordination and communication mechanisms between the bank and Banex Trading; the lack of a performance measurement system for managers; and, the lack of a formal strategic plan with a specific market/service focus (most performance targets are financial rather than strategic in nature).

E. Banking Services - Banex

At the present time, Banex offers five major import/export related banking services to companies in Costa Rica: the collection of foreign payments to Costa Rican exporters; the payment of funds to foreign companies for Costa Rican importers; the provision of import letters of credit for Costa Rican importers and advising/confirmation of foreign letters of credit for Costa Rican exporters; the purchase and sale of foreign exchange; and money transfer services for the transfer of funds between Costa Rican entities and foreign entities, using Banex correspondents in other countries. The export collection and import payment services commenced in August 1981, the letters of credit service in November 1981, the foreign exchange sales and purchases in October 1982, and the money transfer operation in the first quarter of 1983.

Banex has twelve full time people working in the Banking Services Department, which has doubled over the last year. They have reorganized the physical facilities and the systems used, and are in the process of converting the bookkeeping system to computer status which will allow the same number of people to handle increased amounts of business. They have approximately 200 customers, and are actively seeking new business from both existing and prospective customers. Many of the clients are also customers of Banex S.A. and Banex Trading, but a large portion work only with the Services Department. Prospective customers have been developed from a Central Bank list of current exporters, targeting the largest of these, as well as from other known or expected users of similar banking services at other institutions.

The charges for most of the services are controlled by the Central Bank, either through set allowable percentage charges against the total amount handled, with minimums and maximums, or through the exchange rate differentials given by the Central Bank on incoming dollars for exporters.

Banex has lost the export collection business of a few very large exporters since the latter half of 1982 due to the one to two day effective float which arises because Banex must settle with the customer by writing a colon check, as compared with the national banks' ability to immediately credit the account of a customer (Banex cannot have checking accounts on its books for customers). However, because of Banex's high quality of personalized service, substantiated through our customer visits, and its willingness to closely monitor the Central Bank import license issuance process for its import/export customers, Banex has been able to maintain most of its export customers.

During 1982, Banex handled transactions for import, export and letters of credit, totalling U.S. $63,874,000. Import services were responsible for approximately U.S. $23.5 million of which 76% was for industrial companies, 4% for agribusiness firms, and the remainder for commercial and other customers. Export service transactions, totalled U.S. $37.9 million of which 20% were for industrial companies, 80% for agribusiness organizations and the remainder for other companies. Letters of credit were issued for a total of U.S. $2,441,000 of which 77% were for industrial firms, and 19% for agribusiness companies, with 4% for others. Although the number of transactions appears to have remained about the same between the first and second halves of 1982, the average dollar amount per transaction dropped, due primarily to the slowing of the economy in general, and the move of a few very large exporters to the national banks for reasons explained earlier. Comparing Banex to all other banks in the country, however, shows that they currently have approximately 6.3% (in terms of U.S. $) of the total export business being transacted, compared to 4.2% a year ago, showing that they have been increasing their penetration of the total market.

Foreign exchange transactions which began in October of 1982 totalled 299 in the three months of 1982, for a dollar volume of about U.S. $1.9 million in sales and purchases of each. Banex is required by Central Bank regulation to generate no more than a U.S. $50,000 dollar surplus or other foreign currency position over a two day period, although it may have an unlimited negative position; as a matter of policy, Banex attempts to closely balance its foreign exchange position at all times.

The Banking Service Department is not actively considering offering any new non-credit banking services, as it still sees substantial opportunities for refinement and growth with the five existing products. The management of Banex S. A. has stated, however, that they will explore the potential for other import/export related services, such as equipment leasing and physical warehousing, once Banex Trading is operating successfully. They may also review the potential for Banex to provide guarantees to the Customs Department of the Government, which controls the import and export of all goods. At the present time a "maquiladora" or enclave industry operator, can have net imports (defined as the cost of all goods imported less the cost of goods exported) no greater than three times the net worth of the company, which in many cases is understated due to the use of historical exchange reates to calculate the value of machinery and equipment. This creates an opportunity for Banex to provide a guarantee which would allow higher volumes for "maquiladora" activity. This guarantee activity would be similar to the existing guarantee on performance bond service they presently provide and would likely be administered by the Credit Department.

IV. BANEX TRADING

A. Strategy and Expectations

During the initial design of the Banex project, it was recognized that the development of non-traditional exports would require more than just credit. The concept of an export management component was developed to provide producers with the needed marketing know-how as well as with a wide range of additional services to facilitate the penetration of export markets. The Project Paper specified the following objectives for this project component:

- Provide producers with basic export management services.
- Assist producers of non-traditional products to establish and maintain productive capability which would meet the demands of the marketplace.
- Develop export management expertise by including producers and merchants in the export process.
- Establish a strong Costa Rican presence for non-traditional goods in world markets.
- Provide producers with lower cost raw materials, capital goods, financing and better knowledge of technical options.

In order to achieve these objectives, the Project Paper called for a Trading Company made up of: a wholly owned Costa Rican Trading Company, a wholly owned U.S. subsidiary, and partially owned export companies incorporating various producers of the same or related products. The Trading Company would maintain various types of financial relationships with clients, ranging from equity participation to charging fees for services provided, and provide a wide range of services including warehousing, financing, producer liaison, market liaison, procurement, and investment. The Project Paper specified that implementation would involve contracting the World Trade Institute to initially provide the services in the U.S. (while helping to train the Trading Company staff) and to provide training and technical assistance in Costa Rica.

Expectations for the Trading Company as defined in the Project Paper, were based on the assumption that non-traditional exports from Costa Rica would continue to increase.[1] It was estimated that the Trading Company would capture 2.5-4% of the non-traditional export

---

[1]Non-traditional exports increased 36% between 1979 and 1980 while manufactured exports averaged 17.1% between 1979 and 1980. However, in fact, non-traditional exports have declined 24% since 1980.

management business, which with 5-10% commissions, would generate $551,000 in revenues by year 3.

Once Banex Trading (BT) was established in April, 1982, the implicit strategy[1] adopted involved the marketing in the U.S. of products already manufactured in Costa Rica. The idea was to select firms with promising products and surplus (unutilized) production capacity, negotiate representation agreements with these firms, and develop commercial orders for the products involved. It was believed that a sufficient volume of business could be developed this way to provide BT with a solid stream of revenues and a core client base. This business would be supplemented by a procurement function to help clients acquire materials more cheaply and efficiently. Since the number and volume of products already produced in Costa Rica was believed to be somewhat limited, after a year or two BT would begin to get involved in projects aimed at developing additional export production. How this would be done or by whom was never spelled out. In the interim, BT would have to market a wide range of products produced by a large number (20-40) of companies.

This strategy was based on the following implicit assumptions:

- That Costa Rican products were competitive in export markets. The Project Paper, for example, indicates that because of the devaluations, most Costa Ricans products could be exported profitably. Although it recognized that this situation was only temporary (internal inflation would eventually offset the devaluations), a wide range of products with a competitive advantage were identified. The WTI methodology, which did not include any detailed assessment of a given company's intrinsic competitiveness or comparative advantage, appears to incorporate the same assumptions.

