

**REEVALUATION OF THE
FOURTH DEVELOPMENT BANK OF WESTERN SAMOA PROJECT
(Loan No. 527-SAM[SF])**

IN

WESTERN SAMOA

December 1995

CURRENCY EQUIVALENTS

Currency Unit - Tala (WS\$)

		At Appraisal	At Project Completion	At Postevaluation	At Reevaluation
WS\$1.00	=	US\$1.0288	US\$0.48785	US\$0.46082	US\$0.41217
US\$1.00	=	WS\$0.9720	WS\$2.04977	WS\$2.17000	WS\$2.426195

ABBREVIATIONS

CBS	-	Central Bank of Samoa
DBWS	-	Development Bank of Western Samoa
DBWS-IV	-	Fourth Development Bank of Western Samoa
DFI	-	Development Financing Institution
MIS	-	Management Information System
NFI	-	Nonmonetary Financial Institution
PPAR	-	Project Performance Audit Report
REM	-	Reevaluation Mission

WEIGHTS AND MEASURES

NOTES

The fiscal year (FY) of the Government ends 31 December. DBWS's fiscal year ends 30 September.

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I. HIGHLIGHTS

A. Background

1. **Objectives and Scope.** The objective of the Fourth Development Bank of Western Samoa Project (DBWS-IV) was to support economic development in Western Samoa by providing a line of credit to the Development Bank of Western Samoa (DBWS) for the private sector.
2. **Cost, Financing and Schedule.** DBWS provided WS\$10.5 million in subloans for 1,318 subprojects from the loan of US\$4 million from the Bank. About 98 percent (US\$3.9 million) of the loan from the Bank was utilized and the rest was cancelled. The loan was closed 14 months after the original loan closing date.
3. **Implementation.** The actual allocation to the services sector including transport was 35 percent compared with the projection of 10 percent, while the allocation for the agriculture and industry sectors fell short of their targets. About 83 percent of the subloans were for WS\$5,000 or less, but they amounted to only 3.4 percent of the loan. Approximately 62 percent of the loan financed 97 subprojects. The geographical allocation of the subloans was skewed in favor of Apia, the country's capital, and against Savai'i Island.
4. **Project Performance Audit Report Findings.** The Project Performance Audit Report (PPAR) concluded *inter alia* that (i) DBWS-IV has a relatively better performance record because of substantial rescheduling compared to the high arrears and low collection ratios in the overall DBWS portfolio; (ii) the arrears in many of the Project's subloans indicate unsatisfactory appraisal, or credit diversion; and (iii) major areas of concern in DBWS are: the unsatisfactory data collection and processing systems, the inappropriate treatment of nonperforming accounts, the deficient follow-up of the implementation of the subloans, the lack of training and advisory services for its customers, and the lack of emphasis on the environment. The PPAR characterized the Project as partly successful because of the high loan utilization record, organizational flexibility, and associated benefits, despite the overall poor quality of the portfolio, unsatisfactory collection performance, and weaknesses in the data collection system of DBWS.

B. Reevaluation Findings

5. **Subproject Performance.** As of 31 March 1995, about six years after postevaluation, the outstanding balance of subloans under DBWS-IV was WS\$4.4 million, of which subloans of WS\$2.9 million were in arrears, some of them hard core. Thirty-four subloans amounting to WS\$0.63 million were written-off, some 5.7 percent of the total disbursement of WS\$10.5 million. The repayment performance of the subloan reflects adversely on subproject performance as well as on the appraisal and collection of the subloans.
6. **Performance of DBWS.** DBWS has made significant improvements in its operational, financial, and institutional performance during 1991-1994. Its operations have expanded and the quality of its portfolio has improved. Collection has increased; arrearages as well as arrears as a percentage of total loans outstanding have declined. Now DBWS has adequate capital and is a profitable institution with substantial loan loss provisions and sound financial ratios. It has been reorganized and is better managed with lower staff turnover, a more effective training program, improved and culturally sensitive operating procedures, a system to pursue defaulters in

repayments, and an improved management information system (MIS) and accounting system. It has contributed to the rehabilitation of agriculture after a series of natural disasters during 1991-1994. However, its operating procedures, accounting, and, especially, its MIS can be improved further.

7. **Cost-Benefit Assessment.** The substantial reschedulings in the past and the current level of arrears of about 15 percent indicate the performance of the subprojects was mixed and the benefits were lower than anticipated. It has been estimated that the Project created about 700 jobs, and generated annual income of about WS\$0.8 million.

8. **Overall Performance and Sustainability.** There is no basis for changing the categorization of the Project as partly successful by PPAR because of mixed performance of subprojects and no significant improvement in the recovery of subloans since the time of postevaluation. Although the Project contributed to the increase in food production, processing, and social infrastructure in Western Samoa, the level of benefits was below expectations. The sustainability of Project benefits is expected to improve as a result of a reduction in outstanding arrearages and the financial, operational, and institutional improvements in DBWS.

9. **Feedback.** To ensure the self-sustainability of DBWS, the Government should allow DBWS to charge market-based rates of interest, make arrangements for the use of community land as collateral in DBWS loans, and apply prudential standards to DBWS as appropriate. DBWS also needs to improve its collection performance further, and to upgrade its loan appraisal, administration, supervision, and data collection procedures.

II. BACKGROUND

A. Objectives, Scope, and History

10. A loan for US\$4 million for the Project was approved on 29 September 1981. The objective of the Project was to support economic development in Western Samoa by augmenting the foreign currency resources of DBWS during 1982-1986, and thereby enable it to provide financial assistance for development projects. The tentative sectoral allocation of the proposed loan was industry 40 percent, agriculture 40 percent, group/village projects 10 percent, and service industry including transport 10 percent. Within each sector, DBWS was expected to endeavor to make subloans to smaller enterprises (at least 60 percent of the subloans were to be below US\$200,000), particularly in the rural areas, and to those on Savai'i Island.

