Ex post evaluation – Georgia

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Sector: Formal sector financial intermediaries (24030)
Programme/Project: Agricultural financing programme (fiduciary holding) (BMZ No. 2011 66 552)*
Implementing agency: three private financial institutions

Ex post evaluation report: 2015

		Project A (Planned)	Project A (Actual)
Investment costs (total)	EUR million	10.5	9.8
Counterpart contribution	EUR million	0.0	0.0
Funding	EUR million	10.5	9.8
of which BMZ budget funds	EUR million	9.0	9.0

*) Random sample 2015

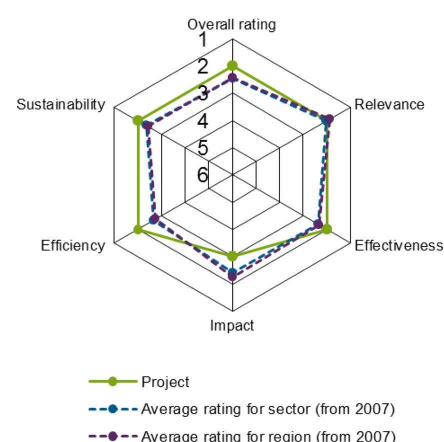
Summary: The programme facilitated the disbursement of subordinated loans to private Georgian partner finance institutions (PFIs), which used these funds to lend to micro, small and medium-sized agricultural companies (agricultural MSMEs) operating in the manufacturing, processing or marketing of agricultural products and animal husbandry. In this first phase, Financial Cooperation (FC) fiduciary funds amounting to EUR 9.0 million were implemented. Additionally, the PFIs were helped with personnel support totalling EUR 0.5 million and a default guarantee for the sub-loans amounting to EUR 300,000 (up to 10% of the FC loan) from the EU's SME Facility. The FC measure was handled in cooperation with the EBRD, which funded parallel financing for larger financial institutions targeting the expansion of agricultural credit through loans, portfolio guarantees and personnel support.

Objectives: The aim of the FC measure (outcome) was to achieve a sustainable improvement in access to agricultural credit for agricultural MSMEs. A contribution was to be made to the economic development of agricultural MSMEs and to boosting their income as the developmental objective of the FC measure (impact). It was also designed to improve food security for the poorer Georgian and regional population and support the broadening and deepening of the Georgian financial system.

Target group: Direct: financial institutions focusing on agricultural MSMEs; indirect: Georgian agricultural MSMEs.

Overall rating: 2

Rationale: The three PFIs have many years of experience in lending to agricultural MSMEs; they work efficiently and professionally. By means of subordinated loans in local currency the three PFIs were able to make quantitative and qualitative improvements to agricultural credit, especially the share of agricultural loans in local currency. Even though there has been no direct increase in income observed with the target group, it can be assumed that most have at least enjoyed income stabilisation and access to financing underwent a sustainable improvement. This is why the project is still rated as good overall.



Highlights: The suitability of micro-finance banks for achieving the programme objective and for supporting structural change in the Georgian agricultural sector in need of reform should be examined. Micro farmers could not be expected to increase their incomes significantly and contribute to structural change in the agricultural sector.

Rating according to DAC criteria

Overall rating: 2

Relevance

Promotion of the agricultural sector is still relevant from today's perspective. Despite favourable natural conditions (good soil, favourable climate) and the fact that 50 % of the population are employed in agriculture, agriculture contributes only around 10 % of the gross domestic product. 15 % of food products are imported, which corresponds, however, to the regional average. Less than half of the agricultural land is cultivated, and the average size of farms is very small at 1 ha. Farmers' knowledge is often outdated, with most still coming from the Soviet era. What is more, the small size of the farms often means that they lack modern technologies (tractors, irrigation facilities) and as a result, efficiency is low.

In addition to the obstacles mentioned above, the following limiting factors were identified at the programme appraisal: in the agricultural sector there was still a substantial residual financing gap overall. Furthermore, the agricultural loans already offered on the market were determined to be too short term (significantly shorter than one year). The loans were generally granted in foreign currency due to the funding also being available in foreign currency. In addition, the product range was small, generally with just one product for the agricultural sector.