- That Costa Rican producers had sufficient excess production capacity to supply export markets. Since the initial emphasis was to be on marketing surplus production, this assumed that existing producers could satisfy market demands in terms of volume, quality and price. The methodology did not specify ways of helping the producer adjust to market demands.

- That Costa Rican producers were committed to developing exports, either as their principal focus, or at least as a substantial

---

[1] We were unable to locate an explicit statement of strategy in written form. The following is based on interviews and a post facto assessment of the strategy underlying the methodology/work program designed by the World Trade Institute. The methodology, as implemented, incorporated only part of the wide range of services and programs called for in the Project Paper.

complement to their domestic sales. In order to penetrate export markets, firms would have to be willing to accept very thin margins (or streamline their operations in order to obtain any profit), improve the quality and quantity of their products, and generally make the investments required to service the export markets.

- That export development was primarily a marketing and sales problem involving the identification of market opportunities and buyers. In addition, producers would be helped with the necessary paperwork, preparing samples and shipments, arranging for transportation, etc. Production was not perceived as a problem (only those who had the potential to meet the demands of the marketplace would be selected as clients).

- That the export potential of specific firms would be large enough to cover the initial costs incurred by BT in developing the sales, and eventually provide an attractive return. This assumption was based on the idea that repetitive commercial orders could be obtained for clients, after which the level of BT assistance would be greatly reduced. However, based on its exclusive representation agreements, BT would continue to earn its commission on these sales.

B. The Methodology

The primary vehicle for implementing the export management component of the project (Banex Trading) was the contracting of the World Trade Institute. This contractor was called upon to: develop the methodology for implementing the marketing/export development thrust described above;[1] to carry out the tasks of preparing marketing studies and developing contacts with potential buyers; provide BT staff with the necessary training to allow it to take over entirely after the second year of operations; and to provide technical assistance to BT in Costa Rica in developing the producer liaison and procurement functions.

The methodology, as defined by WTI in the Scope of Work and contained in its contract with BT, included the following tasks:

- Phase I: Market feasibility analysis and in-country supply verification.
  - Conduct a supply survey of Costa Rica manufacturers to select an initial pool of 50 factories.

---

[1]The contractor had a significant involvement in the initial design of export management concept as defined in the Project Paper.

- Prepare "Pre-market Feasibility Analysis" for selected product sectors indicating U.S. imports, target market price, a price model, target market segments, principal channels of distribution, and U.S. customs classifications, duty and G.S.P. eligibility.

- Analyze and evaluate the export capabilities of the selected factories to prioritize the products/factories to be included in the project. Factors to be considered would include product evaluation, production capabilities, organizational capabilities, financial capability, and raw material requirements (for the procurement program).

- Final selection of 20 manufacturers for inclusion in the program.

- Select representative product samples from each firm and airship to New York.

o Phase II: Marketing Strategy

  - Prepare a Marketing Guide for each manufacturer identifying market segments, optimum U.S.channels of distribution and potential buyers.

  - Present the conclusions of the market studies to the manufacturers, and review Banex profitability and mark-up recommendations.

o Phase III: Target Market Implementation/Trial Orders

  - Carry out the following in preparation for meetings between BT staff and possible buyers: organize counter sampling, forward samples forwarded to potential buyers, set up appointments and prepare agenda, negotiate trial orders, accept trial orders, monitor production, and insure delivery within three months.

o Phase IV: Market Management Service

  - Establish a "bridge" between trial orders and commercial orders by strengthening relations with buyers, monitoring and transmitting market changes, following up trial orders and negotiating commercial orders.

o Phase V: Full Commercialization and Selection of 20 Additional Manufacturers

  - Fully commercialize first 20 manufacturers/exporters.

  - Generate alternate distribution and marketing strategies for the first 20 firms.

- Select and implement Phases I-IV for another 20 firms.

o Phase VI: Deepening Distribution/Implementation; Alternative Marketing Strategies

  - Research and implement alternative marketing and distribution strategies on a special project basis.

In addition to the resources provided by WTI, implementation of the program was to be carried out by a BT organization including: (1) Management, an executive vice-president and a general manager; (2) U.S. office with a manager, procurement officer, product manager, assistant product manager, expeditor, and secretary; and (3) a Costa Rican office with a manager, procurement officer, expeditor, and secretary. By the end of the first year (April 1983), all the personnel except for the manager, product manager, assistant product manager and secretary for the U.S. office were to be in place. The latter would come on board during the second year of operations.

The division of work between the BT staff and the contractor was clearly spelled out in the methodology. In addition to participating in all tasks in a trainee/observer capacity, the BT staff had prime responsibility for:

o Identifying and researching the initial pool of companies;

o Transferring information and samples to New York;

o Evaluating pre and post export financial needs of each factory;

o Negotiating representation agreements with firms;

o Providing the necessary follow-up with producers to insure the adequate production and delivery of trial orders.

o Taking full responsibility for the first 20 producers after one year and implementing the methodology (under contractor supervision) for the second 20 producers during the second year.

It should be underlined that the balance of the responsibility for carrying out the tasks described above was entirely WTI's. Furthermore, by assuming full responsibility for the U.S. operations (the principal thrust of the work program) and for the training and supervision of the Costa Rica operations, WTI effectively took on the responsibility for achieving the project results and objectives.

C. Operations - Implementation of the Methodology

In general terms, the tasks described above were carried out, albeit not as systematically as planned or with the anticipated results. Banex

Trading staffed up as called for in the WTI design with the exception that a procurement officer for the U.S. was not hired. Furthermore, since both the General Manager and the Procurement Officer for Costa Rica left BT and were not immediately replaced, BT was understaffed for several months. (A new General Manager has now been hired.)

The basic tasks laid out in the work program, through mid-April 1983, were mostly carried out. Specifically:

- An initial group of firms was identified. Information on the total production, capacity utilization and average annual sales was collected for about 100 firms, while additional data regarding export sales, raw material requirements and capital requirements was collected for 50 of those firms.

- Market pre-feasibility studies were prepared by WTI for 88 products manufactured by 50 firms while 13 product research papers were prepared for additional products identified during the course of the first year of operations.

- Brief factory visits were made to 40 companies and 21 of these were selected for inclusion in the program. The criteria used in selecting these firms and the findings from the factory visits were not documented. Furthermore, there was no evidence of serious economic opportunity studies to determine: whether a given company could competitively produce goods, generally priced much higher for the domestic market than the prices suggested by the WTI prefeasibility studies, after adding high transport costs and the BT commission; and if raw material supply and cost were adequate not just in the short-term but on a sustained basis to support new levels of production.

- Samples for each company were collected and shipped to New York but representation agreements were signed with only seven firms (with letters of intent from an additional six firms).

- Marketing Guides were prepared by WTI for 14 products (some applied to several companies) and the conclusions (but not the actual studies) were briefly reviewed with BT and the producers. This resulted in a further screening of companies. The marketing guides provided recommendations regarding channels of distribution (usually wholesale), penetration pricing (usually priced to be very competitive in lower price market segments) and quality requirements.