11. Under the Project US\$3.9 million of the loan was disbursed and US\$0.1 million was cancelled. The loan was closed on 13 July 1987. The Project Completion Report was circulated in August 1988, and the PPAR in December 1989. In view of the high arrears of DBWS-IV subloans and relatively weak performance of DBWS, which were highlighted in the PPAR, it was considered useful to undertake a reevaluation of the Project to find out whether the situation had improved, and analyze the factors accounting for such improvement or the lack of it.

B. Reevaluation: Focus and Sources

12. This Reevaluation Report reviews the performance of DBWS-IV subprojects, the developments in the DBWS-IV portfolio, and developments in DBWS during 1989-1994. It is based on the earlier reports on the Project in the Bank, the information made available by DBWS to the Reevaluation Mission (REM) during its visit to Western Samoa in June 1995, and on the REM's discussions with officials of the Government and with the management and staff of DBWS.

C. The Formal Credit Sector

13. Traditionally credit did not figure prominently in Western Samoan culture. Informal credit does not appear to be significant in the economy even today. The major source of formal domestic credit in Western Samoa are seven nonmonetary financial institutions (NFIs) including DBWS.¹ The NFIs provided about 74 percent of formal domestic credit at the end of December 1994, with about 24 percent being provided by DBWS, the second largest NFI in the country. The sectoral distribution of credit by NFIs at the end of December 1994 is shown in Appendix 1.

14. Historically, DBWS has been the major source of term credit to agriculture, providing, until 1989, close to 98 percent of the sector's term borrowings in a sector where 17 percent of the total 15,500 rural households are borrowers. Since its inception, the loan portfolio of DBWS has been characterized by a large number of small loans in the agriculture sector mainly to assist subsistence farmers. This is not surprising because agriculture, including fishing and cattle farming, contributes over 50 percent of GNP and small farmers are the backbone of agriculture. However, between 1988 and 1993, term lending by DBWS to farmers fell by 42 percent in nominal terms² (see Appendix 2).³ This was due to the resource constraint of DBWS and to the low interest rate ceilings applicable to agriculture.⁴ The interest rate ceiling, which is lower than the rate on other sectors,⁵ reduces the return on agricultural lending, discourages other financial institutions from lending to the sector, and contributes to the erosion of credit discipline in the sector. The combination of the interest rate ceilings and the relatively poor performance of its agriculture portfolio in the 1980s caused DBWS to shift its resources out of agriculture.⁶

¹ The other six NFIs are: The National Provident Fund, National Pacific Insurance Limited, Western Samoa Life Assurance Corporation, Public Trust Office, Post Office Savings Bank, and the Housing Corporation.

² DBWS's market share of credit to manufacturing and transport, which was high in the past, has also been declining with the increase in the term operations of commercial banks.

³ During the period, the agricultural operations of commercial banks expanded rapidly, even though they constituted only about 5 percent of the total operations of commercial banks. However, these operations were not primarily in term lending. Commercial banks do not provide credit targeted by sector. Also the other NFIs do not appear to be deeply involved in agriculture.

⁴ These were 8 percent on loans to specified crops/agricultural subsectors including the tree crops (coconut, cocoa, coffee, and kava) and the livestock subsector, and 10 percent to other crops and subsectors in agriculture.

⁵ All commercial bank loan operations are subject to a ceiling of 12 percent rate of interest imposed by the Central Bank of Samoa (CBS). Some specified loans attract 14-16 percent term deposit rates.

⁶ The fall in DBWS credit to agriculture during 1990-1994 coincided with a fall in agricultural output during the same period (see Appendix 3), though it also coincided with two major cyclones in 1991 and 1993, and the taro blight in 1993, which destroyed the country's main food crop.

III. POSTEVALUATION FINDINGS

A. Project Performance

15. The loan was utilized over a period of about five years (1982-1987) during which US\$3,923,460 was disbursed. The remaining amount of US\$76,540 was cancelled. The distribution of Project subloans by sector, size, location, purpose, and maturity is shown in Appendix 4.

16. Only two subloans exceeded US\$200,000 for a total of US\$0.485 million or 12 percent of the loan amount, so that 88 percent of the loan amount instead of about 60 percent as originally envisaged was lent to enterprises that required less than US\$200,000, a distribution more favorable to smaller enterprises. Of the 1,318 subloans financed, 1,089 or 83 percent were below WS\$5,000 for a total of WS\$0.23 million, or 3.4 percent of the total amount. The 27 subloans of WS\$50,000 or above amounted to WS\$2.73 million and constituted 41 percent of the loan amount. By location, 87 percent of the loan amount was allocated to Upolu Island (with 54 percent going to metropolitan Apia for relatively large industrial and service including transport projects, and 33 percent to the rest of Upolu) and 13 percent to Savai'i. This was due to the lack of infrastructure in areas other than Apia.

17. The actual sectoral distribution was about 28 percent for industry, 28 percent for agriculture, 9 percent for group/village schemes, and 35 percent for services including transport. The substantial proportion of loan utilization in the services sector was due to the approval of larger projects in the construction, tourism, and transport subsectors.

