Ex post evaluation – Ghana

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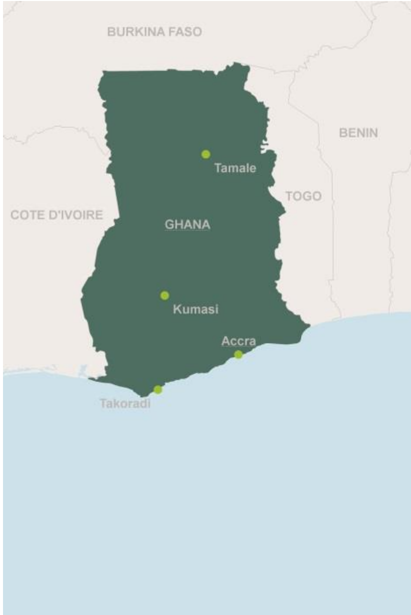
Sector: 2403000 Formal sector financial intermediaries
Programme/Project: Microfinance II (KfW trust funds) BMZ No. 2005 65 556*, Basic+advanced training measure I BMZ No. 1930 03 654, Basic+advanced training measure II BMZ No. 1930 03 662
Implementing agency: A refinancing fund and an urban financial institution (FI) in Ghana



Ex post evaluation report: 2015

		FI (Planned)	FI (Actual)	Fund (Planned)	Fund (Actual)
Investment costs (total)	EUR million	0.42	0.92	3.50	3.50
Counterpart contribution	EUR million	0.00	0.00	0.00	0.00
Funding	EUR million	0.42	0.92	3.50	3.50
of which BMZ budget funds	EUR million	0.42	0.92	3.50	3.50
Basic+advanced training measures EUR million (BMZ funds)		0.80	0.80	1.00	1.00

*) Random sample 2015

Summary: The project comprised two equity investments using trust funds from the BMZ budget. One to an urban financial institution totalling EUR 0.92 million, the other totalling EUR 3.5 million to a refinancing fund that provides local currency for Ghanaian financial institutions. Additionally, two basic and advanced training measures were carried out between 2008 and 2013 with volumes of EUR 1 million and 0.8 million by external consultants at the project-executing agencies.

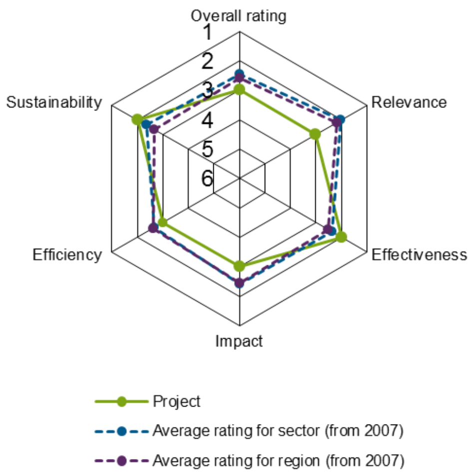
Objectives: The overarching developmental objective of the measures was to contribute to the development of efficient structures in the Ghanaian financial sector and to support an increase in employment. The objective of the FC measures was the efficient, adequate and sustainable provision of loans and other financial services by private financial institutions to the target group of micro, small and medium-sized enterprises.

Target group: The target group was private micro- (< 5 employees), small- and medium-sized enterprises (< 30 employees) both in urban and rural regions (MSMEs).

Overall rating: 4

Rationale: The project did not achieve the desired signalling effect in the Ghanaian financial sector because the funds flowed into areas in the sector that were already served by other institutions. This is one reason for the unfavourable ratio of the project costs to the impact achieved. The developmental impact on the target group (MSME) cannot be verified.

Highlights: --



Rating according to DAC criteria

Overall rating: 4

The project consists of two different components. The evaluations carried out separately were used together to obtain the overall rating.