- Contacting of potential buyers was carried out for about 20 producers, of which 16 still had active leads as of the end of January 1983. The procedure basically involved sending samples to clients, transmitting price quotations and potential order quantities, and negotiating trial orders.

- BT staff in Costa Rica followed up with producers mostly by conveying requests from New York for samples, price quotations, coordination of trial orders, etc.

Some tasks referred to in the work program were not carried out including:

- Follow-up by BT and the bank to integrate financing and trading functions.

- The procurement function since raw material requirements were identified only in aggregate and the steps taken to pursue this opportunity area were limited. However, how this procurement function would work or how it would be carried out were never documented.

Training and transfer of technology were major components of the program. It was recognized that BT staff would have little or no experience with export trading and would have to be fully trained during the first two years of operation. In addition to participating as "observers", formal training programs were organized for the staff members, including:

- A three week training program for the "expeditor" in the Costa Rica office involving workshops and lectures on market research and analysis, pricing and distribution strategy, buyer identification, international cargo movement, customs procedures, etc., as well as exposure to specific case studies.

- A four week program for the procurement specialist (Costa Rica office) focused on purchasing, warehousing, materials management, and related topics.[1]

- Three months of in-service training for the manager of the U.S. operations involving participation in the follow-up potential buyers and total orders.

Although these courses and training were provided, their effectiveness in terms of transferring technology and insuring that BT staff would be able to begin to take over after a year is not clear. After a year with the firm, the remaining staff members indicated they still did not fully understand the methodology, which they believed had not been properly communicated to them.

---

[1]This individual is no longer with Banex Trading.

D. Results

By the end of year 1, the Project Paper had expected revenues from exports of about $25,000, which assuming commissions of 5-10%, would mean an export volume generated of between $250;000 and $500,000. An additional $10,000 was to be earned from the procurement function. First year costs were to be $238,000. By the second year, revenues were projected at $262,000 of which $200,000 would be commissions on export sales.

During the first twelve months, BT generated $251,630 in exports sales but earned only about $7,760 in commissions. An additional $76,800 in orders have been confirmed with delivery expected by June 1983. If these orders materialize, total BT sales will have amounted to $328,422 over 15 months, while commissions will have totaled $10,045 (see Table IV-1). This indicates that although total sales have been within the lower range of expectations, commissions have been considerably lower. The average commission was only 3.1%. In contrast to the lower than expected revenue actual costs have exceeded initial projections by a considerable margin (about $383,000 for the first nine months).

Almost all of the initial sales have been trial orders, as anticipated in the original work program. Commercial orders have been placed for four products (cocoa powder, cookies, dresses, and plastic bags) at a total value of $389,802 to be delivered during the next year. However, this will generate only $6,000 in BT commissions because the principal sale of $234,300 (cookies) is not covered by a BT representation contract. Of 12 trial orders placed, at least 3 appear to have been unsuccessful, while 4 have resulted in repeat orders. The results of the other trial orders are not yet evident.

To date, 9 different firms (of the 20 plus selected for inclusion in the project) have actually sold their products through BT to a total of 9 different buyers. Of the remaining firms, promising leads are being pursued for four additional companies while buyers have been contacted for the rest with no results as yet. The results of the efforts made in behalf of the various companies is shown in Table IV-2.

The volume of potential sales in the pipeline was estimated by WTI to be slightly over $8 million as of the end of January 1983. This estimate has since been raised by WTI to $13.5 million but the breakdown was not yet available at BT.[1] Full realization of the $8 million in sales would represent about 2.5% of Costa Rica's non-traditional exports

[1]These estimates, however, appear to reflect the buyer's total potential purchasing capability for the given product and does not consider whether the producer is able to handle the volume, quality and price requirements.

53

TABLE IV-1

BANEX TRADING - SALES AND COMMISSIONS AS OF APRIL 1, 1983

Product	Type of Order	Date	Value FOB	Commission - BT $	Commission - BT %
Candies	Trial	11/06/82	$26,208.00	$1,572.18	6
Dresses	Trial	11/06/82	1,756.80	52.69	3
Dresses	Trial	11/16/82	2,030.00	52.69	2.6
Cookies	Trial	12/82	117.136.00	-	-
Plastic Bags	Trial	12/27/82	18,947.64	1,072.51	5.7
Doors	Trial	12/11/82	3,680.00	158.47	4.3
Cocoa Powder	Trial	01/02/83	747.60	7.48	1
Doors	Trial	03/83	40,527.60	2,460.00	6
Dresses	Trial	03/25/83	1,733.16	51.99	3
Candies	Trial	03/13/83	18,225.00	1,002.38	5.5
Plastic Bags	Commercial	03/83	20,637.32	1,238.24	6
Cocoa Powder	Order Placed	05/02/83	5,316.15	53.16	1
Doors	Trial Order Placed	05/06/83	16,829.25	673.17	4
Doors	Trial Order Placed	05/14/83	16,720.00	668.80	4
Doors	Commercial Order Placed	05/20/83	24,535.25	981.41	4
Tables	Order Placed	06/83	13,392.00	N.A.	N.A.
TOTAL			$328,422.57	$10,045.16	3.1

Source: Banex Trading.

TABLE IV-2

SUMMARY RESULTS FOR FIRMS INCLUDED IN THE PROJECT

Firm (By Product)[1]	Potential Sales[2] (As of 01/28/83)	Buyers Contacted	Trial Order	Commercial Order	Comments
Bathroom Accessories	$420,000	X	Possible	–	o Possible sales from Guatemala factory.
Doors	$1,020,000	X	X	X	o Producer has hired own agent in U.S.; unhappy with BT.
Wire & Cable	–	X	–	–	o Hope to participate in int'l bidding together with U.S. firm.
Sailboats	$240,000	X	Possible	–	o Delayed by depressed market, financing problem.
Cookies	$328,000	X	X	X	o Not covered by representation agreement.
Doll Dresses[3]	–	X	–	–	o Buyers have other suppliers.
Dresses	$200,000	X	X	–	o Not in initial group; took over opportunity from another firm.
Dresses	–	X	X	–	o Quality of trial order unacceptable.
Dresses	–	X	X	–	o Production cost too high
Cocoa & Candy[3]	$1,193,000	X	X	X	o Unsuccessful in product where producer most interested (candy).
Banana Chips	$500,000	X	–	–	o Producer unable to meet quality standards.
Plastic Bags[3]	$950,000	X	X	X	o Producer trying to develop new product for niche identified; most actual exports outside of BT.
Furniture	$148,000	X	–	–	o Producer unwilling to lower price.
Furniture[3]	$33,390	X	Placed	–	o Producer waiting for letter of credit from buyer: has cash flow problem.

