Ex post evaluation – Honduras

Sector: Sustainable economic development
(CRS code: 24030 Formal sector financial intermediaries)
Project: MSME financial sector promotion II (BMZ no. 2011 65 976)*
Implementing agency: Banco Hondureño para la Producción y la Vivienda (BANHPROVI)

Ex post evaluation report: 2019

		(Planned)	(Actual)
Investment costs (total)	EUR million	12.20	12.20
Counterpart contribution	EUR million	1.20	1.20
Funding	EUR million	11.00	11.00
of which BMZ budget funds	EUR million	11.00	11.00

*) Random sample 2017

Summary: The funds from the FC measure (FC loan) were made available to the Honduran development bank BANHPROVI as the "apex bank". BANHPROVI channeled the funds to qualified financial institutions (mainly microfinance institutions), which they used to finance loans to MSMEs. The FC measure was implemented through a total of 29 financial intermediaries. On the one hand, they were divided into several commercial banks and a larger number of formal and informal financial institutions (FIs) with various legal forms. A heterogeneous mixture of FIs thus carried out the implementation.
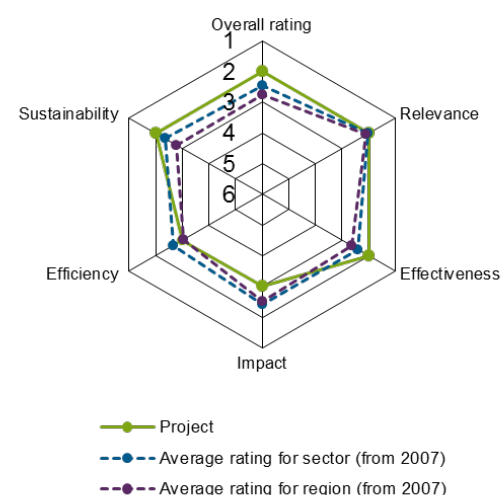
Objectives: The overarching developmental objective (impact) aimed to contribute to improving the competitiveness of micro, small and medium-sized enterprises (MSMEs) and to strengthening the financial sector. The module objective (outcome) defined at the project appraisal was to improve MSMEs' needs-based access to financial services in rural areas as well.

Target group: The direct target group of the project were the FIs with a focus on MSMEs, and the indirect target group the MSMEs in rural and urban areas. At the time of the EPE, about 550,000-700,000 MSMEs were registered in Honduras.

Overall rating: 2

Rationale: Promoting MSMEs and improving access to financial services continue to be priorities of the Honduran government. Improving access to financial services is also a priority need for Honduran MSMEs. The project was thus highly relevant. The project objectives were largely achieved. BANHPROVI's margin, at around 10%, was too high from an ex post perspective. The significant developmental expansion of long-term financing in rural areas also fell well below expectations. The project just narrowly rates good overall.

Highlights: ./.

Legend:
— Project
- - - Average rating for sector (from 2007)
- - - Average rating for region (from 2007)

Rating according to DAC criteria

Overall rating: 2

Ratings:

Relevance	2
Effectiveness	2
Efficiency	3
Impact	3
Sustainability	2

Relevance

Honduran MSMEs are affected by a structurally driven lack of adapted financial services in rural areas on the one hand, and long-term loan products on the other. This was already identified as a core problem at the time of the project appraisal (PA) in 2012. In the case of BANHPROVI, sufficient and reliable sources of refinancing to fund MSMEs also represented an important bottleneck. The financial intermediaries in turn also had a special need for reliable refinancing and also sought to diversify their sources of refinancing. The FC measure helped to tackle these challenges in the Honduran financial sector.