18. In terms of purpose, expansion projects utilized 56 percent of the total amount, while the remaining 44 percent was used for new projects (38 percent) and for balancing, modernization, and replacement projects (6 percent). The maturity of subloans ranged from less than 2 years to 12 years, with most of the subloans by number (52 percent) having maturities of less than 3 years. There was a preponderance of small agriculture loans, the majority of which had maturities of up to two years. In value terms, 64 percent of subloans carried maturities of four years or more.

19. At the end of June 1989, of the WS\$10.5 million subloans made by the DBWS, WS\$5.3 million (50.4 percent) had been repaid. Of the balance of WS\$5.2 million outstanding, WS\$1.4 million or 27.1 percent had been rescheduled. Approximately WS\$1.9 million was in arrears. In terms of the number of subloans, 791 (60 percent) out of 1,318 were repaid, and of the 527 still being repaid, 316 (60 percent) were restructured.

B. Operational, Financial, and Institutional Performance of DBWS

1. Operational Performance

20. The number of loan approvals declined from 2,529 in 1984 to 1,474 in 1987, but the value of approvals increased by 12.2 percent per annum during 1982-1987, reflecting DBWS's efforts to scale down microlendings and to concentrate on loan recovery and portfolio improvement.

2. Financial Performance

21. Equity injections of WS\$0.86 million in 1988 and WS\$1.4 million in 1989 were provided by Government to redress the debt-equity ratio, which had exceeded the covenanted level of 3:1. Collections as a percentage of current maturities fluctuated between 59-70 percent during 1984-1988. On 30 June 1989, DBWS had 5,654 loans amounting to WS\$34.8 million in repayment stage, of which 73 percent by number and 20 percent by value were in arrears despite reschedulings.¹ Of the loans in arrears, 42 percent by number and 28 percent by value were considered nonperforming. About 90 percent by number and 65 percent by value of the subloans in arrears were in the agriculture sector, with small-scale loans accounting for 55 percent by number and 15 percent by value. Evidently, the Arrears Reduction Plan adopted in 1984 had not been a success. The less than satisfactory quality of the DBWS portfolio and poor collection performance necessitated high provisions for bad debts. DBWS incurred losses of WS\$0.5 million in 1984 and WS\$1.1 million in 1985, but, as covenanted, Government covered the losses during 1986-1989.

3. Institutional Performance

22. Frequent changes in the composition of the Board of Directors disrupted institutional development. Some board members reportedly were direct or indirect borrowers of DBWS, a conflict of interest. The policy and directional contribution of the Board was limited. In May 1989, DBWS was reorganized and loan appraisal was separated from loan implementation and recovery. The training was focused on the recovery of loans, and appraisal and supervision functions were neglected. There was a need to strengthen subproject identification, processing and supervision as well as the MIS. The staff turnover was high at 18 percent between 1981-1987.² The key issues included appropriateness of DBWS as a lender for small-scale agriculture, and of DBWS's lending procedures.

IV. REEVALUATION FINDINGS

A. Subproject Performance

23. The actual sectoral distribution of loans reflected market realities. It appears that the ceiling of 40 percent of the loan amount for loans of US\$200,000 or more was too high in relation

¹ The extent of the reschedulings could not be determined.

² Low emoluments and disciplinary action were cited as reasons, among others.

to market demand, as only 12 percent of the loan amount was utilized for loans above US\$200,000. This illustrates that the assessment of the needs of subborrowers during appraisal was inadequate.

24. In the agriculture sector, the subloans were utilized primarily for expansion of farms and for capital improvements on farms. In the industrial sector, the subloans for over US\$10,000 were utilized to finance printing and publishing, iron and steel fabrication, veneer products, aluminum products, upholstery, bakery, coconut processing, and ice cream projects, among others. In the group/village sector, the relatively larger (over US\$10,000) subloans were used for the construction/expansion of schools, hospital buildings, and churches.

25. The latest available status of the portfolio of subloans financed under DBWS-IV is shown in Appendix 5. As of 31 March 1995, 1,200 (91 percent) subloans amounting to about WS\$6.1 million (58 percent of the loan amount) had been fully repaid. Thus collection between 30 June 1989 and 31 March 1995 had increased by WS\$0.8 million, or by about 7.5 percent of the loan amount.

26. Of the 118 outstanding subloans amounting to WS\$4.4 million,¹ or 42 percent of the loan amount, 38 had been rescheduled, and 80 subloans (including the 38 rescheduled subloans) with an outstanding balance of WS\$2.9 million, were in arrears totalling WS\$677,360. Of the 38 rescheduled subloans, 27 had been in arrears for more than two years, while 9 were in arrears for more than a year, although after the rescheduling in the first quarter of 1995, no subloan on 31 March 1995 was technically in arrears for more than one year. The rescheduled subloans had been in chronic default, and were in default even after the rescheduling in early 1995. Their arrears amounted to WS\$537,545 and formed the bulk (79 percent) of total arrears of WS\$0.67 million, which were the cause for the arrears for subloans under DBWS-IV being 15.4 percent compared with the arrears of 7 percent for the overall portfolio of DBWS.

27. Of the 1,318 subloans, 34 subloans, which amounted to WS\$0.63 million or 5.7 percent of the total disbursements of WS\$10.5 million, were written off. The amount collected against these bad debts is WS\$21,489. Further write-offs of the hard core arrears may be necessary.

28. Many of the subloans in the DBWS-IV portfolio have been rescheduled. Overall rescheduling as of 31 March 1995 amounted to WS\$7.73 million equivalent to 74 percent of the total portfolio of DBWS-IV. The extensive rescheduling illustrates that the appraisal, supervision, and recovery of the subloans was not adequate. The payment record for the 80 subprojects with an outstanding balance of WS\$2.9 million indicates that the performance of the subprojects was poor. The continued uncertainty about the collectibility of the subloans for these subprojects (especially the 38 rescheduled ones) compounds the situation and detracts from the quality of DBWS-IV portfolio.