TABLE IV-2 (Continued)

SUMMARY RESULTS FOR FIRMS INCLUDED IN THE PROJECT

Firm (By Product)[1]	Potential Sales[2] (As of 01/28/83)	Buyers Contacted	Trial Order	Commerical Order	Comments
Furniture	$500,000	X	-	-	o Poor quality control.
Candy[3]	$2,500,000	X	X	-	o Question whether can keep price competitive.
Gelatine	-	X	-	-	o Unable to meet market specs.; cost too high.
Jeans[3]	-	X	-	-	o Buyer lost interest.
Parquet flooring	-	X	-	-	o Cost too high; producer unwilling to cooperate.
Athletic shoes[3]	-	X	-	-	o Production cost too high.
TOTAL	$8,032,390				

[1] Efforts were also made for the following: coffee essence, canned fish, blankets, shoes, drawback textiles, and sandals.

[2] Potential sales as estimated by World Trade Institute as of 01/28/83. Estimate primarily based on buyer purchasing capability and assumes that producer can meet quality, volume and price specifications.

[3] Representation contract signed.

Source: Banex Trading and WTI status report.

in 1982, while the $13.5 million level would represent 4.2% of non-traditional exports. Although this performance is in line with the 2.5-4% goal set forth in the Project Paper, it should be noted that non-traditional exports declined 24% between 1980 and 1982, whereas the Project Paper had anticipated rapid growth.

There are, furthermore, serious questions as to whether this level of sales will be realized. Most important, the estimate appears to be based on what the buyers indicate could be their potential purchases of the product in question, and by no means represent a committment. The estimates assume that the Costa Rican producers would meet the quality, cost and volume specifications required by the buyer. Interviews with sample firms suggest that at least 45-50% of the potential sales will not be realized because of non-competitive costs or inadequate quality. An additional $420,000 in exports (if realized) would actually accrue to Guatemala. Based on these considerations, actual BT/WTI promoted exports are likely to account for at best about 1.7% of Costa Rica's non-traditional exports (based on 1982).

Another concern regarding the potential sales arises from the limited number of representation contracts actually signed with clients. If all the possible sales identified for the seven companies with contracts are realized, the revenue for BT would be $232,000 annually (compared to costs of about $400,000). The real revenue potential from these firms is likely to be a small percentage of the estimates because they largely depend on sales for hard candy (non-competitive due to increases in the price of sugar in Costa Rica) and plastic bags (product not yet adequately developed).

In addition to total exports generated, the Project Paper specified that the export management component of the project would be evaluated in terms of its impact on individual producers. The idea was to help firms develop an export capability and become more efficient. Appendix B reviews the experiences of a sample of 10 firms. Some of the general observations resulting from the interviews included the following:

- o The initial assessment by BT/WTI of a firm's export potential was largely based on the factory's idle productive capacity, resulting in very optimistic estimates.
- o The service offered to clients involved the identification of market opportunities and specific buyers, and the actual sale of the product.
- o Clients selected to participate believed that their products were marketable without any major effort on their part in terms of product redesign, improved packaging and presentation, investment in new equipment, cost control, etc.
- o Most clients became disenchanted with BT because of: slow results; lack of feedback; too many requests for additional

surplus or modifications; unacceptable, low prices offered by BT/WTI buyers;[1] the need for the producers to intervene directly to complete a sale ("that was BT's job"); poor targetting of the company's products (usually perceived as too low a price segment); lack of BT knowledge of the product or industry; overly optimistic BT estimates of probable sales; and inadequate BT relations with the producer.

- o Some of the successful exporters attribute their success to their own intervention rather than BT/WTI's.

- o Financing was not usually offered in combination with the export management services. Banex loans were perceived as totally separate from the trading service.

- o Clients did not receive any direct guidance or assistance from either BT or WTI in modifying their products or improving their productivity.

- o Investments made by clients as a result of export opportunities opened by BT/WTI were limited to a few cases of product and package modification; however, no plant expansion or significant streamlining of operations resulted as had been hoped for in the Project Paper. Although one cannot expect companies to have invested during the first year, it does not appear that they plan to do so in the foreseeable future.

- o Clients were generally unwilling (or unable) to modify their cost structure based on expectations of export sales. Some agreed to accept buyer prices for trial orders (often at a loss) hoping that their product would prove so successful that a higher price would stick. However, producers were not encouraged or helped to evaluate whether they could be competitive over the longer run or to determine what steps would have to be taken.

These observations indicate that the project impact at the firm end was poor. Not only did some companies become disillusioned with exporting (and BT/WTI), but virtually no real investment or significant efforts to improve productivity resulted.

Project results in terms of institutional development were also disappointing. After one year of operation, two of the five people hired to staff BT had left the firm, including one of three people for whom formal training was provided. By the second year, the BT staff was to be able to carry out the trading program with a new set of clients (albeit under contractor supervision). However, the remaining staff believes it

---

[1] In several cases, the BT commission was the factor in making a possible sale unprofitable.

does not fully understand the "methodology" utilized nor know how to implement it.

Banex management, however, believes that institutional development has occurred at the top level as a result of the learning experience of the first year. It believes it has a better understanding of what functions a trading company should provide in Costa Rica and argues that serious mistakes have been made in terms of strategy and implementation.

E. Evaluation

Banex Trading must be evaluated at two levels: (1) the implicit or explicit assumptions and strategy underlying the current design of the trading company; and (2) the implementation of the strategy.

Because some of the assumptions underlying the initial strategy and design were incorrect, BT was structured with some intrinsic limitations. Some of the factors not adequately considered include the following:

- Producers lack a real commitment to exporting. The basic assumption underlying BT was that existing manufacturers would be anxious to export in order to fully utilize their capacity, and would be willing to make the investments and adjustments required to take advantage of the attractive opportunities identified by BT/WTI. In fact, most producers would like to export their surplus production, even at marginally profitable prices. However, most firms have proven to be unwilling to make major investments or to significantly re-orient their operations to meet export market requirements.

  The reason, as was illustrated in Arthur D. Little International, Inc.'s recent report "CENPRO: In the Context of an Export Development Strategy for Costa Rica", is that the local market continues to be more profitable and safer for most firms, even when not operating at full capacity. This was verified in interviews with BT clients. Three of the most successful clients (candies and cookies) indicated that the local market is their prime interest (because of higher profits) and that exports are being developed largely to supplement local sales and offset the loss of Central American markets. One firm would not export more than 15% of sales, even if excellent opportunities were available, because, "we can't ignore the local market". A furniture maker preferred not to export at the prices being offered, even though they had invested in new capacity.

  Only the few firms exclusively oriented towards exports or with a long exporting tradition, would not have this ambivalence towards foreign markets. However, only two clients (doors and sailboats) had this orientation.

- <u>The macro-economic policy framework was assumed to be adequate.</u> Based on the devaluations of the colon and the references made by the government to the need for exporting, it was assumed that the overall policy framework would be conducive to a trading company. However, as was indicated in the first point, the underlying market "signals" received by existing producers are not conducive to a significant commitment to exports.