General conditions and classification of the project

The provision of financial services to the Ghanaian population remains underdeveloped. Only approximately 30 % of the population has a bank account. The discrepancy between urban areas, where there is some over-supply, and rural areas, where there is extreme under-supply, is huge. The Ghanaian financial sector is highly fragmented and urgently in need of consolidation. It consists of 26 banks, which together make up approximately 85 % of the total lending volume. The remaining 15 % is attributed to non-banks: approximately 11 % to 28 savings and loan companies (S&Ls) with a lending volume of around GHS 2.9 billion[1], approximately 3 % to the 138 rural and community banks (RCBs) which operate exclusively in rural areas, and just 1 % to the approximately 503 micro-finance institutions (MFIs) and registered money lenders. With regard to savings, here too the lion's share of 86 % is found in banks, followed by GHS 2.9 billion and thus approximately 8 % in the S&Ls. The rest is accounted for by the RCBs (4 %) and MFIs (2 %).

Non-banks, however, lead in terms of the number of customers. They serve a total of approximately 8 million savings and loan customers and thus more than the banks, which tend to disburse larger loan amounts. In terms of the number of customers, the non-banking sector is dominated by the RCBs, which serve around 65 % of all savings customers and 57 % of all loan customers in the non-banking segment. The S&Ls come in second place, with a market share of 17 % of savings customers and 9 % of loan customers. S&Ls serve around 1 million savings customers, but just 138,000 loan customers. The remainder of the deposit and credit market is split between micro-finance institutions, moneylenders and savings collectors (known as Susu collectors).

The Ghanaian financial system is also characterised by a distorted interest rate structure. The rate of inflation is currently around 17 %. The heavily indebted Ghanaian government increasingly raises funds on the domestic capital market. As of June 2015, it had made payments in local currency of approximately 25 % on 90-day bonds (T-bills). In 2011, this figure was around 12 %. Banks thus have a good alternative to loans and therefore tend to grant few or only very expensive loans. This is one reason why the lending rates in the country are high overall. As a result, the willingness of customers to take on long-term loans is small, as these are of little economic benefit. It is therefore predominantly short-term loans for the financing of working capital that are taken up – and most of these in the trade sector, as it is only in this field that the correspondingly high sales margins required to manage the high interest loans can be achieved.

During the past two years, Ghana has been in the midst of an economic crisis. Despite economic growth of at least 8 % over the past 5 years, difficult conditions (price of oil, energy crisis) and the reduction of public spending for 2015 mean that expected economic growth will be between just 2.7 % and 4.2 %. External and public debt as well as debt servicing have increased dramatically in face of the chronic current account deficit (around 9 % of GDP), the continuing high budget deficit (around 10 % of GDP) and increasingly non-concessional debt (total debt around 66 % of GDP). In addition, the devaluation of the GHS, which has lost approximately 50 % of its value in the last two years alone, has also played a part here.

Relevance

Both the overarching development objective (to contribute to the development of efficient structures in the Ghanaian financial sector and to support an increase in employment) and the objective of the FC measure (efficient, responsive and sustainable provision of loans and other financial services by private financial institutions to the target group) - were in line with the Financial Sector Strategic Plan (FINSSP) and the

[1] Exchange rate: EUR 1 = approximately GHS 5 in September 2015.

Ghanaian government's National Strategic Framework for Microfinance (NSFM). At the same time, the programme concept was consistent with the objectives pursued by the German federal government. Thus it was argued that, through the provision of capital from the credit market, formerly marginalised micro, small and medium-sized enterprises (MSMEs) would be able to make new investments to expand business and would be better able to respond to external shocks. In terms of developmental policy, this means better protection from sliding into poverty. This aimed at ensuring that the programme pursues a primary objective of the Millennium Development Goals (poverty reduction) and was thus in line with points 3.1 and 3.4 of the German federal government's Action Programme 2015, which aim to strengthen economic dynamism and the participation of the poor and to finance development. The programme targets were to be achieved with the establishment of a refinancing fund and a urban financial institution (FI).