B. Performance of DBWS

¹ At an average of WS\$37,260.

1. Operational Performance of DBWS

a. Overview

29. DBWS is a statutory corporation created by the Development Bank Act of 1974. As of 31 March 1995, it had 155 million authorized shares valued at WS\$1.0 each, of which 1.39 million had been issued for a total paid up equity of WS\$13.9 million, which is all held by the Government. DBWS operates within the general framework of the Government's economic policies, plans, and priorities. The last policy statement of DBWS (dated August 1986) has, in fact, remained virtually unchanged since 1974 when it was prepared in consultation with the Bank. Its main features are the emphasis on providing assistance to the private sector for both new enterprises and the expansion of existing enterprises, primarily for fixed assets; preferring enterprises that use local raw materials, promote labor-intensive technologies, and support local entrepreneurship; and financing activities with a favorable impact on economic efficiency, product quality, and foreign exchange resources. DBWS aims at increasing production in (i) agriculture, including horticulture, livestock, and fishing; (ii) timber extraction and reforestation; (iii) quarrying; (iv) industry, manufacturing, and processing; (v) tourism; (vi) transport and communication; and (vii) other service industries that contribute to development in these fields.

30. With loan approvals averaging WS\$9.0 million per annum during 1989-1994, the portfolio of DBWS including current maturities increased by about WS\$8.1 million or 23 percent from WS\$34.4 million in 1988 to WS\$42.5 million in 1994. But there were major swings in the loan operations of DBWS during 1989-1994. The favorable conditions in the economy led to a 66 percent increase in loan approvals in 1989, but the trend was not maintained in 1990. In 1991, following the devastation caused by cyclone Ofa in February, loan approvals contracted to WS\$6 million. In 1992, there was a substantial increase in the number and the amount of small loans for agriculture for rehabilitation. In 1993, cyclone Lynn seriously damaged the banana crop, and leaf blight virtually wiped out the taro crop, the country's staple food. Loans for agriculture for rehabilitation figured prominently in loan approvals in 1994. During 1989-1994, the number of loans to agriculture constituted 90 percent of the loan approvals by DBWS; those for industry 8 percent, and those for others 2 percent. In terms of amount, loan approvals to agriculture were 41 percent, industry 45 percent, and others 14 percent, indicating that the size of loans to industry and other sectors was much larger than that for agriculture. The sectoral distribution of DBWS loans over 1989-1994 is shown in Appendix 6. Disbursements over 1989-1994 kept pace with approvals.

31. The loan portfolio, collection and arrears situation of DBWS is summarized in Table 1.

Table 1: DBWS Portfolio, Collection, Arrearages, and Provisions 1989-94
(WS\$'000)

	1988	1989	1990	1991	1992	1993	1994
A. Portfolio							
Gross Portfolio	34,381	40,561	43,200	40,995	43,412	40,146	42,458
Less: Maturities Beyond 12 Months	20,658	24,414	26,884	24,958	25,890	24,416	25,930
Net Portfolio	13,723	16,147	16,316	16,037	17,522	15,730	16,528
Less: Provision for Doubtful Loans	2,938	3,511	5,585	7,453	8,086	8,021	7,682

Current Maturities of Portfolio	10,785	12,636	10,731	8,584	9,436	7,709	8,846
B. Collections							
Cash Collections During the Year	7,562	8,043	8,798	13,708	11,361	11,482	9,952
As Percentage of Current Maturities	70.1	63.6	81.9	159.7	120.4	148.9	112.5
C. Total Arrears	6,452	7,807	9,271	8,119	5,482	4,642	2,954
E. Provision for Doubtful Loans							
Opening Balance	3,068	2,938	3,511	5,585	7,453	8,086	8,021
Provision Made During the Year	1,403	2,237	5,208	1,868	800	800	-
Total	4,471	5,175	8,719	7,453	8,253	8,886	8,021
Less: Bad Debts Written Off	1,533	1,664	3,134	-	167	865	339
Closing Balance	2,938	3,511	5,585	7,453	8,086	8,021	7,682

32. Arrears increased significantly during 1989 and 1990 as a result of the inadequate loan monitoring and supervision by DBWS staff, and the defaults by borrowers (see Appendix 7). The collections of past dues plus current dues as a percentage of current dues were 64-82 percent in 1988-1990. A vigorous collection drive during 1991-1994 resulted in collections ranging from 113 to 160 percent during these four years. Arrears, which had increased from about WS\$6.5 million in 1988 to about WS\$9.3 million in 1990, declined to about WS\$3.0 million in 1994. Arrears thus declined from about 19 percent of the portfolio in 1988 to about 7 percent in 1994. During 1989-1994 bad debts totalling WS\$6.2 million were written off, of which WS\$1.9 million was subsequently recovered.

b. Bad Debts and Provisions

33. The provision for doubtful loans are made by DBWS after a review of individual subloans and consideration of the realizable value of securities. As of 30 September 1994, the provision for doubtful loans amounted to WS\$7.7 million (representing an increase of WS\$4.74 million over the WS\$2.9 million at the end of 1988), which was equivalent to 18.1 percent of the gross loan portfolio of WS\$42.45 million, and is much higher than the requirement of 10 percent specified in the policy statement of DBWS.