- <u>The opportunities for export from existing producers was overestimated.</u> By quantifying excess productive capacity, it appeared that there was a large volume of production to be exported, which given the devaluations of the currency, was assumed to be mostly cost competitive. This resulted in a strategy to market this surplus production. However, if the cost structure, production management, factory layout, equipment, and owner committment had been fully analyzed, it would have been apparent that the number of real opportunities were limited and that a strategy oriented more towards development of production would be required. This has now been learned the hard way. After trying (often unsuccessfully) to identify possible buyers, most producers have been unable to meet the prices and quality specifications, reducing to a handful, the number of firms actually able to exort their surplus production. Since BT/WTI started with the 20 most promising firms, the future potential based on this strategy is highly questionable.

- <u>The methodology, as designed by WTI and reflected in its contract with BT, was oriented towards selling and the buyers, not production and the producers.</u> Since the principal constraint to exporting was perceived to be marketing and sales management, the design of BT was primarily based on a U.S. office supported by a Costa Rica office staffed by expeditors and procurement specialists. There was no capability built into the design to assist producers in meeting quality standards, cutting costs, or developing new products. When these problems have arisen in practice, BT has had to drop the clients.

- <u>The strategy required BT to market a wide range of products.</u> Marketing surplus production meant that BT would have to work with a wide range of firms and products in order to generate the volume needed to make the venture profitable. This had a number of shortcomings: (1) developing and implementing a marketing program for each product required a significant investment in relation to the possible returns to BT. This benefit cost relation was never determined on a product-by-product basis. (2) Marketing a wide range of products requires a sophisticated knowledge of different industries, marketing, distribution channels, etc. . Even though specialized firms with extensive experience (such as the contractor) may be able to manage many products simultaneously, it is doubtful whether a new organization could be expected to be successful in this regard, even with one or two years of experience. Most trading companies around the world tend to begin very specialized in a few products. (3) A wide range of products sold in relatively small volumes, also implies a poor benefit cost relationship to the producing firm such that there is little interest in new investment or streamlining.

While the issues outlined above are related to the conceptualization of the problem and the strategy incorporated into the design of the BT project, a number of problems have also been identified regarding the implementation of the strategy:

- The approach, as implemented in BT is that of an export promotion agency. The services offered by BT, and the way in which they are carried out, resembles those of a traditional export promotion agency. Some of the similar characteristics include: (1) A focus on marketing surplus production for existing producers. (2) A willingness to try to promote products without an adequate assessment of the real potential (both as an export product or as a source of BT profit). (3) Selection of products and companies without a clear definition of criteria. (4) The level of effport put into marketing different products is not in proportion to the possible returns.

- WTI's strategy for penetrating the U.S. market appears to have been largely based on price. Since Costa Rican products lack a reputation in the U.S. market, the thinking seems to have been in order to firmly establish those products in the U.S. market, it would be necessary to compete on the basis of price. Most products were placed in the lowest price market segments where they competed against high volume imports from other developing countries. The basic problem with this approach is that it requires high volume and very low cost production. Costa Rican industries which largely developed to satisfy small, protected local and regional markets, are not in a position to meet these requirements. For most of them to be successful exporters, it would be necessary to identify specialized and small volume market niches where some particular attribute of the Costa Rican product can be appreciated.

- The Costa Rica office, after initial contacts with the producer, acted primarily as a transmitter of telexed requests from the New York operations and the contractor. These requests (e.g., for price quotations, samples, packaging, specifications) are telexed or telephoned to the producer with the information passed on to New York. However, it is up to the producer to figure out how to deal with the request with little assistance from BT. This is clearly documented in the three case studies presented in Appendix A.

o <u>There is no sense of partnership between BT/WTI and its clients.</u> BT appears to perceive itself as providing a service to clients which requires results in terms of sales. However, BT does not see itself as a partner in an export development project with its clients. Instead, if problems arise with the product or the buyer, BT tends to perceive it as the producer's problem.

For example, when a small table manufacturer received a purchase order it went ahead and bought materials and began production before a letter of credit was opened, in order to meet the delivery date. The buyer has since delayed opening the letter of credit, creating a major cash flow problem for the producer. Although BT has offered financing (at 35%) it basically, sees the problem as being the producer's fault for starting without a letter of credit. BT could have offered to buy the tables or work out another solution in order to develop a sense of partnership and keep the client.

o <u>BT's concept of a trading company has been limited to acting as an agent.</u> Until very recently, BT perceive the role of a trading company to being largely an agent in contacting buyers and then selling. The question is whether producers would not do better lining-up specialized agents in markets of interest. In fact, some of the more successful BT clients have since obtained better results by hiring their own agents in the U.S. or by negotiating directly with buyers. Few companies could justify paying a 6% commission on all U.S. sales when the principal service provided was a one-time identification of market opportunities and potential buyers. Other more unique services often provided by trading companies, such as financing, taking title to the goods, warehousing, shipping, equity investments, etc. have not been integrated into the services offered by BT.

o <u>BT has been perceived by other parts of the organization as being a marginal component of the Banex project.</u> As discussed earlier in the report, the Banex project was initially conceived of as a commercial bank. The trading company concept was fused on as a result of discussions and studies conducted with AID. Although the Banex Board endorsed the trading component, it appears to have done so on the expectation that the activity would be profitable (albeit after several years) without too great an investment or risk. The primary focus continued to be the Bank. As it became increasingly evident that export development would be much more difficult and costly than expected, the tendency was to cut back on the already small trading company organization and put even more emphasis on the Bank. It appears that expectations were too high while the investment and resources required were underestimated.

APPENDIX A - THE BANEX TRADING EXPERIENCE - THREE CASE STUDIES

The following case studies are intended to illustrate the way in which the BT/WTI methodology was implemented in practice. The information presented below in chronological order was drawn from the Banex files and relies exclusively on written documentation. The three cases were selected at random during our first day of field work, but our subsequent research indicates that they are representative of BT's clients and experience, although among the more successful cases.

Bathroom Fixtures Manufacturer

Feb. 1982 - BT asks WTI to investigate opportunities for toilet tank accessories, center seats and single faucets. Indicates that the firm could export 8,000 sets per month at prices between $4.75 and $7.00 per set.

Mar. 1982 - Client sends background information on the products to BT which forwards the information to New York (WTI).

- WTI prepares a Pre-Market Feasibility Analysis for toilet accessories and faucet sets detailing U.S. imports, distribution channels, pricing model, and target penetration price and market segment. Concludes that the quality is acceptable but that the prices are highly uncompetitive. Recommendation is not to pursue this situation.

Apr. 1982 - Note to the file indicates that further product and market evaluation is to be carried out for the company.

- Client provides information on monthly production capability of single faucets (6,000), double faucets (4,500) and bath accessories (10,000) as well as prices. Total potential exports estimated at $130,000.

July 1982 - Client provides samples which WTI ships to WTI.

- Commercial profile of company prepared by BT.
- Client updates price list for bath accessories.
- BT sends client draft of exclusive representation contract.
- WTI requests whether and at what price client can produce 6 piece bathroom accessory sets and include towel bars. BT relays request.

- BT informs WTI that client can produce 6 piece sets but without plastic towel bar; this would be too expensive.

- WTI requests information on 5 piece sets in response to specific inquiries.

- Information provided and additional samples sent.