The establishment of the fund was intended to create an innovative investment platform for national and international investors at the meso level in Ghana for the first time. Since Ghanaian S&Ls and RCBs are permitted to operate only in the local currency and their deposits are mostly short-term, they require a source of funding for their long-term lending business. Borrowing on the international markets is expensive because the currency hedging costs for GHS are high. A local interbank market for GHS in general and among the S&Ls in particular was virtually non-existent. The purpose of the fund was therefore to close this gap in the market. This specialised funding unit was intended to ensure a permanent provision of financing in local currency to selected financial institutions for the funding of loans to MSMEs. The novelty of the programme idea was to provide an investment platform managed professionally in accordance with the rules of the financial sector and which was therefore attractive for national and international investors. At the time of establishment there was only one other fund, established by the GIZ and DANIDA, which fulfilled these tasks. Donor harmonisation was planned with DANIDA and the GIZ in particular. At the time of the project appraisal in 2006, the plan was made to merge the two funds. Even against this backdrop, however, the fund was not equipped at the start of the programme with a volume corresponding to the high funding requirements and the fund's ambitious impact targets.

Moreover, the founding of two non-banks was intended to establish good practices on the market as well as structural conditions for the development of an efficient and sustainable micro-finance sector. It was thus planned to set up one urban and one rural FI as S&Ls[2]. Donor harmonisation was carried out with the IFC, which was also involved in establishing the urban FI. At the time of the programme appraisal, there were already 120 RCBs and 10 S&Ls that mainly served the lower market segment as non-banks. Some of these S&Ls, such as Opportunity International, Sinapi Aba and EB Accion for example, had already been established and were among the more responsible market participants that also met international standards. At the time they covered virtually identical market segments (mostly urban traders). As a result, the foundation of another small S&L in this supersaturated sub-market was therefore hardly suitable as a means to realising the programme's objectives.

Relevance rating: 3

Effectiveness

The objective of the FC measure was the efficient, responsive and sustainable provision of loans and other financial services by private financial institutions to the target group. The achievement of the programme objectives defined during the programme appraisal can be summarised as follows:

Indicator	Status PA	Ex post evaluation
(1) For all three institutions, the loan portfolio at risk of default – i.e. loans with arrears on interest	n/a, 3 %	FI: PAR > 30 = 4.3 % (April 2015) Not achieved

[2] The establishment of the rural FI did not come to pass. This was partly due to the fact that KfW had doubts as to whether the holding company would be able to properly support this new foundation with the necessary management resources, while KfW also recognised the high credit risks involved in establishing an FI specialising only in rural areas. The "rural MSMEs" customer group was thus served by a standalone programme (Microfinance Programme III). The funds intended for the rural MFI were redirected into this new programme.

and/or principal payments of more than 30 days – makes up a maximum of 3 % of the loan portfolio from the outset and throughout their lifetime. This indicator should be reviewed for the fund and the rural FI after presentation of the business development plans.		Fund: PAR > 30 = 0 % (April 2015) Achieved Rural FI: not relevant as was not established
(2) All three institutions achieve operative and financial sustainability no later than the end of the fifth financial year.	Return on equity (RoE) at least equal to rate of inflation (FI) Overall return on capital employed (ROCE) at least equal to rate of inflation (fund) [3]	FI: Losses 2008-2012, since 2013 RoE > 0, but RoE < inflation rate (17 %) Operative sustainability: Achieved Financial sustainability: Not achieved Fund: Losses 2010-2013, since 2013 ROCE > 0, but ROCE < inflation rate Operative sustainability: Achieved Financial sustainability: Not achieved
(3) Indicators which affect the portfolio growth of the fund shall be determined after the creation of the business development plan.	Min. plan fulfilment	Fund: Plan 2008-2014: Not achieved (e.g. 18 % below plan in 2014)
(4) The credit portfolio of the urban FI has increased to a minimum of EUR 10 million (with at least 13,000 active loan customers) by the end of the fifth financial year.	EUR 10 million / 13,000 loan customers	FI: EUR 8.3 million / 11,445 (April 2015) Not achieved
(5) Indicators which affect the portfolio growth of the rural FI shall be determined after the presentation of the business development plan.		Not relevant as was not established