The project's objective corresponded with the BMZ's developmental goals and guidelines focusing on "sustainable economic growth". From today's perspective, the core issues were correctly identified. The project was centred around relevant points and was well-designed in principle. The results chain assumed at the appraisal, according to which the subordinated loans to Georgian PFIs will boost lending to agricultural MSMEs and therefore contribute to economic development and the increase in income of MSMEs as well as subsequently to expanding and deepening the financial sector, is still plausible from today's perspective. Donor coordination, in particular with the EU – which is also active in the agricultural sector – the European Bank for Reconstruction and Development (EBRD) and the World Bank, worked well.

Relevance rating: 2

Effectiveness

Through the programme, agricultural MSMEs which previously had no or very limited access to appropriate financing opportunities through the formal financial sector were to be given access to funding predominantly in the local currency. The achievement of the programme objectives defined during the programme appraisal can be summarised as follows:

Indicator	Status PA	Ex post evaluation
(1) The funds made available are paid out to the agricultural target group in full within 24 months and are made available on a revolving basis.		Fulfilled: The funds were made available to the PFIs as subordinated loans, were paid out to the agricultural target group within one year and are made available on a revolving basis.
(2) In the three years after the programme started, the total volume of agricultural loans increased by at least 10 % annually.	2012: PFI 1: USD 2.8 million PFI 2: USD 14.6 million PFI 3: USD 42.6 million	Fulfilled (2015): PFI 1[1]: USD 7.7 million PFI 2: USD 23.1 million PFI 3: USD 86.0 million
(3) The proportion of medium- and long-term agricultural loans	2012: PFI 1: 57 %	Fulfilled (2015): PFI 1: 66.5 %

in GEL (term > 12 months) in the agricultural portfolio has increased by at least 5 % per year in the three years since the programme started and is now more than 50 %.	PFI 2: 62 % PFI 3: 30 %	PFI 2: 62.1 % PFI 3[2]: 49.7 %
(4) The proportion of agricultural loans which are paid out in GEL is increasing. (new indicator)	2012 (no target value) PFI 1: 69 % PFI 2: 89 % PFI 3: 40 %	2014: PFI 1: 83 % PFI 2: 90 % PFI 3: 52 %
(5) The quality of the loan portfolio in the agricultural sector is satisfactory, i.e. the proportion of agricultural loans in the gross agricultural loan portfolio for which repayment is more than 30 days overdue (Portfolio at Risk > 30) is at a maximum of 5 %.	2012: PFI 1: 0.2 % PFI 2: 0.2 % PFI 3: 0.0 %	Fulfilled (2015): PFI 1: 3.11 % PFI 2: 2.41 % PFI 3[3]: 0.69 %

1) In the case of PFI 1, a significant increase was observed in 2013 which, however, was partly influenced by the new classification of some loans in the category of agricultural loans.

2) PFI 3 fulfils the indicator despite a share of just under 50 % as a result of annual growth rates in excess of 5 % (+6.3 % in 2013, +11.2 % in 2014).

3) Twice a year, PFI 3 writes off loans which are more than 12 days in default and for which no repayment has been recorded in the last 60 days.

The funds made available were paid out in full to the agricultural target group within less than 24 months as planned and made available on a revolving basis (programme objective indicator 1). The three PFIs recorded significant growth both in the overall loan portfolio and in the agricultural loan portfolio after disbursement of the loans with growth values well over 10 % per year (programme objective indicator 2). This was achieved thanks to the expansion of the branch network of PFIs to rural areas and the improved access of PFIs to further borrowed capital as a result of the subordinated FC loan, among other factors. All three PFIs increased the number of agricultural loans disbursed each year, with the share of agricultural loans (volume) in the total portfolio increasing constantly in the case of one of the PFIs, and fluctuating in the cases of the other two. The share of the agricultural portfolio in the total portfolio (volume) is currently 22.8 % for PFI 1, 57.5 % for PFI 2 and 34.2 % for PFI 3.