Aug. 1982 - WTI indicates that buyers want ceramic bath accessories with soap dishes without grab bars and that two buyers could buy 4 containers per month. Could this be provided and at what cost?

- Client responds (through BT) that it can produce two containers per month but that some pieces would have to come from factory in Guatemala.

- BT asks client to send samples from Guatemala.

- Client provides price information for individual pieces.

- WTI indicates it is negotiating a trial order with an importer/distributor with a total purchasing capability of 6-8 containers per month. Interested in 4 and 6 piece sets and individual pieces.

- WTI indicates it is preparing a report on the buying potential, quality and sample requirements of potential buyers and promises to obtain samples of competitive imports.

- Client provides BT with catalogues and prices for exploring the Venezuelan market.

Oct. 1982 - WTI reports it is sending samples to buyers and feedback indicates quality is good but prices too high. At competitive prices, 4 containers a month could be sold ($120,000).

- WTI reports that for soap dishes, clients price of $2.00 is too high compared to $1.09 from Mexico and $1.24 from Philippines. Countersamples sent. Suggests problem could be difference in weight. Unclear whether client can meet volume requirements. Recommends client come to New York.

Nov. 1982 - Client provides new price list; indicates that accessories can be produced in the volume and price requested at the Guatemala factory. Production facilities could be transferred to Costa Rica if justified by the sales volume.

Lerl

- Integration with the credit and banking services has been minimal. Although some clients have used trading company, banking and credit services (see Table IV-3), the promotion of the different services occurred separately rather than as an integrated package. None of Banex's loans have gone to finance BT generated exports. Similarly, BT only explored opportunities with 9 of the 38 firms with loans from Banex. As another example, one of the most promising export clients (door manufacturer) was denied a long-term loan by Banex. Although from the perspective of a conservative commerical bank, there were valid reasons to turn down the request, no attempt was made by BT to evaluate whether the export potential of the firm justified the risk or to explore some joint export development relationship.

- Communications among BT, clients and BT's contractor have been very poor. Most BT clients have been unhappy with the amount of feedback they have received. In many cases where market opportunities or buyers have not been found, this information has never been passed on to the firm. Other companies are annoyed that the results of the marketing studies which were prepared were not shared with them. Those still pursuing opportunities find that the communication line from buyer to contractor to BT to producer is cumbersome and slow. In many cases, WTI has raised high expectations among clients by communicating a potential buyer's total purchasing capability for a given product, and giving the producer the impression that this would be its likely sales. Although many companies could not meet the buyer's requirements, especially regarding price, this was never explained to the clients such that the eventual collapse of a deal would be blamed on BT/WTI. Furthermore, BT and its contractor in New York agree that communications between the two have been very poor (albeit with different explanations).

- BT has relied too heavily on its contractors to implement the program. The expectation that another firm could be contracted to implement an entrepreneurial undertaking appears to have been misplaced. BT perceived that its contractor was to provide a "turnkey" implementation of the entire trading concept.[1] It accepted a passive role in its definition and implementation of the program, apparently because it lacked a full understanding of what else a trading company could do. The possibility of using this contractor for one aspect of the trading company services (e.g., marketing in the U.S.) while developing other services (alone or with other experts) was never adequately considered.

---

[1]The WTI contract calls for it to implement the U.S. operations but for BT to retain responsibility for the Costa Rica operations with technical assistance from the contractor.

TABLE IV-3

INTEGRATION OF BANKING, CREDIT AND TRADING SERVICES

	Number of Firms
Banex Trading Clients[1]	20
Number using:	
o Dollar credit for BT generated exports	0
o Colon credit for BT generated exports	0
o Dollar credit for self-developed exports	4
o Colon credit for self-developed exports	0
o Recapitalization loans (colon)	4
o Banking services	7
o All Banex Services	5
Bank Clients[2]	38
Number of instances where:	
o BT explored idea of joint export development	9
o BT undertook marketing efforts	6
o Client has no relations with BT	29

[1]Defined as firms for whom BT has had an ongoing relationship and has made a concerted effort to develop new exports.

[2]Includes only firms with dollar or colon loans from Banex. Excludes approximately 140 firms which have made use of the banking services.

- BT informs client that deals are being pursued but that a further breakdown of prices and a color catalogue is needed.

Dec. 1982 - WTI reports buyers interested in trial order at new prices. Potential sales of 4 containers per year. Another buyer, with potential purchases of 6 containers per year, might also place a trial order. More samples indicating actual colors and packing needed.

- WTI indicates that prices are still to high. If lowered, client could sell 3-4 containers in trial orders and 30 containers per year in commercial orders ($600,000 per year).

- Client sends samples and indicates it prefers to sell sets.

- WTI reports on conversation with client: firm cannot meet price requirements for individual pieces so this will not be further pursued. This is too bad since it is a large market segment.

- BT reports that problem is that packaging costs for individual pieces are too high and that the client lacks the necessary production capacity.

- More samples requested by WTI.

Jan. 1983 - Samples delayed because Guatemala factory was taking inventory in December.

- BT and WTI informed that Guatemala plant lacks inventory in the colors requested but that the samples should be produced soon.

Feb. 1983 - WTI informed that samples ready but that held up at airport.

- WTI reports that samples finally arrived but that 5 sets had broken pieces, and soap dishes came without the grab bars specifically requested.

- Client promises to send new samples.

<u>Candy Manufacturer</u>

Mar. 1982 - BT prepares profile on client indicating products (hard candy, mints, etc.), prices, overall production, capacity utilization (80%), and quality ("best in Central America").

6/x

- Client provides list of products and prices. Indicates that could produce additional $1 million for export.

- WTI requests data on shapes, weight and packaging.

Apr. 1982 - BT/WTI visit to factory. Conclusion: "Huge potential" with the opportunity to adapt to buyer needs. Large quantities could be produced competitively.

- WTI prepared pre-market feasibility study indicating U.S. imports, distribution channels, market segments (English hard candies, medium price, penny candy), growth of market (positive), pricing model for mints and hard candies (FOB Costa Rica $0.30-0.40 per lb.), government regulations. Concludes that Banex's candies should be positioned in penny candy segment and sold through wholesalers.

May 1982 - Client indicates it could produce 50,000 kgs. of candy at $0.40 per lb.

June 1982 - BT discusses representation contract with client.

- Client sends samples with new flavors requested by buyers.

- BT informs WTI that mint (and other candy) prices will rise due to increases in sugar prices. Reports that client cannot produce different shapes since it requires an investment; however, would like to know how profitable this might be.

- BT indicates that there has been a misunderstanding on price; mints would actually cost $0.67 per lb. FOB Costa Rica.

- WTI asks how long prices can be held. Advises against informing possible buyers of price increases until well after trial orders are placed in order to develop commercial relations.

- WTI meets potential buyer who wants a trial order of one container (about $20,000) of mint and fruit rolls at a price of $0.90 per pack (excluding BT commission). Request specifies required packaging and labelling.