2. Financial Performance of DBWS

a. Profitability

34. The details of audited income statements, balance sheets, and cash flow statements of DBWS for FYs 1989-1994 are in Appendix 8. The highlights of the financial statements are shown in Table 2. During FYs 1989-1991, DBWS incurred net losses totalling WS\$1.31 million despite continued equity injections and subventions from the Government to cover operating losses. These losses were due to concessional interest rates unrelated to risk charged by DBWS, and resulted in a decline in earnings in relation to average earning assets; the large provisions and write-offs necessitated by poor collection levels; and the increase in administration and borrowing costs. The organization was turned around in 1992 although the level

of profit has fluctuated since then. During FYs 1992-1994, aggregate net profit was WS\$1.40 million. A liberal provision for doubtful loans has resulted in a healthy portfolio, but it has had an adverse impact on profitability. Administration expenses as a percentage of the portfolio have also continued to increase, especially the expenditure on salaries which increased rapidly in recent years.

35. The interest cost on borrowings was reduced from 6.2 percent in 1989 to 4.8 percent in 1994, while the interest income averaged 8.9 percent over the period. The 4 percent spread indicates that management of financial resources has been sound. During FYs 1989-1994, the return on assets improved from a negative 0.4 percent to 1.3 percent. The return on equity has improved from a negative 2 percent to 4 percent despite the heavy equity injections by the Government and the low leverage of DBWS (see para. 36).

b. Financial Position

36. The financial position of DBWS has been satisfactory. The current ratio improved from 3.5 to 6.5. The debt-equity ratio was reduced from 2.5 to 1.8 (compared with the covenanted level of 3.0) because of an increase of WS\$7.6 million in paid-up capital during FYs 1989-1994. The debt-service coverage ratio of DBWS was higher than 1.2 during 1989-94 except for 1991 when it was minus 0.5 percent. DBWS has met its debt servicing obligations. The Bank loans provided under DBWS I, II, III, and IV Projects have been fully repaid¹ by DBWS to the Government.

c. Sustainability

37. The financial performance of DBWS has improved recently. The loan portfolio and the collection performance are satisfactory. Its operations have become profitable. Given the current level of management, DBWS is expected to sustain its current performance and improve upon it. The projected financial statements for FY1995 to FY2000 are in Appendix 9. Although based on conservative assumptions, these statements indicate that the operational and financial performance of DBWS is expected to improve in the future.²

3. Institutional Performance of DBWS

a. Board of Directors

38. There are ten directors on the Board of Directors of DBWS. The official members are the Finance Secretary of Western Samoa and ex officio Chairman; Director of Agriculture, Fisheries, and Forests; Secretary Commerce and Industry; and the General Manager of DBWS. There are six directors from the private sector, three each from agriculture and industry. All the directors are appointed by the Government and serve an unspecified term.³ The current Board of Directors is considered relatively more professional than the one during the late 1980s (see para.

¹ Payment of DBWS-IV was intimated by DBWS on 16 November 1995.

² The amount of WS\$3.976 million received from the Government in September 1995 as compensation for foregone income has not been taken into account in the estimates of profits in these statements.

³ Apparently, to make these appointments coterminous with political governments and thus to avoid conflict and acrimony with directors carried over from a previous government.

22).

b. Organizational Structure

39. The organization chart of DBWS is in Appendix 10. Since 1988, DBWS has undergone two organizational changes. The first one in 1989, which separated the loan appraisal function from the project supervision and follow-up functions, did not improve the performance of DBWS. The second reorganization took place in 1992 based on the recommendations of the consultants for TA No. 1399, Rehabilitation of Development Bank of Western Samoa.¹

¹ Approved on 25 October 1990 for an amount of US\$203,000.

Table 2: Summary of Financial Statements FY 1989-1994

FY Ending 30 September	1989	1990	1991	1992	1993	1994
Total Income	5,328	5,846	5,424	5,208	5,886	5,113
Total Expenses	3,279	3,766	3,808	3,671	3,954	4,236
Operating Profit	2,049	2,080	1,616	1,537	1,932	877
Provisions	2,262	5,234	1,868	800	800	7
Pre-tax Profit (Loss)	(213)	(3,154)	(252)	737	1,132	870
Income Tax Provision/Adjustment	49	2,142	109	(299)	(747)	291
Net Profit (Loss)	(164)	(1,012)	(143)	438	385	579
Current Assets	16,755	17,950	18,654	20,032	23,091	21,415
Fixed Assets	779	698	889	806	1,249	1,267
Other Assets	22,273	23,979	20,367	20,948	19,065	20,777
Total Assets	39,807	42,627	39,910	41,786	43,405	43,459
Current Liabilities	4,725	5,814	5,075	8,343	7,018	3,294
Term Debt	24,278	26,046	22,977	20,647	22,206	25,404
Equity	10,804	10,767	11,858	12,796	14,181	14,761
Total Liabilities and Equity	39,807	42,627	39,910	41,786	43,405	43,459
Internal Cash Generation	4,286	6,183	4,028	3,339	3,779	4,605
Other Sources	11,537	9,738	13,744	10,484	10,661	9,940
Total Cash Inflow	15,823	15,921	17,772	13,823	14,440	14,545
Servicing of Term Debt	2,379	1,906	7,689	2,334	1,951	3,929
Other Payments	13,394	11,744	9,281	11,410	13,403	11,177
Total Cash Outflow	15,773	13,650	16,970	13,744	15,354	15,106
Ratios:						
Return on Assets	(0.4)	(2.4)	(0.36)	1.05	0.89	1.33
Operating Profit/Equity	26	20	14	12	14	6
Net Profit/Equity	(2.0)	(9.8)	(1.2)	3	2.8	4
Interest Cost of Borrowings	6.2	5.2	5.0	4	5	4.8
Interest Income on Loans	8.7	9.17	8.5	8	10.2	8.8
Administrative Expenses/Portfolio	0.4	0.6	0.7	0.6	0.8	0.9
Current	3.5	3.1	3.6	2.4	3.3	6.5
Debt-Equity	2.5	2.3	1.8	1.6	1.6	1.8
Debt Service (Times)	1.8	3.2	(0.5)	1.4	1.9	1.2

