Ex post evaluation - in a very fragile country

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Sector: Formal sector financial intermediaries (CRS 24030)
Programme: Credit line to a Microfinance Bank*
Programme Executing Agency: The supported Microfinance Bank

Ex post evaluation report: 2014

		Programme A (Planned)	Programme A (Actual)
Investment costs (total)	EUR million	4,00	4,00
Counterpart contribution	EUR million	0,00	0,00
Funding	EUR million	4,00	4,00
of which BMZ budget funds	EUR million	4,00	4,00

*) Random sample 2013

Description: The Partner Bank of the programme under evaluation is located in a very fragile country. It was founded in the early 2000s as a full-fledged licensed commercial bank (closed joint stock company) targeting micro, small and medium sized enterprises (MSME) and lower income households. In a former phase of support, KfW as trustee of the German Federal Government provided about one third of equity while the other shares are held by well-known international donor agencies and Development Finance Institutions. Phase II of German Financial Cooperation support for the development of the Partner Bank, which is evaluated here, comprised a grant of 4.0 million EUR to the national Ministry of Finance, which was forwarded by the Ministry to the Bank as a local currency loan for refinancing loan portfolio growth. Originally, the funds were intended to being disbursed in 2008. However, the disbursement was delayed until May 2011 due to a slower growth of the credit portfolio than originally expected and an unexpectedly high growth of deposits at the same time extending the scope of internal refinancing.

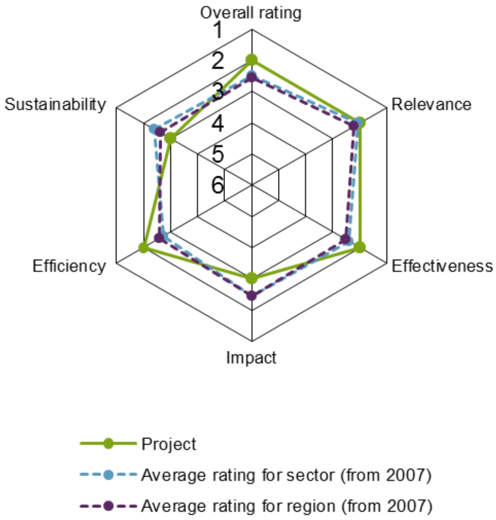
Objectives: The programme's objective was to support the provision of access to basic financial services (loans, savings and payment services) under market conditions for MSME as well as households. The overall development goal was to contribute to income improvement and job creation and to support stabilisation and deepening of the financial market.

Target group: The target group were private MSME, including informal enterprise, as well as households, particularly lower income households that were and still are lacking access to formal financial services.

Overall rating: 2

Rationale: In spite of the tense security situation, the Partner Bank managed to defend its outstanding position as the leading provider of financial services to the target group of private MSME and low-income households. Credit portfolio growth was much slower than expected at the time of project design. Accordingly, refinancing needs were not as pressing, leading to a slight curtailment of the programme's relevance. However, in contrast to many microfinance institutions in the country and around the world that grew with an unhealthy pace and were hit by a microfinance crisis in the late 2000s, the Bank managed to achieve a steady and sustainable extension of service provision. The programme under evaluation supported the outstanding success of the Bank in providing local currency loans.

Highlights: Uncertainty about the future development of the country, in particular of national security, has been showing severe effects on the economy in 2014. Economic downturn was reflected in the performances of the Bank and its customers' enterprise. Nevertheless, the Bank seems sufficiently strong to weather this crisis as successfully as the previous microfinance crisis.



Rating according to DAC criteria

Overall rating: 2

Overall context

The programme under evaluation was implemented in a very fragile developing country. Comparing 2014 to an almost inexistent formal banking sector a decade ago, we find that considerable positive changes have taken place, and this despite the fact that less than five years ago the banking sector had suffered a severe setback from the near collapse of one of its biggest private commercial banks.