The aim of the FC measure was to refinance FI loans to micro, small and medium-sized enterprises with a focus on rural areas as well as long-term loan financing. The project design was based on the impact hypothesis that the FC measure would both increase the volume of MSME loan funding and stimulate expansion of lending in previously underserved areas (rural areas). In addition, incentives were to be created to introduce adapted financial services (long-term products for financing fixed assets). The investments financed by the loans were intended to secure and expand the business operations of MSMEs in the medium to long term, strengthen their competitiveness and increase planning reliability for loan customers. Financial intermediaries were to contribute to product diversification and thus to strengthening the financial sector by offering a better range of financial products. This would enable a larger number of MSMEs to meet their demand for financing, which in turn would have a positive impact on the job situation. These interdependencies underlying the project design are assessed by the evaluation as fundamentally appropriate. However, the impact logic does not include the rural component and, in particular, how to reach the agricultural community.

From today's perspective, the project is compatible with the priorities of the Honduran government in terms of promoting MSMEs and strengthening the financial sector. The previous government contributed to making MSMEs more dynamic and competitive by setting up government-funded institutions to promote MSMEs. The government newly elected in 2017 under President Juan Orlando Hernández explicitly mentions MSME access to loans as an important element in one of the "seven pillars" of the government plan for the period 2018 to 2022. Moreover, better access to financial services tailored to their needs is still highly relevant for Honduran MSMEs today. In addition, the FC measure took into account the priorities of the German Federal Government related to promoting the MSME sector (e.g. in implementing the G20 action plan for financing SMEs) and the overarching objective of German development cooperation of securing and creating jobs.

The relevance of the project is rated as good.

Relevance rating: 2

Effectiveness

The project's module objective was to improve MSMEs' needs-based access to financial services in rural areas as well. To measure the achievement of the module objective, three indicators were used. They cover the development of lending to MSMEs and the development of the financial sector.

The achievement of the indicators can be summarised as follows:

Indicator	Target value PA/status PA (2012)	Ex post evaluation
(1) The total volume of rural MSME loans from the financial institutions (FIs) participating in the programme is growing by an average of at least 10% annually (total amount of loans).	10%/PA: no data	8% -> Indicator almost achieved (see above).
(2) The disbursements of BANHPROVI's own funds under its programme to promote the MSME sector for long-term MSME loans average at least 30%.	30%/PA: no data	6.5% -> Indicator not achieved.
(3) The delinquent loan portfolio of the FIs participating in the programme amounts to a maximum of 4% for banks and financieras[1] (PAR 90 days) and 6% for all other FIs (PAR 30 days).	<4% (PAR 90); <6% (PAR 30) PA: average 3.4%	Banks: 2.9% (90) Financieras: 3.2% (90) Cooperatives: 5.8% (30) Microfinance institutions: 1.4% (30) OPDF[2]: 2.8% (30) -> Indicator achieved.
(4) The average profitability (RoE) of the financial intermediaries participating in the programme is positive in real terms (real capital value).	≥0% (real) PA: positive on average in real terms	Consistently positive in real terms On average: 9.6% p.a. -> Indicator achieved.

As regards the total volume of MSME loans granted in rural areas (Indicator 1), the implementing agency explained that the loans were not granted by BANHPROVI itself but by the financial institutions (FIs) and that, consequently, it had no influence on the sectors in which the loans were granted. The financial institutions (FIs), on the other hand, were not subject to any sectoral conditions for lending. In addition, rural borrowers already accounted for 84% of the total number of loans granted between 2013 and 2016, making large growth rates difficult to achieve.

The implementing agency provided the following two explanations for Indicator 2 (disbursements of BANHPROVI's own funds for long-term MSME loans): first, 86% of the loans are granted in the agriculture and trade sectors, which require short terms based on their activities, for example to finance seasonal workers or to purchase goods. Second, borrowers have other lower-interest, government-subsidised financial products at their disposal for long-term investment. In comparison, loans granted via BANHPROVI and FIs are not very competitive. The programmes were not yet available at the time of the project appraisal. These arguments are straightforward and make it clear why the expected results were not fully achieved.