40. The report of consultants for TA No. 1399 identified four interrelated problems: (i) inappropriate organizational structure, operating procedures, allocation of responsibilities and management information system; (ii) lack of manpower development and training; (iii) disproportionate amount of time spent on a large number of small loans; and (iv) lack of a program to pursue major defaulters. The report recommended: (i) the authority for credit and the procedures should be revised; (ii) DBWS's portfolio should be reviewed to identify a properly performing core portfolio, loans in default which are potentially collectible, and loans which are uncollectible and should be written off; (iii) a strategic plan should be formulated for portfolio management and

diversification; (iv) DBWS's policies regarding interest rates and terms and conditions of loans such as collateral and borrower equity should be reviewed; (v) an improved MIS should be introduced; (vi) loan appraisal, supervision, and collection procedures should be improved; (vii) DBWS's staff should be trained and redeployed and staff benefits should be reviewed; and (viii) forecasts, budgets, and targets for DBWS should be prepared on a regular basis to monitor and evaluate its performance.

41. DBWS has taken action on some of these recommendations,¹ which has helped DBWS improve its institutional performance during the last three years despite the cyclones and crop failure. The subsequent reorganization included (i) merging of loan operations and supervision divisions into a single division which was subsequently reorganized on regional lines; (ii) setting up of an executive management committee to oversee DBWS operations; and (iii) computerizing the accounting system, and improving the MIS. This reorganization has had positive results.

c. Management and Staff

42. The morale of the staff has improved with the introduction of competitive salary levels from July 1993, the more effective training programs organized by a revitalized training unit, and the perception of the enhanced security of the organization.² As a result, staff turnover in DBWS declined from 21 percent in 1989-1991 to 7 percent in 1994 (see Appendix 11).

d. Operating Procedures

43. Some improvement has also been made in the follow-up and supervision of subprojects. However, the appraisal of loan applications needs to be upgraded. In the case of small village-based borrowers where a traditional relationship between the borrower and the loan office exists, the investigation by the loan officer is minimal. A more commercial orientation on the part of loan officers and a rigorous assessment of the client's history and character is required. One major improvement has been the increase in the borrower's equity to 20-50 percent. Credit approval authorities have been revised, but further delegation and decentralization of authority are required as shown in Appendix 12.

44. An agricultural lending manual, an industrial loan appraisal manual, and a project promotion and business advisory assistance manual exist, but are not used. Although the manuals are useful, they need to be updated, and guidelines based on them prepared for field staff who also need to be trained in their use. So far, a loan administration/supervision manual has not been prepared.

e. Improvement in Collection

45. The sharp decline of 68 percent in arrears over 1990-1994 (see para. 32) was the result of the creation of a Legal and Securities Division and Management Recovery Committee as part of the 1992 reorganization, and the appointment in 1993 of an expatriate solicitor to head the division. The average turnaround time for a court case has declined from 9-12 months to 2-3 months. Of the current loan portfolio, about 7 percent or 2,250 loans amounting to WS\$3.0 million

¹ Notable exceptions were the recommendations to review of interest rate ceilings and to expand and reconstitute the board of directors.

² In addition, the labor market in Western Samoa has stabilized during the last three years.

are in arrears. Of these, 900 loans totalling WS\$2.6 million have been referred for legal action.¹ In addition, there are attempts to recover bad debts.

46. Western Samoa has a judicial system with two main tiers. The magistrates' courts are empowered to try cases where the amount of claim is WS\$1,000 or less. All other cases go to the Supreme Court.² If it is not considered practicable to have a separate court for claims of financial institutions, or a middle tier in the judicial hierarchy, Government may consider conferring increased powers on senior and experienced magistrates to hear cases of claims of say upto WS\$9,999 in order to expedite settlement of cases.

f. Budgeting, Accounts, and Management Information System

47. Before 1992, DBWS did not have a proper budgeting procedure. No operating budget was prepared for 1991. The lack of scrutiny of budget proposals could in part be responsible for the sharp increase in administrative costs until 1992 even though salaries were not revised significantly. In addition, there were no targets to compare the actual results with, and therefore a lack of accountability. Since 1992, an operating budget has been prepared, but forward planning on a comprehensive and consistent basis is still lacking.

48. DBWS shifted from the manual accounting system to a system based on its loan ledger at the end of 1989, with a computerized data base. A major innovation was the change in the classification of interest income from an accrual basis to a realized basis. An accounting manual was prepared under TA No. 1399. An audit manual has been used but the internal audit section, which has only one officer assisted by a clerk, needs to be strengthened. The annual accounts of DBWS are audited by the Controller and Chief Auditor of the Government of Western Samoa. This office has contracted Messrs. Price Waterhouse to audit the accounts of DBWS. The quality of audit has been high and in accordance with international standards.

49. The computerized MIS currently produces reports only in an aggregate form. Sometimes reports are required that are specific to each client, credit officer, task, region, and sector. However, these specific reports can not be produced as the computerization program recommended was not implemented because it was considered too expensive.³ If the recommended computerization program had been installed, it would have been cost-effective and would have improved the quality of the loan portfolio.