Matching the development in the banking sector as a whole, the microfinance sector has seen a very positive progression since more than a decade ago when the first microfinance institutions (MFIs) started to operate in an environment where access to formal or semi-formal financial services was completely lacking (for both MSMEs and lower income households). However, like the formal banking sector, the microfinance sector did not display a steady upward trend but went through a severe crisis. After a vast expansion during the period 2002-2008 (with a credit growth rate of around 100% in 2007), the sector had to go through a drastic consolidation phase after a serious repayment crisis became apparent in the late 2000s. The number of MFIs, which at the time had reached its peak with almost 20 institutions, decreased considerably. Some MFIs suffered such severe losses that they had to exit the market, while the portfolios of six institutions were united under the roof of a new public MFI in 2011. After an additional two well-known MFIs gave up their national business in 2013, less than half of the number of MFIs that were existent before the crisis remained. The programme’s Partner Bank is the most important remaining institution targeting the MSME sector and lower income households. The Bank, founded in the early 2000s, is the largest remaining MFI and - as before the crisis - the only one licensed as a full-fledged bank by the Central Bank.

Relevance

The general situation in the financial sector has greatly improved since the turn of the millennium, and certainly the Partner Bank contributed a great deal towards improving access to formal financial services for MSMEs and lower income households. Nevertheless, at the time of the programme appraisal in 2007/2008, the lack of access to adequate financial services was still considered an important impediment to the development of the MSME sector. Consequently, the basic assumption of the programme’s result chain that improving access to such services has the potential to contribute to economic development and stabilisation was still valid.

There are still certain doubts, however, as to whether the contribution of the programme - the provision of refinancing sources for the Bank - actually addressed the key challenge at that time. While the Bank's loan portfolio grew in rates of up to 100 % annually before 2007, growth slowed down remarkably in the following years to rates of 30 %, even though deposit growth exceeded expectations. Although this unexpected development had to be welcomed from a developmental point of view as it contributed to sustainable growth of the Bank at a time when many MFIs in the country (and globally) fell into crisis, it made the provision of additional refinancing resources in 2008 obsolete.

Fortunately, KfW was able to adapt the programme’s time schedule to the new situation, delaying the disbursement of funds until early 2011. By doing so the funds retained the potential to contribute to the programme’s objectives, particularly as the money was provided through the Ministry of Finance in local currency. Hence, the refinancing line was both well suited to supporting the on-going efforts of de-dollarizing the economy in general, as well as the efforts of providing local-currency loans to MSMEs. Furthermore, the refinancing line was delivered with a maturity of 15 years, a length of maturity not available to the Partner Bank in the commercial market.

The general outline of the programme is in accordance with both the policy of the Partner Government to develop the national economy, as well as the policy guidelines of the German Federal Ministry of Economic Cooperation and Development for financial sector development support. Coordination with other international donors and Development Finance Institutions active in the country's financial sector was also guaranteed, first and foremost via the composition of the Partner Bank's shareholder structure.

In light of these findings we come to the conclusion that the relevance of the programme is substantial, although it is not able to match the relevance of earlier German support for the set-up of the Microfinance Bank. We, therefore, assess relevance as good.

Relevance rating: 2

Effectiveness

Although access to financial services is still rather limited in many areas of the country, mainly due to security reasons, the Partner Bank has established itself (with roughly 50 points of sale, including branches and outlets, throughout the country) as a reliable source of finance for MSME clients and a financial service provider for low- and middle-income households. The Bank has disbursed more than 370,000 loans since the start of its operations in 2004 and in 12/2013 served roughly one third of active MFI borrowers and roughly a third of active MFI depositors in the market.

The main objective of the programme under evaluation, as defined during the programme appraisal stage, was to improve access to basic formal financial services under market conditions for MSMEs and households that were formerly excluded from formal banking services.

At the same time (programme appraisal stage), the following indicators were set to proxy target achievement. As the refinancing funds were disbursed much later than originally intended, achievement of the targeted indicator values was postponed to May 2013. Furthermore, in order to reflect the programme's support for local currency lending, a target-indicator was added by the evaluation mission.