In the case of all three PFIs an increase in the proportion of medium to long-term loans (> 12 months) in the local currency can be observed in the agricultural portfolio. In two of the three PFIs, this share is well over 50 %. The third PFI was able to expand its share to just under 50 % as a result of annual growth rates of over 5 % (programme objective indicator 3). The subordinated loans to the PFIs were paid out in the local currency, with the aim of increasing lending to the agricultural MSMEs in the local currency and reducing the currency risk for the PFIs. Access to funding in the local currency is difficult for Georgian financial institutions as well as being relatively expensive due to the sharp and steady depreciation of the lari against the US dollar, which has been ongoing since autumn 2013. The disbursement of subordinated loans to PFIs in the local currency was rated as very positive by all PFIs (also because of the comparatively favourable conditions). The proportion of agricultural loans awarded in the local currency has increased since 2012, with one of the three PFIs lending to the agricultural sector almost exclusively in the local currency (approximately 90 %) even before programme start. When it comes to improving access to local currency funding and thus to lowering exchange rate risks for ultimate borrowers, the project is therefore assessed as very good. The average effective interest rate (varies depending on the term and volume of the loan) has declined for agricultural loans in the local currency in all three PFIs by almost 6 % on average over the course of the programme. This development is positive from the perspective of the

ultimate borrowers. The negative effects of the slight deflation in 2012 (-0.9 %) and 2013 (-0.5 %) on real interest rates have diminished thanks to the moderate inflation since 2014 (+3.1 %).

The quality of the agricultural credit portfolio (programme objective indicator 4) was within the boundaries of the guidelines for all three PFIs by the first quarter of 2015. However, the poor economic development in Georgia – which has also resulted in the depreciation of the lari – has had a negative impact on the quality of the loan portfolio of the three PFIs. This is attributable to defaulting borrowers, who are affected by rising prices and marketing difficulties (also in the export markets of Russia and Ukraine). Despite a difficult market environment, the Portfolio at Risk values of the three PFIs are significantly below the prescribed limit of 5 % and thus fall within an acceptable range. In order to evaluate the quality of the portfolio, the write-downs were also taken into account at the ex-post evaluation (not included in the indicator). These include restructured loans and defaults. An increase was also observed here in 2014, though this is not critical at present.

The issue of responsible finance is tackled differently in the three PFIs. Two of the three PFIs focus strongly on advising their clients with regard to manageable loan amounts, any charges involved and the repayment plans. In addition to a detailed repayment plan, the loan agreement also stipulates the effective interest rates of the loans, thus providing comparability for the customer. Some shortcomings can be observed in the third PFI in terms of responsible finance. Effective interest rates are not published and charges are not made transparent, and as a result comparison with other banks is difficult for customers. Upon receiving a banking licence (target for 2016/2017), this PFI will have to disclose effective interest rates. The practice of this PFI with respect to the granting of parallel loans and the shortcomings in terms of transparency is heavily criticised by competitors. Nonetheless, the PFI's portfolio does not demonstrate any increased rate of default. In summary, the objectives have been achieved well at the outcome level. We therefore rate the effectiveness as good.

Effectiveness rating: 2

Efficiency

The consultant supported the PFIs above all in the automation and standardisation of recording customer data. The processing time for a loan application has declined significantly, supported by the training courses carried out by the consultant. Trainers have also received training, meaning that the training of PFI staff can continue even after the programme has ended. Although the quality of the portfolio has dropped slightly, the default rate in the agricultural portfolios of the three PFIs continues to be very good. This suggests a good and adequate risk analysis as well as adapted financial products.

The cost-income ratios of the three PFIs up to 2014 have been over 70 %, and are thus still capable of improvement. We expect that the above measures will contribute to improving these values.

The profitability of the PFIs has remained at a consistently good level over the course of the programme. All three PFIs consistently achieve an annual net profit. Comparisons with competitors with regard to the profitability indicators “return on assets” and “return on equity” are possible only to a limited extent due to poor data availability. All three PFIs show a positive “return on equity” and a “return on assets” which exceeds the rate of inflation, indicating that they are profitable. It is clear from their focus on the growing market of agricultural loans to MSMEs and their extensive branch networks and loyal clientele that the PFIs will continue to operate profitably in the future.