C. Socioeconomic Impact

50. A large number of subprojects financed under the loan were family enterprises which did not keep accounting records. Therefore it is difficult to assess the operational and financial performance of these subprojects. A covenant in the Project Agreement required DBWS to compile financial and socioeconomic information for completed subprojects with subloans above the free limit of US\$50,000, but this was not done. Therefore the REM was not able to quantify the

¹ A difficulty in the case of legal action is that assets seized from defaulters, even freehold land, do not have a market. Suing is thus an act of last resort. The only solution is rigorous appraisal before approval of the loan.

² In addition, there is a court of appeals consisting of expatriate judges which meets occasionally. There also is a separate Lands and Titles Court.

³ It was expected to cost between WS\$200,000 to WS\$250,000.

impact of the Project on employment created, income generated, or foreign exchange earned or saved. It was only able to assess the broad non-quantifiable benefits of the Project. Under the Project, farmers were trained in the use of credit and the pool of new entrepreneurs in the economy was enlarged. It also helped mobilize local funds for development. The assistance to agriculture increased production facilities so the economy was better able to cope with the consequences of the cyclones in 1990, 1991, and 1993, and the taro blight in 1993. Group/village schemes contributed to an increase in social infrastructure in the country.

51. At appraisal, it was estimated that the 1,000 subprojects to be financed under the Project would create about 1,000 jobs, generate about US\$1.2 million in annual income, and save or earn foreign exchange of US\$2.5 million. In the absence of other data, the repayment performance is the only indicator of subproject performance and socioeconomic impact. The write-off of WS\$0.63 million and arrearages of WS\$0.68 million account for about 12 percent of the total disbursements of WS\$10.5 million by DBWS under the loan. The reschedulings of the subloans indicate that several of the subprojects were only a partial success (see paras. 26-28). It has been estimated that the socioeconomic impact of the Project was about 30 percent lower than expected, i.e., the number of jobs created would be about 700, and the annual income generated would be about WS\$0.8 million. Because of the lower than expected allocation of subloans for the industrial sector, a higher than expected allocation for the services sector, and the fact that arrearages are largely in the larger loans, primarily in the non-agricultural sectors and schemes other than group/village schemes, the foreign exchange saved or earned would be much lower than appraisal estimates.

D. Environmental Impact

52. The environmental impact of the Project could not be assessed in the absence of data. However, the agricultural subprojects which the REM visited had a positive impact on the environment because of the new and expanded plantations, crops, and vegetation. The scale of the industrial and service sector subprojects in Apia was not large enough to have had a major adverse impact on the environment. On an overall basis, the environmental impact of the Project was minimal.

V. KEY ISSUES

A. Interest Rate Ceilings

53. DBWS' losses have been the result of a combination of low interest spread, poor recovery performance, and rapid increase in loan loss provisions. The foremost issue in the operations of DBWS is the interest rate ceilings fixed by Government. Interest in the operations of a bank should be determined by transaction costs, i.e., the costs (including staff time) involved in processing, delivery, administration, and collection of loans, as well as the risk of default. The financial intermediary's spread should cover these costs and the cost of funds, and generate profit

on equity not below the market rate of interest.¹ However, it is not uncommon that loans to small farmers, which are at high risk, are provided at low rates of interest fixed by the Government as part of the policy to assist farmers, and this is precisely the case in Western Samoa. It has also been established that small agricultural loans with lower than market rates of interest are often misdirected and misused, and that their repayment is no faster than loans at market rates of interest. A large representation of such loans in the portfolio of a financial intermediary militates against its profitability. Therefore it is in everyone's interest, the borrowers' whose primary requirement is a ready and regular source of credit; the Government's, which wants provision of credit to facilitate acquisition of inputs for higher agricultural production; and the financial intermediary's, which wants to be self-sustaining, to have a strong financial institution that is able to deliver credit without requiring cash injections from the Treasury.

B. Collection and Collateral

54. The other determinant of sustainability for a financial intermediary is the collection ratio. Unless collection ratio is high enough, the financial intermediation costs will be too high. DBWS needs to attain a collection ratio of at least 90 percent to maintain its interest rates at reasonable levels. Collection is a function of sound appraisal, collateral, and vigorous supervision. The primary security for term loans for agriculture for capital improvements is, or ought to be, land. However, Article 182 of the Constitution of Western Samoa prohibits this: "It shall not be lawful or competent for any person to make any alienation or disposition of customary land or of any interest in customary land, whether by way of sale, mortgage or otherwise how so ever, nor shall customary land or any interest therein be capable of being taken in execution or be assets for the payments of the debts of any person on his decease or insolvency". About 80 percent of the land in Western Samoa falls in this category. Therefore, DBWS is usually left with the option of accepting chattel and personal guarantees as security for term loans to small agriculturists. The first is often inadequate; and the second is notoriously unreliable. The loans written off by DBWS are largely the small agricultural loans difficult to collect. The Alienation of Customary Land Act 1965 empowers the Government to grant a lease or a license for customary land under certain conditions. It should be considered whether arrangements could be made to lease/license customary land to a corporation created by the Government and enable the corporation to guarantee loans, similar to the arrangements in Fiji. Such arrangements would solve the collateral problem for small agricultural loans and would improve the availability of credit for agriculture by diversifying its sources and improving its sustainability. It will also help to improve the collection performance, financial position, and self-sustainability of DBWS.