July 1982 - Producer agrees to hold price for 4 months even though the Government raised sugar prices 100%. Prices will be $0.55 per lb. for most hard candies and $0.67 per lb. for other candies (FOB vessel). Producer reports that it has communicated with this potential buyer for 2 years and that price has always been a problem. The $0.90 per pack price was quoted in 1981, but increased sugar and transport prices would require a $0.95 per pack. Private label programs could be accepted if at least one container per item could be sold.

- BT informs WTI that samples are being sent. Client could produce 40,000 kgs. of fruit rolls per month. Could be willing to go back to $0.90 per pack because cheaper transport has been identified.

- Client indicates that the products to be included in the representation contract are chocolates, soft candy, hard and filled candy and mints. Contract signed (excludes Florida and Puerto Rico).

- WTI indicates that price reduction not necessary, it will look for new buyers.

- BT/WTI request samples and product display board from client.

- WTI asks for clarification on how contract with client restricts distribution in Florida.

Aug. 1982 - BT status report concludes that response by client has been good. However, only one interested buyer has been identified (already known to the client).

- WTI requests samples and prices of new products.

- BT requests that WTI look into competitive prices from Colombia and Brazil for these products (these provided).

Sept. 1982 - WTI requests further information on the chocolate hearts included in the samples. BT reports that the client is no longer interested in exporting this product.

- Client requests information on status of BT/WTI initiatives.

- WTI responds that 2 new buyers (with potential orders of $600,000) have accepted the price for mint rolls but that these prices must be held.

Oct. 1982 - WTI reports negotiation for trial order of one container of fruit mints under a private label at a price of $0.81. Packaging must be changed. Buyer has annual needs of $240,000.

- Client indicates it is willing to hold the price, despite the increased cost of sugar. However, changes in packaging will affect the price.

- WTI confirms trial order of $20,000 for strawberry mints but the coloring must be darker red. Provides sample box and labelling instructions.

- BT meets with client and reports that preparing box will not be a problem.

- BT reports that the client lacks the necessary strawberry essence but is obtaining some in Europe. Some changes in the box are necessary.

Nov. 1982 - Sample boxes and candies sent to U.S.

- Client travels to U.S. to meet buyers and WTI.

Dec. 1982 - Report on BT-WTI-client-buyer meeting: sample and prices acceptable and purchase order issued for $21,000; letter of credit to be opened when packaging approved; buyer expresses interest in chocolate heart.

- BT reports to WTI that client wants to enter a higher price market segment.

- BT tells client that WTI will identify buyers in higher market segment and provide samples for the client to analyze and replicate.

- WTI identifies possible $20,000 trial order for mint and anise flavored candy. Target price $0.52 per lb. FOB. Potential commercial orders of 6 containers per year. Samples of candy sent to client.

- BT meets with client to review 1983 relationship.

Jan. 1983 - Preparation of box (for strawberry mint orders) delayed.

- Client indicates interest in producing anise and mint candy under private label.

Feb. 1983 - Sample boxes received but printing changes needed. Buyer willing to open letter of credit provided that BT agrees to take responsibility for the changes. This agreed to.

- WTI sends samples of chocolate candies to see if the client is interested and able to produce them.

- Client indicates ability to produce chocolate candies and prepares samples with various fillings. If samples accepted, willing to change shapes. Can produce 40,000 lbs. per month (eventually 80,000), but not yet sure whether a $0.43 per box price is acceptable.

- WTI reports it is looking into an opportunity for selling hard candies to the airlines.

- Changes made on strawberry mint boxes and delivery scheduled. Letter of credit opened for $18,225 and BT management alerts Banex bank to handle transaction.

- New potential buyer identified for chocolates possible trial order of $21,500 (if samples adequate) and potential annual orders of $285,000 at a price of $0.43 per box. Additional sales of $528,000 possible if client can produce peanut butter crisps.

Mar. 1983 - Client expresses interest in meeting buyers in U.S. and WTI arranges meeting.

- BT informs WTI that $0.43 per box for chocolates is below client expectations and requests negotiation.

- WTI responds that client can negotiate directly with buyer at meeting, but requests samples immediately.

- Trial order of strawberry mints delivered to ship; documents sent.

- WTI sends samples of peanut crisps.

<u>Door Manufacturer</u>

Dec. 1981 - Client provides information on types of doors, types of wood, prices ($48-55), production capability (1,600 per month immediately and 2,900 per month after 6 months).

- WTI requests more information.

Jan. 1983 - WTI reports that outlook is good for doors in U.S. market. Wood types are good but prices will need adjusting. Likely products: louvers, solid doors, flush doors. Need samples.

Feb. 1982 - Client provides price list.

- WTI provides target prices: $33.40-35.58 for solid panel doors. Two buyers could place trial orders worth $64,000 upon inspection of the samples. Potential commercial orders of $585,000 per year.

- Samples delivered.

- BT meets with client. The latter reports that their own research indicates that their prices are competitive. Request information on the type of buyers being identified.

Mar. 1982 - BT reports that client has signed a contract to sell in Florida ($619,000) without BT/WTI participation. (Banex handled the letter of credit.)

- BT informs WTI that client rejects buyer concerns regarding color and nodules as unreasonable.

- BT presents representation contract.

- WTI prepares marketing guide which indicates: market segments (residential and commercial); distribution channels (home improvement chains and lumber yards); size of market ($20 million); competition (Mexico, Canada and Taiwan); review of consumption and preferred types; product characteristics and requirements; pricing (e.g., solid wood door for $47); suggested penetration price (e.g., wood door for $35.89); possible buying organizations.

Apr. 1982 - BT/WTI meeting with client. Review status with various buyers.

May 1982 - WTI reports on opportunity to sell 600 doors (trial order) to Buyer A, but that more samples are needed. Buyer finds quality to be excellent but can't pass along higher prices. Price for producer is $42 FOB Costa Rica.

- WTI reports that Buyer B agrees to buy 40 doors at $60-83, depending on the model. Reports on status with the 7 buyers contacted.

- Client provides data on how humidity affects the wood.

- BT indicates that the client has accepted the price for Buyer A in order to establish a relationship.

- BT reports on possible deal in Bonaire.

June 1982 - Status report from BT-New York indicating that Buyer A still interested (but price too high) while other buyers are holding back.

- Interchange of telexes regarding the actual cost of shipping.

- WTI reports that Buyer A will place trial order for $25,800 ($43 per door) if they receive 5 more samples; potential orders of $129,000.

- Client agrees to modify price list.

July 1982 - Representation contract signed by client.

- WTI provides new list of buyers; requests samples.

Aug. 1982 - BT status report indicates that progress has been slow and that the client's previous success in the U.S. market with higher prices is leading to difficulties.

- Buyer A confirms interest in a trial order of 2 containers.

- WTI reports that Buyer C may be interested.

- Client provides revised price list and drawings. Indicates that its products are of much higher quality than those produced in Taiwan and have competed successfully (at higher prices) in Florida and Puerto Rico.

Sept. 1982 - WTI reports that Buyer D could be interested in 70 doors.

- Client responds it would only be interested in Buyer D's price if a high volume can be sold.

Oct. 1982 - WTI meets with Buyer C and transmits questions to client.

- WTI and BT-New York representative schedule trip to California to meet buyers.