The FC trust funds were made available to the PFIs as subordinated loans. The procurement of additional borrowed capital for the funding of agricultural loans should thus be facilitated on the basis of eligibility for equity capital. All three PFIs were able to procure additional borrowed capital as of the beginning of the programme and in particular to acquire other international financial institutions as investors. From the perspective of the PFIs, this is more down to an “improved image” than it is to eligibility for equity capital. In any case, the programme has had a positive effect on the procurement of additional capital and thus the allocation of resources can be considered beneficial.

When designing the project, it might also have been possible to target larger financial institutions (with banking licences, for example). However, in light of the fact that the target group MSMEs were from the agricultural sector, we feel the selection of the PFIs was sensible. With the funding of larger financial institutions, such as in the case of the approach followed by the parallel EBRD project, it would likely have

been possible to reach larger agricultural businesses, thus serving a different target group. However, the question arises whether the target group of agricultural MSMEs was suited to making a contribution to structural change in the agricultural sector and whether it was fit to achieve all the programme objectives to an equal extent. The portion of the loans disbursed to micro-entrepreneurs (some of these farmers practise only subsistence agriculture) has contributed to consumption smoothing and food security. Neither a contribution to structural change in an agricultural sector in need of reform nor increases in income for these borrowers were to be expected in this customer segment.

The three PFIs which were selected already served MSMEs in the agricultural sector prior to the launch of the programme by means of a network of branches in rural areas. Since the beginning of the programme all three PFIs have been able to expand their networks, with the result that all agriculturally active regions of Georgia are now being reached. Lending to agricultural MSMEs on the whole could thus be increased in terms of volume and number. The three PFIs in this segment are amongst the leading financial institutions in Georgia. The increased competition among financial institutions in rural areas has led to a slight decline in interest rates since 2012. All three PFIs offer their customers customised loan products which take into account both the special earnings situation and the seasonal nature of the sector. The allocation efficiency of the project can therefore be rated as good.

The three PFIs were well suited to reaching the agricultural target group efficiently thanks to their existing branch network – which was expanded over the course of the programme – and to their previous experience with agricultural financing. Altogether we assess the efficiency of the project as good.

Efficiency rating: 2

Impact

The overarching development objective was to contribute to economic development and to increasing the income of agricultural MSMEs as well as to expand and deepen the financial sector. It was also designed to improve food security for the poorer Georgian and regional population. At ex post evaluation (EPE), the following indicators were redefined:

Indicator	Status PA	Ex post evaluation
(1) Lending to the private sector (in % of GDP)	34.4 % (2012), no target value available	39.8 % (2013)[1]
(2) Share of agriculture (value added) in GDP	8.6 % (2012), no target value available	9.2 % (2014) [2]
(3) Share of agricultural loans in total credit volume	1 % (2012), no target value available	3 % (2014) [3]

Sources:

1) World Bank (2015), Data, Domestic credit to private sector (% of GDP), http://data.worldbank.org/indicator/FS.AST.PRVT.GD.ZS, as at 11 June 2015.

2) National Statistics Office of Georgia (2015), Agriculture, Share of Agriculture in GDP (%), http://geostat.ge/index.php?action=page&p_id=428&lang=eng, as at 11 June 2015.

3) National Bank of Georgia (2015), Statistical Data, L 3.11 Loans by Type of Activity (flows), https://www.nbg.gov.ge/index.php?m=306, as at 11 June 2015, own calculations

Both the proportion of loans to the private sector as well as the share of agricultural loans in the total lending volume have increased overall since the project appraisal. Furthermore, the share of agriculture in gross domestic product (GDP) rose slightly from 2012 to 2014. However, this increase is probably largely attributable to the Ministry of Agriculture's massive subsidy programmes which have, amongst other things, set aside GEL 800 million for interest subsidies for larger agro loans since 2013 and in some cases have also led to market distortions in the corresponding segment.