Overall, the participating financial intermediaries offered longer-term loans than before the programme, i.e. loans with terms of more than 2.5 years. However, in rural areas, which were the focus of the programme, the demand for long-term financing was low, partly because government loan programmes offered more favourable conditions. All loans were granted in local currency in line with the needs of rural

[1] Financing companies

[2] Organizaciones Privadas de Desarrollo Financiero - private finance development organisations

customers. The exchange-rate risks were borne by BANHPROVI. The proportion of own funds used by BANHPROVI for long-term loans was about 6.5% per year (total of 55% own funds instead of the planned 10%). However, discussions with financial intermediaries and participating companies suggested that demand was on the rise.

Overall, however, the question arises as to whether such high interest rates made long-term investments in agriculture realistic at all for the ultimate borrowers (see section on efficiency: approx. 30%) and whether this was the reason that the objective of expanding long-term financing in rural areas fell far short of being achieved. Although subsidising interest rates through the government programmes mentioned above is not an ideal solution either, this aspect should have been taken more into account from the outset.

The investments supported by the FC measure were distributed among the following economic sectors:

– Agriculture: 44.0%

– Trade: 41.7%

– Services: 9.7%

– Industry: 4.6%

As a result, more than 85% of the loans went to agriculture and trade. An analysis of the distribution of loans between urban and rural areas shows the project's clear focus on rural areas. 84.3% of borrowers resided in rural areas and 15.7% in urban areas. The analysis of borrowers by company size also shows the project's very clear focus on microenterprises, which accounted for 93.4% of the loans granted. 5.5% of the loans were used by small enterprises and 1.1% by medium-sized enterprises.

From the implementing agency's point of view, the following factors had a positive effect on project implementation:

– a growing microfinance system in Honduras

– growing demand for loans

The following aspect negatively affected the module objective:

– competing offers of other BANHPROVI financial products with lower requirements for the collateral provided by customers, partly due to state subsidies.

The indicators of the module objective were largely achieved. Due to the low proportion of long-term financing, the project is still rated as good.

Effectiveness rating: 2

Efficiency

The interest rates charged by the intermediary FIs were variable and calculated at the market price. However, due to the high operating costs and risks in the microfinance sector, real interest rates for final consumers were comparatively high at 30% on average. BANHPROVI is currently exploring the possibility of introducing an interest rate ceiling for microfinancing. However, this measure is still contentious and a decision has not yet been taken. BANHPROVI confirms that the margins for the transfer of loan funds were reasonable. BANHPROVI's margin was high at 10%, and may have been appropriate at the time of the project appraisal given that BANHPROVI also had to bear the exchange-rate risks. In view of the lower exchange-rate risks[3] in recent years, however, the margin appears to be too high from an ex post perspective.

According to the business owners visited, the good, long-standing and trust-based relationship with their respective financing institution has a positive effect on borrowing. In particular, the visits revealed that the FC measure promoted economically viable investments.

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[3]
http://country.eiu.com/article.aspx?articleid=1057341289&Country=Honduras&topic=Risk&subtopic=Credit+risk&subsubtopic=Overview and https://www.imf.org/external/pubs/ft/wp/2014/wp14163.pdf

The project achieved low default rates, a high number of ultimate borrowers and was efficiently implemented by BANHPROVI. The bank was able to use the funds on a revolving basis due to the long term. Given BANHPROVI's relatively high margin, the project's efficiency is rated as satisfactory.

Efficiency rating: 3

Impact

As an indicator for the achievement of the overarching developmental impact, the EPE has defined the following indicator; the table shows to what extent it was achieved.

Indicator	PA target value	Ex post evaluation
(1) The number of loans granted to the private sector is to increase in relation to GDP.	n/a	2011: 46.9% 2013: 54.3% 2016: 56.2%[4] -> The indicator was achieved, but the programme only has a relatively small effect on this figure.