Indicator	Target value	Ex post evaluation
(1a) Outstanding loan portfolio in May 2013	≥ 85 million USD (base value 2011 (first disbursement): 55 million USD)	72.4 million USD (12/2013)
(1b) Number of borrowers in May 2013	≥ 100,000 (base value 2011: 49,029)	61,645 (12/2013)
(2) Number of depositors in May 2013	≥ 35,000 (base value 2011: 53,342)	Depositors: 71,998 (12/2013), including 1,244 institutional depositors
(3) Portfolio at risk (interest or instalment overdue more than 30 days)	< 5 % of outstanding amount	2.5 % (Portfolio at risk > 30 days, 12/2013)
4) Ratio of local currency loan portfolio to US dollar loan portfolio	Rising in favour of local currency without increasing bank's currency mismatch (added by evaluation mission)	High negative open currency position in 2010 versus positive net open foreign currency position in 2013

In 2013, the Bank's actual loan volume and number of borrowers were clearly below the programme's targets. During the year, there was almost zero growth of the portfolio when measured in local currency, while the value of the portfolio measured in US dollar actually declined due to the devaluation of the local currency against the dollar. As noted earlier, however, ambitious targets for loan portfolio growth are now challenged from a developmental perspective. As long as the achieved growth - even if lower than what was targeted - occurs in parallel with sustainable development of the institution it should be considered as a completely satisfactory result.

The portfolio at risk > 30 being way below 5 % gives an indication of sound institutional development. Portfolio at risk rates, however, give limited information on portfolio quality without the corresponding write-off figures. Taking these into consideration, there is in fact a noticeable deterioration of portfolio quality in 2013 compared to 2012, even if portfolio quality can still be rated as acceptable and is certainly well above the local average in the banking sector.

The target for the number of deposit accounts has been surpassed by almost 100 %. It is clear, however, that the target was set too moderately as it had already been surpassed when the line was finally distributed in 2011. Nevertheless, the number of deposit accounts points towards an excellent service for lower income savers who are confronted with insurmountable minimum deposit thresholds at most formal banking institutions. From a financial point of view, concentration of the majority of the deposit volume in the hands of a small number of institutional depositors gives some cause for concern on deposit stability, which the Bank is well aware of. This though does not diminish the favourable development achievements of offering savings opportunities to households independent of their wealth.

As the credit line under evaluation was disbursed in local currency, thereby supporting the efforts to offer loans in local currency without contributing to currency mismatches in the Bank, programme objectives and corresponding indicators had to be complemented in this respect. The evaluation mission therefore added the following target: The ratio between the loan portfolio in local currency and foreign currency will have changed in favour of local currency since the disbursement of the line in early 2011, without any increase in the currency mismatch of the institution. Results on this target are extremely positive. While the bank had a highly negative net open foreign currency position at the end of 2010, this has changed to a small positive net open foreign currency position at the end of 2013. At the same time, loan volume in foreign currency grew only slightly and almost all portfolio growth since 2010 can be attributed to loans in local currency. This positive development is underlined by the information collected during interviews with loan officers who stated that all customers who require local currency loans are served according to their preference. Furthermore, as interest rates for US dollar loans are the same as for local currency loans – a very unique feature compared to MFIs around the world – there is no incentive for customers to apply for presumably cheaper foreign exchange loans without having corresponding income in foreign exchange.

In summary, the findings suggest that all outcome targets - with the only exception of portfolio growth - have been achieved in a good and in some respects even excellent manner. As the programme was clearly designed to support lending in local currency, we rate effectiveness as good.

Effectiveness rating: 2

Efficiency

The Bank's key performance indicators, such as return on equity, portfolio at risk, market penetration, loan portfolio increase in local (not foreign) currency, as well as savings (number of accounts and volume) growth can be considered excellent when compared to other local MFIs. The Bank does have relatively low loan officer productivity when compared to best practice benchmarks globally. However, this can be explained by (a) the disbursement of loans in areas of low client density, and (b) security reasons. It is also noteworthy that, according to the Bank's management, roughly 30 % of the loan portfolio consists of agricultural loans. For certain types of agricultural loans, repayment schedules are even adjusted to match crop cycles.