At present, the fund finances 8 financial institutions exclusively in local currency. As subordinated loans and equity capital are made available to the fund in local currency, the fund incurs no currency risks. The risk of a drop in the value of loans due to currency devaluation is borne by the investors. The fund's portfolio is currently around GHS 17.8 million. The fund is starting to become operationally sustainable. 2013 was the first profitable year. At the end of 2014 too, the fund reported a small profit. As a result, the fund is able to sustainably serve its existing S&L and RCB target group, albeit to a lesser extent. In addition to financing by KfW (on a trust basis) and another investor, the plan was to raise capital from other investors, such as a Ghanaian pension fund for example. After the Ghanaian pension fund was persuaded to participate at the end of 2012, the economic crisis began in Ghana. The pension fund's participation was therefore delayed. Only at the end of 2014 was the capital finally paid in by the pension fund. The fund was

[3] As the fund is financed exclusively by equity capital, the overall return on capital employed corresponds to the return on equity.

thus unable to achieve its growth targets in 2013 as growth was limited by the capital available. The pension fund, whose holdings are widely diversified across many sectors such as breweries, production facilities, real estate, commodities, health, services and even financial institutions, held a total of roughly 60 investments at the end of 2013, of which around 20 were in the financial sector. The pension fund has no current plans to increase its participation in the fund, as it does not wish to hold a higher percentage than the second co-founder. In addition, the pension fund has an investment strategy according to which it should expect a return on equity of at least T-bills + 3.25 % each year, which currently corresponds to 28.25 %. The fund currently generates less than a third of this return. There is therefore no reason to believe that the pension fund will increase its participation in the fund, especially as its other investments are more profitable.

The urban FI established as an S&L was founded as the subsidiary of a network bank, in which KfW and other international donors such as the IFC, EIB and FMO hold a share. The network bank operates nine banks throughout the world, of which seven are located in Africa. The FI evaluated here currently serves approximately 11,000 loan customers and 18,000 savings customers. Its business activity is focused on the urban areas which are already well-served by financial services. It is not represented in rural areas. More than 80 % of its customers are micro customers with loan amounts less than EUR 1,000, which are usually taken up only short-term. The customer segment of trade, which is also highly competitive and well-supplied with credit products, accounts for around 80 % of the loan portfolio. The FI is gradually withdrawing from group loans too, since these have proven too costly and impractical. With a loan portfolio of approximately GHS 33 million, the FI is the tenth-largest S&L in Ghana, with a huge gap between it and its S&L competitors in the micro and SME segment (which award three to eight times more loans, for example). According to reports, the market share (lending volume) of the FI among the S&Ls in the field of micro and SMEs is around 6 %, and is thus low at 0.36 % of the financial sector (banks and non-banks). Its deposits total GHS 12.5 million. Here again, the gap between it and its competitors is large. The impact of the evaluated FI on the Ghanaian banking system as a whole can be considered very low. Although the loans and other financial services (savings) provided by the FI are adapted effectively towards the target group, they meet demand only to a limited extent and unserved customer segments (= rural population) have thus far been excluded.

The FI is also starting to become operationally sustainable. 2013 was the first profitable year. The FI was ranked 6th out of 27 S&Ls in terms of return on equity (RoE) and is thus better off than many of its competitors in the S&L sector. The RoE was 11 % at the end of 2014 and thus below the inflation rate, which is why the institution is not yet financially sustainable. Looking at the portfolio at risk figures of the larger competitors at year-end 2014, the FI was ranked in the middle range at 9th out of 27.

Effectiveness rating: 4

Efficiency

Ultimately, two components from the programme were implemented. KfW's participation in the fund (on a trust basis) consisted almost entirely of a loss-participating subordinated loan in local currency, which was partially converted to equity capital (GHS 7.774 million) in December 2014, while the rest remained as a subordinated loan (GHS 5.076 million). Due to the losses during the start-up phase and taking currency devaluation into account, KfW's initial contribution amount of EUR 3.5 million was reduced to an equivalent value of EUR 3.2 million (GHS 12.85 million). The shareholders have not received any dividends thus far. The FC also financed the costs of establishing the fund in the amount of EUR 1 million, disproportionate to its shareholding, in the form of advisory measures provided by Cyrano, the fund manager. In terms of the low fund volume (GHS 17.8 million, corresponding to approximately EUR 4.45 million), the formation costs (EUR 1 million) are very high. The portfolio must grow exponentially in the future to justify these costs.