- Report from California: Buyer D opens letter of credit for 70 doors. Potential commercial orders of $200,000. Buyer E to open a letter of credit. Potential orders of $200,000. Other buyers to consider first.

Nov. 1982 - Buyer E agrees to trial order of 400 doors.

- Buyer C agrees to trial order of 400 doors ($17,200).

- BT reports problems with the shipment of 70 doors to Buyer D. Production delays, then miss the ship.

Dec. 1982 - Client reports it has hired a new marketing director, modified its prices and strategy, and requests status report.

- WTI responds that there is no need for client to have an update on the negotiations and reports that it is checking on the Taiwan and Philippine competition.

- WTI reports its program will lead to $1 million in annual sales. The client lacks the ability to formulate and implement a marketing strategy on its own. The client's strategy of selling in a higher price market segment will only work if BT agrees to take title of the product and distribute it directly to retailers.

APPENDIX B

EXPERIENCES AND PERCEPTIONS OF TEN BT CLIENTS

Door Manufacturer

Background: Entirely export oriented firm; was technically bankrupt; capacity - $2.4 million per year; was using 5% of capacity, now 50%. Exporting $100,000 per month.

Initial Banex Assessment: Export potential not determined.

Banex Services Provided: BT services; short-term credit; long-term loan denied.

Results: $44,207 in trial orders; $58,193 in additional trial orders placed.

Evaluation of Services: Firm perceives that BT-WTI marketing strategy for product was poor (based on its own experience); Buyer-WTI-BT-producer communications weak; inadequate integration between bank and trading.

Bathroom Fixtures Manufacturer

Background: Licensee of U.S. firm; exporting $400,000 per year through U.S. partner (25% of sales); utilizing 50% of capacity; 100% of raw materials imported.

Initial Banex Assessment: Not on initial list of possible clients.

Services Provided: Firm requested help in exporting toilet seats, chromed plastic faucets and porcelain bathroom fixtures; signed representation contract; used banking services.

Results: No sales to date. Opportunities being explored for Guatemalan licensee of the same U.S. firm.

Evaluation by Firm: BT prices are too low, particularly with 5% BT commission.

Candy Manufacturer

Background: Produce good quality candies and chocolates. Capacity to produce almost $10 million annually. Export 15% to Caribbean. Seek to export products where firm has surplus capacity. Exports seen as secondary since local market is more profitable.

Initial Banex Assessment: Annual exports of $3 million. Excellent product at very low prices.

Services Provided: BT services; re-capitalization loan; export credit.

Results: Trial order of $18,255; large commercial order possible.

Evaluation by Firm: Initial problems due to poor product selection and targeting. BT/WTI have helped in establishing contacts. Sugar price in Costa Rica has made it difficult to stay competitive. BT could be more effective by providing more financing.

Blankets & Textiles Firm

Background: Produce blankets and industrial textiles made from scrap and polyester. 60% of materials imported. Sales about $1 million, 80% local and 20% to CACM.

Initial Banex Assessment: Not on initial list of possible Banex clients.

Services Provided: Provided samples to BT for test marketing. Negotiating colon loan for recapitalization. Used banking services.

Results: Never heard back from BT regarding test marketing.

Evaluation by Firm: Would like to hear results of BT efforts. Banking and credit services are efficient.

Sailboat Manufacturers

Background: Produce high quality sailboats. Capacity of over $2 million but only 25-30% utilized. Depend largely on exports to U.S. Sales down due to U.S. recession (lost 3 of 9 dealers). Should be competitive on quality and price.

Initial Banex Assessment: Potential exports of $2.3 million annually.

Services Provided: BT/WTI prepared marketing strategy; sought new dealers. (No Banex loans.)

Results: No sales through BT. WTI identified dealers who insist on 100% financing by producers.

Evaluation by Firm: No feedback from BT/WTI regarding market strategy. Don't like exclusive representation concept. Want BT to provide 100% of financing for export sales (80% offered). Firm thinks it might do better on its own.

Furniture Manufacturer

Background: Capacity of $1.4 million of which 50% utilized. Expanded factory with FODEIN loan in order to export.

Initial Banex Assessment: Top quality furniture. Export potential of $750,000 annually.

Services Provided: BT/WTI visited plant and took samples. Promised sales of $250,000 in first year.

Results: Little feedback regarding progress. Recently heard that all leads fell through.

Evaluation by Firm: Communication with producer is very weak. Don't like exclusive representation contracts. Cost of Banex loans too high. Generally disappointed.

Produce Processing and Canning Plant

Background: Capacity of $16 million of which about 65% utilized. Successful exporter (10 years experience) in Europe, U.S. and Latin America. Produce 47 products but only heart of palm is exported. Other export products being developed. Integrated operation.

Initial Banex Assessment: Additional export potential of $4.3 million annually.

Services Provided: Firm declined BT services.

Evaluation by Firm: BT clearly lacked know-how. Approach seemed superficial.

Candies and Chocolates

Background: Production potential of about $6 million per year compared to sales of about $4.4 million. Experienced exporter of industrial products, but wanted to penetrate U.S. market for candies. Have license from European firm for candies. Invested in increased capacity and improved packaging for this line.

Initial Banex Assessment: Potential exports of $2.4 million annually. Foreign brand name "sells the product easily".

Services Provided: Signed contract with BT. From the Bank, received colon loan for recapitalization and two working capital loans in dollars (only one used).

Results: Trial order of $26,000 for candies (no commercial order resulted) and two trial orders totaling $6,000 for cocoa powder. The latter was sold at a loss, due to high local sugar prices, in order to test the market.

Evaluation by Firm: BT lacks the necessary people and organization. Feedback is poor. Candies (believed to be high quality) were placed in lowest price market segment which was perceived to be incorrect.

Furniture Manufacturer

Background: Small firm with potential sales of $250,000. Mostly produces top quality custom made furniture. Under-utilized capacity led to interest in exporting. Potential for exporting 30 pieces per month.

Initial Banex Assessment: Not included in initial BT list.

Services Provided: Contacted by BT because another client could not meet U.S. buyer request for a certain type of table. Agreed to produce sample.

Results: Firm received trial P.O. worth about $13,000, but letter of credit not yet opened. In order to deliver on time, the firm went ahead and started production without the letter of credit. Now that delivery has been delayed the firm has a major cash flow problem.

Evaluation: The firm is dismayed that BT is not providing financial support. A loan was offered at 35% with the letter of credit as security. BT has not offered to take title of the tables.

Plastic Bags

Background: Potential sales of about $3.7 million compared to actual sales of$2.2 million. 100% of new materials imported. Eight years experience exporting to Caribbean. Export about 50% of sales. Have identified market niches involving small volumes of custom made product.

Initial Banex Assessment: Additional exports of 300,000 kgs. per month.

Services Provided: BT services; colon recapitalization loan; export credit (non-BT exports); and banking services.

Results: Trial order of almost $19,000 and commercial order for about $21,000.

Evaluation by Firm: BT/WTI failed to identify the appropriate market niche. Service focuses on finding a few buyers. Too expensive for the results. Market study too superficial.