Judging by the present situation in the country the Bank's production efficiency is considered to be highly satisfactory. This assessment has taken into account the fact that, during the past few months, the Bank has suffered from high staff turnover and vacancies in senior management positions. We are convinced that the Bank's management – as soon as it is up to full capacity again (which was already in progress during the evaluation mission visit) – will make an extra effort to increase productivity through optimisation of the credit process. In view of this, some very promising activities have already taken place, most notably the piloting of an innovative GPS-based information system, which will help improve the process of tracking and monitoring loan clients and collateral.

Allocation efficiency is also considered to be high as customers greatly value the service they receive from the Bank. Overall, customers are very satisfied with the Bank, even though they consider interest rates to be rather high and would sometimes prefer longer maturities or more flexible repayment schedules. The Bank was criticised as well for being unable to offer products carrying more risk, e.g. venture capital, being suitable for financing the realization of unique business opportunities, such as buying a stake in a new company. Furthermore, there were some complaints about long waiting queues for commercial services in the branches and about a lack of differentiation between old and new customers. Repeat borrowers are keen on preferential procedures and conditions (in relation to new clients) in acknowledgement of their good credit history. The Bank's management initiated a survey on microfinance customer satisfaction (completed shortly before the evaluation mission) and is planning to conduct a similar survey to cover small and medium enterprise clients. Hence, steps are already being taken to improve the information platform and service delivery according to systematic findings.

Although all customers interviewed were worried about the economic downturn during the last twelve months, which has often meant halving of their turnover, the repayment performance of the portfolio is still acceptable, which is an indication of clients investing their loans productively. It should also be noted, though, that individual clients have admitted to relying on the help of friends and family to be able to fulfil their repayment obligations.

As a positive contribution to efficiency, the programme has supported the policy of the Bank to relieve customers from foreign exchange risk by offering loans in the currency they trade in, which in the majority is local currency.

In summary, we rate the efficiency as good, particularly when taking into account the extremely difficult economic and security situation in the country.

Efficiency rating: 2

Impact

The overarching developmental objective (defined at the appraisal stage) was to assist in the creation of employment and income for the target group, in addition to helping to deepen and stabilise the financial market.

Obviously, it is impossible to quantify any specific contribution of the programme to these overarching developmental objectives. Nonetheless, the Bank has established itself as the leader in the microfinance sector and the only formal banking institution providing financial services to MSME businesses and lower income households on a long-term basis, thus enabling their development and the creation of additional income and employment. Due to the absence of reliable data, however, it is difficult to provide even a rough estimation of the contribution of the Bank as a whole.

In attempting to assess the service of the Bank with respect to the responsible delivery of financial services, it has to be pointed out that the consistent policy of thorough credit analysis and very conservative assessment of customer repayment capacity offers strong protection against over-indebtedness. On the other hand, it must be noted that the Bank still charges flat interest rates on its older products. Nonetheless, all new offerings are structured on a declining basis and the older products will eventually be faded out to put the conditions of all credit services in line with accepted rules of transparency. The Bank’s management acknowledges the shortcoming still prevalent in its older products and is currently working on the introduction of a new information technology system, which will create the administrative prerequisites for charging interest on a declining balance for all its loan products.

Regarding the objective of helping to deepen and stabilise the financial market, it seems plausible that the programme contributed to the Bank’s success in de-dollarising its business, thereby helping to prevent foreign exchange risk being passed on to customers and supporting the national policy of de-dollarisation. Still, the generally accepted indicator for financial market development - domestic bank credit to the private sector in relation to gross domestic product - is still extremely low and has been declining from its peak of 11.6 % in 2010 to only 4.1 % in 2012 (last available data). This is a clear indication that (a) trust in the financial system, which suffered from the banking crisis in the late 2000s, has not been fully re-established, and (b) that the private sector is reluctant to invest due to the problems of security and economic downturn.