In the case of the FI, the contribution consisted of an equity participation which took place in several stages. As a result of currency devaluation, the equivalent value fell from an initial EUR 0.92 million to EUR 0.477 million. Taking into account the losses from the initial years, the equivalent value was further reduced to EUR 0.343 million (GHS 1.369 million). The shareholders have not received any dividends thus far. It was required as a matter of principle that the equity capital be made available to the FI in the local currency, as high currency hedging costs must then not be paid by the company. Here too, the FC financed the costs of the FI's foundation in the amount of EUR 0.8 million, disproportionate to its shareholding, rendered in the form of advisory measures by the network bank's consultant. The consultant is also a shareholder in the network bank holding company which, in addition to the FI in Ghana, operates several banks worldwide. In the case of network banks it is common that only the network bank's consultant performs advisory measures. In this way, the Group hopes to ensure consistent quality across its network. As a result of the consultant's participation in the capital of the holding company it was assumed that they had an incentive to provide good consulting services to the FI, as the consultant would benefit later from the profits made by the institution. It remains questionable, however, whether another consulting firm could potentially have offered the same services at a more favourable cost, though this can now no longer be verified. On the whole, the foundation of a new institution is always a relatively cost-intensive measure. Considering the fact that the non-banking sector much rather requires consolidation, these costs are seemingly unjustified.

Efficiency rating: 4

Impact

The overarching developmental objective of the project was to contribute to the development of efficient structures in the Ghanaian financial sector and to support an increase in employment. No indicators for measuring the achievement of these objectives were defined.

At present the fund finances 8 financial institutions exclusively in local currency. The fund's portfolio is currently around GHS 17.8 million. Considering that the loan volume of S&Ls (market share 11 %) alone amounts to GHS 2.9 billion, it is clear that the volume set out for the fund is very low, at approximately 0.6 % of the S&L lending volume. In the case of the fund's eight customers, financing from the fund only makes up between 1 % and 8 % of their total funding, which clearly indicates that the fund is not the only funding alternative in the local currency (S&Ls are not permitted to participate in foreign currency financing), because the funding conditions on the market have significantly improved since the conception of the project under review here. In addition, funding via the fund is only available in the short-term thus far (max. 3 years). This is made available to the customer mainly in the form of a deposit. Thanks to this, the fund has better termination options than a loan. As a result, fund customers have to present these resources as short-term instruments on their balance sheets and are permitted to use them to fund their long-term lending only to a limited extent. Interest rates are in line with the market, at 2-4 % for 90-day T-bills.

In Ghana, interest is specified per month. Most non-banks offer these as flat rates, i.e. they calculate the interest based on the initial amount, without taking into account intermediate repayments during the term. These interest rates are usually between 3.5 % and 4 % per month. The high lending rates often come with a correspondingly high handling fee of between 2.5 % and 4 % added on. Here again the information is often inconsistent, and varies between a one-off fee on the loan amount and a fee that is either reduced each month or is calculated as a flat rate and which markedly increases the total cost of a loan. The interest rates of the FI are in the middle of the range in terms of their competitors. On the whole, the credit conditions of the S&L are not transparent, which is due to a lack of regulation and inadequate consumer protection. The loan agreements at the FI are also written in English, which much of the population can barely read. The Terms and Conditions as well as the 'small print' are printed in a small font and are often copied in a way that renders them illegible. Effective interest rates are not specified in the loan agreements. Interest rates and fees are not mentioned in the brochures of the FI, instead being displayed in branches in areas where they are not immediately visible. What is more, rates and fees are usually only negotiated in definitive terms during contract negotiations. It is therefore difficult for the customers with a low level of financial literacy to compare the offers. Since the FI, as one of the few S&Ls, offers no flat rates, interest rates often appear higher to customers than those of their competitors. In fact, the FI is priced in the midfield. On average, interest at the FI amounts to approximately 73 % per year (47-83 % for SMEs and 53-83 % for micro loans). This is around 48 percentage points higher than the interest rates on risk-free business (= government bonds) and 56 percentage points above the inflation rate. The institute's funding costs (deposits and borrowed funds) are around 21 %. Interest on savings deposits is around 7.5 % and approximately 9.5 percentage points below the rate of inflation. Interest on time deposits is approximately equal to that on government bonds. The customers of the FI are mainly urban small traders and therefore part of the most sought-after customer group in the non-banking sector. The strong competition for this customer group also explains why the FI was unable to achieve its growth targets.

