

SUMMARY OF THE OPERATION PERFORMANCE EVALUATION REVIEW

The project

This evaluation concerns a small business finance framework in the form of credit lines to local commercial banks for on-lending to micro and small enterprises (MSEs). The design of the framework replicated a model developed by the Bank in other countries. It was anticipated that additional debt financing would be provided by another international financial institution. This, however, did not materialise.

A risk-sharing facility was made available but was not utilised since the sub-loan portfolios proved to be of good quality. Technical assistance was provided over a five-year period by a number of donor countries and, latterly, the European Bank for Reconstruction and Development's (EBRD) Early Transition Countries Fund.

When the original loan funding was fully committed and utilised, the Board approved a loan extension that was to be partially provided through co-financing. However, the co-financing did not materialise in the prevailing market conditions. A number of local partner banks received credit lines and technical assistance from MSE lending specialists.

Project rationale

The project had a clear rationale that built on experience in other countries. Its aim was to extend the availability of MSE finance while also improving the quality of partner bank performance and services.

Achievement of objectives

- **Provision of finance to MSEs (Achieved):** As of the end of December 2007, the partner banks had outstanding portfolios amounting to almost US\$ 60 million. The early success of the facility in reaching MSEs justified the extension of funding.
- **Develop sound MSE lending techniques to demonstrate that MSE lending is commercially viable and encourage other banks to enter the market (Achieved):** Partner banks benefited from the introduction of an MSE lending methodology that was based on cashflow analysis rather than collateral. This methodology was rolled out through branches and outlets by the TC-funded consultants. Arrears under the facility have been maintained at a very low level.
- **Develop skills and capacity to provide creditworthy MSEs nationwide with access to finance (Largely Achieved):** By December 2007 the facility was operating through around 90 partner bank outlets. In addition to the EBRD credit lines, partner banks have been willing to commit funds from other sources to micro-lending, although liquidity constraints have had some dampening effect on the pace of expansion of micro-lending to new branches.

Overall assessment

Based on its independent evaluation, the OPER team assigns a rating of "Successful" to the project overall. In a very challenging and difficult environment, the facility has succeeded in rolling out a national programme of MSE lending. The facility was based on the principles of *downscaling*, equipping local commercial banks with the skills and confidence to make loans to micro and small borrowers for business purposes.

Technical cooperation funds have supported local banks in the acquisition of necessary skills and in effecting institutional changes and corporate governance improvements. Objectives, which were set at appraisal and concerned outreach in terms of loan numbers and volumes, have been met. Partner banks appear to have internalised the main aspects of the programme and have committed own funds to MSE lending insofar as liquidity constraints permit. Transition impact is rated “Excellent”.

Beyond the impact on individual partner banks, substantial numbers of small business borrowers have received reliable access to finance in order to meet their business requirements. The facility has introduced many small entrepreneurs to the formal banking sector and encouraged them to develop basic business skills. Additionality is “Verified in All Respects”. Bank handling is rated “Good”, both with regard to the relationships with partner banks and in respect of TC performance.

Transition impact and additionality

Overall transition impact

The small business finance facility was designed to achieve transition impact at multiple levels. Specialised and continuous institution building in partner banks was intended to improve the quality of services and assets. The loan agreements covenanted a policy statement for the use and implementation of technical cooperation (TC) and the provision of local loans to MSEs.

Beyond the impact on individual partner banks, the facility aimed to demonstrate that MSE lending is commercially viable and sustainable. It thereby encouraged other banks to enter the market and improved the overall level of financial services available to entrepreneurs. The facility extension laid further emphasis on the development of branch networks. This fostered penetration of the banking sector in secondary cities and towns, increasing financial intermediation in the regions. Overall, the OPER team assigns transition impact ratings of “Excellent” (realised) and “Excellent” (potential) with “Medium” to “High” risk. The risk derives from partner banks that have experienced difficulties with liquidity and staff turnover. These could jeopardise the sustainability of the programme, but banks so far appear to have managed the difficulties reasonably well.

The facility has encouraged and enhanced competition among participating banks in the capital and in the regions. Partner banks have contributed to market expansion through their willingness to accept downscaling. They have also internalised small business lending procedures, contributing own funds in addition to EBRD funds, as far as liquidity constraints have allowed.

The partner banks have initially shown a warm response to a new lending product that has been developed by the consultants and is targeted at smaller businesses in the agribusiness sector and rural communities. This has potential to expand the market for formal banking services significantly. The operation team has estimated that up to 75 per cent of clients that had benefited from the facility as of the end of 2006 were new to the banking system. Additionality is “Verified in All Respects”.

Bank handling

Bank handling is rated “Good” overall. Partner banks were required to sign a comprehensive policy statement (in addition to undertakings in loan agreements) that specified the adoption of effective anti-money laundering measures and the application of sound governance practices. Partner banks were selected on the basis of their willingness to finance MSEs, their prospects for growth and capacity for expansion.

Nevertheless, there were a limited number of suitable EBRD partners because of low capitalisation and problems with transparency of ownership. The programme consultants began working on graduation plans for the partner banks about three years after commencement of the facility.

The EBRD operation team, after reviewing the progress of partner banks and the TC budget projections, decided to refocus the graduation effort and bring the graduation date forward by about six months. The OPER team considers that the review of the graduation plan by the Bank's operation team helped to maximise the effectiveness of the graduation process.

Key issues and lessons learned

The creation of a credit registry is an important element in the institutional, legal and regulatory framework necessary to support the development of MSME finance. Depending on the size of the market, one or more private credit bureaux could be formed (on a for-profit or not-for-profit basis) to facilitate the exchange of credit information among banks and non-bank financial institutions. It is essential to ensure the confidentiality of the information held by the credit registry. This will guarantee that borrowers' details are not accessible by or released to unauthorised persons. Where necessary, the Bank should pursue active policy dialogue with the authorities with a view to establishing a formal credit reference agency.

The Bank should establish clarity with regard to post-graduation information technology (IT) support and software licensing in TC-supported programmes. To facilitate the graduation process and avoid misunderstandings over user rights, the Bank should ensure that a clear agreement is reached with the consultant on post-graduation IT support and software licensing to partner banks. This is especially important where initial software and later improvements have been paid out of TC funds as part of the consultants' remuneration. In such cases the most equitable solution could be a free-of-charge licensing agreement that does not restrict own use by a partner bank.

The Bank should consider limiting TC contracts for MSE programme implementation to periods of not more than two years. The Bank now has sufficient experience to clearly define the terms of reference and benchmarks for MSE programme implementation assignments and closely monitor consultant performance. While it is not suggested that any one consultant should be limited to a single two-year contract, splitting the implementation programme from inception to graduation into segments with clearly defined goals would secure more effective performance against benchmarks and achieve faster graduation of partner banks.

The Bank should periodically review the terms of reference and benchmarks of MSE programme implementation assignments and introduce amendments where they could improve programme performance. The Bank should consider introducing the following benchmark targets in downscaling operations as measures of the institutionalisation of MSE lending by partner banks:

- increase in the proportion of MSE loan volume to total loan volume and increase in the overall number of MSE borrowers (as a measure of commitment to MSE portfolio growth)
- improvement in loan officer productivity over time (number of loans made and volume of portfolio handled by each loan officer).