The expansion of the products offered to the agricultural sector by the three PFIs has resulted in the better reach of the target group.[1] However, the investments did not lead to significant productivity gains in most cases, but rather to the preservation of subsistence agriculture. It can nevertheless be assumed that the access to financing for these borrowers has contributed to food security. Overall, the project has contributed to the expansion of the financial system in Georgia. The broader range of products which were adapted to the needs of the sector also resulted in significantly more farmers being reached by the loan offer. Thus a deepening of the financial sector took place. The programme counteracted the neglect of MSME financing in the agricultural sector without distorting the market.

It is also plausible that the programme has led, at least in the case of some borrowers, to increases in income, provided the loan was used for productive purposes. The borrowers involved appeared to some extent to increase their incomes and agricultural production up to a point where a certain minimum level was achieved. However, they continued to invest to the point that additional jobs were created only in rare cases. This was also not anticipated in the case of the target group of MSMEs. For most borrowers, and for subsistence farmers in particular, income stabilisation and the stabilisation of agricultural yields were a particular focus. Given the other existing obstacles in the agricultural sector, large growth effects and the full achievement of the overarching development policy objectives were also unrealistic with the intended target group.

Impact rating: 3

Sustainability

The funds made available were quickly paid out to the target group and made available on a revolving basis. The performance of the three PFIs was consistently good between 2012 and 2014 with respect to the profitability indicators. All three PFIs are currently well-funded, which enables them to acquire sufficient borrowed capital to finance their operations. The raising of capital in the local currency is difficult due to the exchange rate risk (depreciation of the lari) and is associated with high costs. However, it is apparent that the PFIs also increasingly have access to other sources of funding. By obtaining a banking licence, one of the PFIs is now also able to operate a deposit business. In addition, this PFI has recently issued a bond in the local currency. Moreover, the PFIs, with the support of the FC consultant, have also undergone further institutional development and been brought up to professional standards. Another PFI is also aiming to acquire a banking licence within the next 1-2 years and will consequently be expected to gain access to other funding options. It should be noted that this PFI has been taken over by a larger European microfinance institution, by means of which a positive development in terms of the better implementation of responsible finance is also hoped for.

The granting of local currency loans to agricultural MSMEs through the PFIs has developed positively since 2012. It can be assumed that the three PFIs will continue to serve this target group at an acceptable cost thanks to their now extensive branch network. The extensive experience of the three PFIs in the agricultural sector is noticeable in this regard. By expanding their product ranges since the start of the programme, the three PFIs now offer their customers customised products to suit their needs.

Risks for the Georgian financial sector and for the agricultural sector stem from the difficult market environment. In particular, the deterioration of the economic situation in Georgia and, consequently, the depreciation of the lari could adversely affect the business of the PFIs. The poor economic situation in Russia and the Ukraine crisis, among other factors, can be felt in the 50 % decline in migrant remittance transfers from the two countries, which has a direct effect on the repayment capacity of the ultimate borrowers. The PFIs have continued to demonstrate an acceptable portfolio quality, however, which implies good risk analysis and good risk management on the part of the PFIs. This guarantees the sustainability of their business. The declining interest rates since 2012 due to the higher levels of competition should be seen as positive for the ultimate borrowers.

Given the government's existing political commitment to the agricultural sector (it currently subsidises both agricultural loans and agricultural insurance), it can be assumed that political influence may adversely affect the impact of the programme in the long term due to market distortions. The contribution of agricultur-

[1] The products specifically developed for agricultural MSMEs are shown in Appendix 3.

al MSMEs, and in particular of micro-enterprises, to economic growth is expected to continue to be low in future due to low productivity. When it comes to future programmes aimed at funding the Georgian agri-cultural sector, it appears sensible to us to focus on medium-sized enterprises as a target group, from which employment effects and growth are to be expected. From today's perspective, the sustainability of the project is rated as good, despite the uncertain economic outlook, thanks to the good performance and further institutional development of the PFIs.

Sustainability rating: 2

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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).