C. Application of Prudential Standards to DBWS

55. A third issue is the application of prudential standards to DBWS. A draft law for application of prudential standards to NFIs is pending before the legislature. Although DBWS is currently ahead of some of the internationally accepted prudential standards, the institutional strength and credibility of DBWS in the long term would increase if it adhered to all these standards and was subject to the monitoring of the Central Bank of Samoa (CBS). The redrafted bill would

¹ Provided the intermediary operates efficiently, these costs can be low.

require financial institutions doing banking business to be licensed by CBS. When DBWS starts accepting deposits, it would be required to adhere to requirements covering (a) capital adequacy; (b) maintenance of liquid assets; (c) asset concentration and risk exposure; (d) asset quality, adequacy of provisions for losses, and interest suspension; (e) in-house (insider or connected) lending and activities unrelated to banking; and (f) adequacy of accounting and internal control systems. Prudential regulation would be conducive to transparent good banking practice¹ at the appropriate time. The immediate effect of the measure would be to make DBWS, which at present is under the direct control of the Government, subject to the CBS's regulation of interest rates and the extension of credit. This would substitute professional regulation for political control.

D. Continued Availability of Funds

56. A fourth issue is the continued availability of funds for the operations of DBWS. Given that Government (primarily through its share capital) and international aid agencies have been the major sources of its funds, and that equity is substantially paid-up, recourse by DBWS to borrowing from multilateral development banks is necessitated.

E. Professionals as Directors

57. Fifth, there is the issue of the lack of professional expertise among some members of the Board i.e., the three persons nominated to represent agriculture, and the three persons nominated to represent commerce and industry. In the past, this lack of expertise has affected the quality of decision making in the Board as well as the Board's relationship with the management. The appointments to these six positions in the future should include reputable professionals with experience in banking or the financial sector, expertise in accounting, law, management, or other appropriate professions.² This would improve the quality of the Board's decisions.

F. Technical Assistance

58. Finally, there is the issue of the type of technical assistance provided by the Bank and other aid agencies to DBWS. The technical assistance provided so far has not been guided by a strategy for the overall and comprehensive development of DBWS. The quality of the technical assistance has varied in its assessment of needs, its delivery of services, and its long-term impact.³ The provision of a long-term consultant to train loan officers in educating clients in account keeping and monitoring and providing relevant information to DBWS could improve future collections and monitoring, and thus overall DBWS performance.

¹ These would reduce the likelihood of liquidity, solvency, and management problems by curbing unnecessary risk-taking and intervention, and provide safeguards against such risk-taking and its adverse consequences. For the CBS to be able to monitor these indicators, a database would have to be maintained by DBWS.

² Under the Development Bank of Western Samoa Act, directors or employees of other banks or NFIs cannot be directors on the DBWS board.

³ A separate Special Study on the Assessment of the Effectiveness of Bank Assistance in Capacity Building to Western Samoa currently underway will review the quality of technical assistance provided to DBWS.

G. Other Considerations

59. It is premature to consider issues of greater autonomy or mobilization of savings for DBWS. The charter of DBWS covers deposit mobilization. However, at this point in time such an attempt would shift the focus from making the lending operations sustainable. Savings mobilization would be appropriate after several years of profitable operations.

IV. CONCLUSIONS

A. Overall Assessment

60. The performance of subprojects under DBWS-IV has been mixed, as indicated by their repayment record. With the total rescheduling of subloans equal to 74 percent of the loan amount, with subloans of WS\$2.9 million in arrears, some of them hard core, and subloan collections during the last six years of only WS\$0.8 million, there is no basis for changing the overall assessment of the PPAR that the Project is partly successful. However, there has been an improvement in the financial, operational, and institutional performance of DBWS, due partly to the technical assistance provided by the Bank, but it is unrelated to the Project. As such, the partly successful rating for the Project is retained.

B. Lessons Learned

61. First, using market rates of interest, and having an effective collection performance, are the only guarantee of the long-term success and sustainability of financial intermediaries. Second, collection is dependent in substantial part on collateral, and if there are institutional bottlenecks that prevent use of standard collateral items, innovative solutions to the collateral problem must be found. Third, effective methods must be found to ensure collection of operational, financial, and socioeconomic data by financial intermediaries from the subborrowers. In the case of institutions that are not ready to collect the data because of staff constraints or lack of experience, it is not sufficient for the Bank to just include a loan covenant requiring that such data should be collected. The Bank should provide technical assistance for long-term consultants to undertake this work and to train and supervise their counterparts. The same applies to the assessment of the environmental impact of subprojects. Finally, voluminous high quality operating and other manuals tend to adorn shelves; the field staff of DFIs should have portable, user-friendly guidelines based on these manuals.

C. Follow-Up Actions

62. To continue to strengthen itself as an institution, DBWS should (i) reconsider upgrading the MIS, in view of its strengthened financial position, and the cost-effectiveness of such systems; (ii) continue to improve its operating procedures and training program, as well as prepare a field officer's handbook with loan appraisal, administration, collection and other essential guidelines; (iii) delegate higher loan approval authority to its staff (see Appendix 12); and (iv) seek conferment of enhanced financial jurisdiction by the Government on magistrates to enable quicker disposal of its claims.

63. In case the Bank considers another loan for DBWS, it must be predicated upon (i) DBWS charging market-based rates of interest from subborrowers, or at least a clear, graduated movement towards such rates; (ii) the Government allowing land to be used as collateral through a Government-owned intermediary, or appropriate alternatives; and (iii) passage of the redrafted bill on prudential standards. Accompanying long-term TAs should ensure that DBWS collects operational, financial, socioeconomic, and environmental data about its subprojects. This technical assistance should also include a study of priority sectors based on market potential and growth possibilities, and anticipated changes in the economy; provide for the preparation/updating of the various operational, financial, and audit manuals, and environmental guidelines, as well as of simplified guidelines for operational staff; and provide training in portfolio management, and develop a long-term training and manpower development program. The consultants should train staff as understudies to continue training after their departure.

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