

# **Credit line for micro and small enterprises**

## **Summary of the Operation Performance Evaluation Review**

### **September 2005**

#### **THE PROJECT**

In the early 1990s the EBRD signed a sovereign-guaranteed credit line for small and medium-sized enterprises (SMEs) for over US\$ 120 million. The line was slow to disburse and the Bank later re-allocated the unutilised portion of the credit line to a new programme for micro and small enterprises (MSEs). The loan was extended to a company formed by the government to coordinate small business initiatives and funds were on-lent to selected partner banks (PBs). The second stage of the programme was approved in 2002 with the EBRD lending directly to local banks. Technical cooperation (TC) support included long-term MSE credit advisers and training for loan officers and was initially funded from the proceeds of the first loan. Thereafter consulting contracts funded by EU TACIS were signed with a consultancy firm with extensive microlending experience. Further contracts were awarded to an associated consultancy firm and were funded by the EU, USAID and the government of Japan.

#### **PROJECT RATIONALE**

The Bank and the government agreed to establish a mechanism for channelling funds to MSEs. The main rationale of the programme was to enable local banks to lend to small businesses by carefully analysing their financial condition rather than relying on asset-backed lending. The programme therefore aimed to make loan finance available to MSEs while contributing to institution building in the financial sector. A substantial TC component was necessary to work with PBs to make lending to the target group sustainable.

#### **ACHIEVEMENT OF OBJECTIVES**

The objectives of the programme were: to provide finance to MSEs which were unable to access the formal financial sector, to build up the credit capabilities of the financial sector and to establish MSE lending on a commercially viable basis. Evaluation found that not all objectives were achieved in full. Nevertheless, in view of substantial over-achievement in some important areas, especially outreach, the fulfilment of objectives is rated *Excellent* overall. TC objectives concerning training, product development and regional expansion have been achieved. The objectives concerning development of management information systems and strengthening MSE departments at PB head offices have been achieved in part.

#### **OVERALL ASSESSMENT**

The operation is rated *Successful* overall. In quantitative terms the objectives for outreach have exceeded expectations. With regards institution building, the level of commitment to the principles of the programme has varied from bank to bank. Nevertheless, there is evidence that in each of the active partner banks important ingredients of the programme's approach to MSE lending have been institutionalised. TC performance is rated *Successful* overall, although little appears to have been done to resolve the question of EBRD reliance on one source of microfinance consulting. The programme was unquestionably relevant to the institution building needs of the banking sector as well as to the need of small businesses for access to finance. The evaluation has raised questions about the timing of the graduation process and the ongoing viability of the information system installed by the consultant in partner banks. These are matters which should be considered in the planning of future downscaling programmes.

#### **TRANSITION IMPACT AND THE BANK'S ADDITIONALITY**

The short-term transition impact of the programme is rated *Good*. The operation has exceeded any other small business lending programme in the country in size and scope. (This includes

both its outreach to the real sector and its contribution to institution building in the banking sector.) The volume of disbursements has increased rapidly in recent years as PBs have grown more confident about MSE lending, making their own funds available to augment the EBRD's credit lines. While the banks have integrated the principles of the programme at different rates, all PBs – including two banks that are no longer active in the programme – stated that they had applied some of the programme's underlying principles in other areas of their operations. The long-term sustainability of the programme will be determined by the success of the graduation process which is now under way. The Bank's Evaluation Department (EvD) believes there is *Low to Medium* risk to the fulfilment of the remaining transition impact potential (which is rated *Good*). The *Medium* risk lies in the unequal preparedness of PBs for graduation. Nevertheless, the strongest PBs have already internalised the programme's lending principles. Additionality is *Verified in all respects*. When the project was approved in 1997 the transformation of the banking sector was still in its early stages. Banks were unable to attract long-term funding on commercial terms and the small business sector was starved of finance. The programme was additional in financial terms, in providing funds that were not available from other sources, and in introducing a lending methodology to banks which previously shunned the small business sector.

### **BANK HANDLING**

Bank handling overall is rated *Good*. The small business lending programme may be seen as relatively simple in concept. However, the effective implementation of the programme throughout the country in a large number of branches of several banks required complex, staged planning and execution. The move from sovereign to non-sovereign risk was executed smoothly. The small number of EBRD staff responsible for implementation and monitoring has relied heavily on the programme consultants.

### **MAIN OPER ISSUES AND LESSONS LEARNED**

**Lending policy statements agreed with partner banks will help to maintain focus on the target group.** This programme was designed and implemented with micro and small borrowers in mind. The lending policy promoted by small loan programmes must be sensitive and responsive to changes and developments in the local environment, while remaining faithful to the target client group. When a programme is achieving its outreach goal, it is important within reason to maintain limits and definitions. Modifications which encourage partner banks to divert their attention from the target group of micro and small businesses should not be made.

**Matched funding both increases the pool of funds available to service the target group and affirms partner bank commitment.** From the outset of a downscaling programme, partner banks must be prepared in principle to augment EBRD credit lines with funds from other sources. This will enable the programme to build the critical mass necessary to ensure its sustainability. In so doing, banks demonstrate that they are willing to take ownership of the programme.

**In downscaling operations, the graduation process should be commenced in sufficient time to enable partner banks to internalise the necessary management and control functions.** The graduation timetable should allow for delays in setting up the functions needed to manage and supervise the programme post-graduation. Regional outreach may be limited as consultant and partner bank resources are allocated to the graduation process. However, an effective handover by the consultants to partner bank management is essential to ensure sustainability and lasting transition impact. The experience of this programme suggests that a two-year lead time may be necessary to achieve fully successful graduation, putting in place the necessary head office support structures.

**IT requirements should be clearly specified to meet ongoing client needs as well as EBRD reporting requirements.** Where IT and MIS requirements are a significant element of a programme, provision should be made to prepare a detailed IT specification. Implementation should be monitored closely with attention paid to systems upgrades for long-term assignments. Programme graduation plans should ensure adequate IT coverage is provided, preferably through integration with the client's own systems.

**Partner banks should be equipped to assume full responsibilities for environmental due diligence, monitoring and reporting after their graduation from technical assistance.** The EBRD should ensure that partner banks record environmental due diligence findings systematically. During the hand-over, or graduation phase, necessary training should be given to enable banks to monitor environmental issues and report to the EBRD on environmental matters using their own resources.

**Recommendations:**

**The limits of the methodology for appraising micro, small and medium-sized enterprises should be defined.** The Bank should consider commissioning an independent study of the programme methodology to assess its capacity to appraise and monitor larger loans. Partner banks must maintain an adequate balance of growth and controls in conditions of strong competition. Partner banks need to continue building risk management capacity, in line with changing loan characteristics and an expanding portfolio. The results of such a study could also assist the Bank in assessing the credit risk of other SME programmes.

**Consortium bidding for a consulting contract should be required to disclose the ownership of each member.** EVD does not consider it expedient to impose a blanket prohibition on consortia whose members share some common ownership. However, disclosure of ownership information in the Expression of Interest and the Proposal would permit the Bank to examine this on a case-by-case basis. It will enable the Bank to determine whether members of the consortium have sufficient substance and possess a requisite and proportionate mix of skills.

**Future downscaling programmes should include a requirement to record consulting time inputs and provision for the integration of reporting with banks' own systems.** The former will enhance the EBRD's ability to compare and analyse programme effectiveness; the latter should help accelerate the assimilation of similar programmes and strengthen the PB's sense of commitment to MSE lending. Where systems development by partner banks is necessary, it is important to identify requirements at an early stage and to impress upon banks that they must give the exercise the necessary priority.