Since these small traders operate in a polypolistic market, they have only limited options to increase their prices. In times of crisis, they also have to expect lower demand. As a result, these small traders, often operated as sole proprietorships, have to reduce their budgetary expenditure in order to save costs. If they fail to do this, they will end up in default. The increase in default rates in recent years clearly demonstrates this. The appropriateness and sustainability of loans extended at these high interest rates are therefore questionable, particularly in times of crisis like these. While the lending and savings terms of the FI seem to be slightly more transparent than those of its competitors, it is questionable whether the customers are aware of all the risks that they will incur when borrowing due to their often limited financial literacy. This lack of financial literacy as well as cultural differences, which result from the loyalty structures within Ghanaian society, also explain the readiness of customers to invest money below the inflation rate, and even to pay a fee for the collection of funds, as in the case of Susu collectors.

It is unclear whether the programme contributes to the promotion of employment, as appropriate data was not collected. Local surveys, however, have confirmed that many of the clients were already customers of other financial institutions and had, in some cases, been poached. New customers frequently lack financial literacy. They often have not shopped around to compare offers, and are usually not fully aware of the terms of the loan. Almost all customers complained about the high interest rates, which are felt most in relation to the current economic crisis. They also complained of a lack of alternatives, as all S&Ls offer similar (expensive) terms. The risks of indebtedness are mitigated by credit checks, but since credit agency inquiries are not carried out consistently throughout the sector, the FI – which carries out such inquiries when granting a loan – has little chance of recognising over indebtedness. Guarantors in particular are poorly informed about the risks that they may incur, due to the fact that the existing Ghanaian social structure entails that they often vouch for someone as a favour rather than as the result of economic considerations.

Due to the currently negligible market share of both institutions and their resulting low level of impact within the sector, at present neither the fund nor the FI have made any significant contribution to the development of efficient structures within the Ghanaian financial sector. The participation of the pension fund is a positive sign for the fund. But as this does not pave the way for the pension fund to involve the fund in its investment strategy at larger volumes, it fails to overcome the problem of its small size. Thus, neither institution is capable of triggering a corresponding emulative effect, nor of setting market standards. Particularly in the S&L segment, the main focus at the level of regulation should be to introduce financial supervision and consumer protection in order to achieve a significant impact. Unlike the FI, which has no significant unique selling point and which also has very limited growth potential, the fund, as a refinancing vehicle, has a good chance of establishing itself on the market if it succeeds in raising further capital in the future.

Impact rating: 4

Sustainability

The two components, both the fund and the FI, are operationally sustainable. Financial sustainability has not yet been achieved. Long-term financial sustainability can only be achieved if these institutions succeed in either growing accordingly or in serving a niche market. While the fund has achieved the latter, the FI is dependent on the former in order to survive long-term on a market in need of consolidation. The growth potential of the FI, however, is dependent on the willingness of its shareholders to pay in additional capital. To reach the approximate size of its competitors, the FI would need three to four times as much capital. Since the FI belongs to a holding company in which several international donors have invested, there are multiple parties which have to agree to an increase of capital. Although there is a willingness to accompany the growth of the FI, it is questionable whether the existing shareholders are willing to finance such massive capital requirements in the future. From today's perspective, it is not possible to finance growth from retained earnings. It is especially questionable whether sustainable growth in the market can be realised at all without taking on substantially greater risks.

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).