Indicator	Status programme appraisal	Ex post evaluation
(1) Domestic bank credit to the private sector in relation to gross domestic product	11.6 % in 2010	4.1 % in 2012

The establishment of a credit bureau, which is important to combatting multi-source borrowing and over-indebtedness, has not made much progress yet, even though it was meant to have already started offering its services. Regardless, as a national identification system is still lacking, the data quality would in any case most likely be poor for the foreseeable future. In the meantime, informal information sharing on request is practised by financial institutions in the microfinance market as an interim solution.

In consideration of the stable development of the Bank as a reliable source of financial services on the one hand, and the adverse development of the financial market as a whole on the other, we rate the impact as satisfactory.

Impact rating: 3

Sustainability

The Partner Bank’s performance during the entire period of its operations (particularly on return-on-equity) allows us to presume that it will be possible to maintain sustainability in the foreseeable future.

We expect that competitive pressure in the customer segment targeted by the Bank will remain relatively low, although attractive small enterprise clients might prove the exception.

However, continuing economic and political uncertainty could seriously affect profitability and threaten long-term financial stability. Unfortunately, there is no indication of the situation's rapid improvement in the near future.

Despite this unfavourable outlook we have to keep in mind that throughout its more than 10-year existence, the Bank’s performance has surpassed even the most optimistic expectations. In a very fragile setting throughout its existence, the Bank was able to reach and maintain financial sustainability, it survived the national microfinance crisis and the national banking crisis in the recent past without major damage, whereas most MFIs in the market suffered severe losses or even exited the market. Furthermore, the Bank can rely on very robust shareholders with a strong reputation in the country and the international community.

Consequently, we are convinced that the Bank’s management and shareholders will make every effort to find appropriate solutions in the face of adversity. We therefore consider it safe to rate the sustainability of impact as satisfactory.

Sustainability rating: 3

Notes on the methods used to evaluate project success (project rating)

Projects (and programmes) are evaluated on a six-point scale, the criteria being **relevance, effectiveness, efficiency** and **overarching developmental impact**. The ratings are also used to arrive at a **final assessment** of a project's overall developmental efficacy. The scale is as follows:

Level 1	Very good result that clearly exceeds expectations
Level 2	Good result, fully in line with expectations and without any significant shortcomings
Level 3	Satisfactory result – project falls short of expectations but the positive results dominate
Level 4	Unsatisfactory result – significantly below expectations, with negative results dominating despite discernible positive results
Level 5	Clearly inadequate result – despite some positive partial results, the negative results clearly dominate
Level 6	The project has no impact or the situation has actually deteriorated

Rating levels 1-3 denote a positive assessment or successful project while rating levels 4-6 denote a negative assessment.

Sustainability is evaluated according to the following four-point scale:

Sustainability level 1 (very good sustainability): The developmental efficacy of the project (positive to date) is very likely to continue undiminished or even increase.

Sustainability level 2 (good sustainability): The developmental efficacy of the project (positive to date) is very likely to decline only minimally but remain positive overall. (This is what can normally be expected).

Sustainability level 3 (satisfactory sustainability): The developmental efficacy of the project (positive to date) is very likely to decline significantly but remain positive overall. This rating is also assigned if the sustainability of a project is considered inadequate up to the time of the ex post evaluation but is very likely to evolve positively so that the project will ultimately achieve positive developmental efficacy.

Sustainability level 4 (inadequate sustainability): The developmental efficacy of the project is inadequate up to the time of the ex post evaluation and is very unlikely to improve. This rating is also assigned if the sustainability that has been positively evaluated to date is very likely to deteriorate severely and no longer meet the level 3 criteria.

The **overall rating** on the six-point scale is compiled from a weighting of all five individual criteria as appropriate to the project in question. Rating levels 1-3 of the overall rating denote a "successful" project while rating levels 4-6 denote an "unsuccessful" project. It should be noted that a project can generally be considered developmentally "successful" only if the achievement of the project objective ("effectiveness"), the impact on the overall objective ("overarching developmental impact") and the sustainability are rated at least "satisfactory" (level 3).