With the FC measure, BANHPROVI financed an estimated 6,000 to 8,000 sub-loans via 29 financial intermediaries, and even 12,000 to 16,000 sub-loans based on the higher level of own funds reported by BANHPROVI (55% instead of 10% of the loan portfolio disbursed). The discussions conducted with financial intermediaries and participating companies during the evaluation confirmed a demand for credit volumes with higher individual amounts. In addition, the strong growth of the BANHPROVI portfolio for MSMEs by 134% between 2013 and 2017 (from USD 491 million to USD 1,150 million) is clear evidence of the increasing supply. Indirectly, it can be inferred that the measure has led to an improvement in the social and economic conditions of MSMEs and to the creation of direct and indirect jobs. It should be noted in this context that the mutual guarantee system (CONFIANZA) introduced by the Honduran government in 2011, which could also be used in this FC project, also contributed significantly to improving MSMEs' access to loans.

BANHPROVI has repeatedly affirmed the considerable positive impact of the FC project on the Honduran financial sector. The FC measure eliminated bottlenecks both for BANHPROVI and for the financial intermediaries and MSMEs. For BANHPROVI, the FC project represented a reliable source of refinancing for MSME financing and ensured its liquidity. BANHPROVI, in turn, was of particular importance as a reliable source of refinancing for the financial intermediaries, who are reliant on external financing, especially in local currency, due to the difficult access to savings deposits. In addition, BANHPROVI played a stabilising role for the financial intermediaries, particularly in the event of fluctuations in liquidity.

The FC measures strengthened the availability of financing for MSMEs and contributed to securing and creating productive and paid employment in rural areas. One farmer surveyed said, for example, that the loan allowed him to expand his farm and he now has as many as 12 people employed, particularly during the harvest. According to the implementing agency, a total of around 13,000 jobs were created. With respect to the issue of gender equality, BANHPROVI statistics showed that 58.2% of the ultimate borrowers were men and 41.8% were women. This can be attributed, among other things, to cultural norms and traditions in rural areas of Honduras.

No information is available on the programme's negative effects. Due to the nature of the financing (mostly rural investments of small enterprises), however, it must be assumed that there are no serious negative effects. It should be noted here that BANHPROVI's top management aims to monitor the socio-economic impacts of the measures implemented by the Bank better and more comprehensively through an appropriate monitoring system.

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[4] Source: World Bank (https://data.worldbank.org/indicator/FS.AST.PRVT.GD.ZS?end=2016&locations=HN&start=2011)

However, the measure often had rather consumptive than productive use. Long-term investments, especially in agriculture, were only achieved to a limited extent. For this reason the project receives a satisfactory rating for its overarching developmental impact.

Impact rating: 3

Sustainability

The Honduran MSME financial sector is one of the most developed in the region. Over the course of the project, the indicators for the risk portfolio and the profitability of the financial intermediaries steadily improved. As a result, financial intermediaries can now tailor and manage financial services better to meet the needs of Honduran MSMEs. In particular, cooperation between BANHPROVI and the project has improved the management capabilities of the financial intermediaries (in particular administrative aspects and internal controls).

No major risks have been identified which could reduce or jeopardise the positive impacts of the measure both in the financial system and at MSME level. However, there is little risk that, following changes in the political system of Honduras, new decision-makers will try to extend their political influence to BANHPROVI and instrumentalise the organisation for political interests.

Honduras' financial system is stable and healthy, according to information[5] from the Comisión Nacional de Bancos y Seguros (National Banking and Insurance Commission – CNBS) responsible for supervising banks, with both good indicators and rising deposits. Furthermore, BANHPROVI is subject to state supervision and, according to the latest audit report (December 2017), has a good level of financial stability. The financial intermediaries surveyed in the evaluation also confirmed that they also intend to continue focusing on MSMEs.

It is very likely that the positive effects of the FC measure will continue in the future. The project's sustainability is rated as good.

Sustainability rating: 2

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[5] Source: https://radiohrn.hn/2018/07/30/honduras-cuenta-con-un-sistema-bancario-nacional-estable-y-sano-cnbs/ (accessed on: 31 August 2018)

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 **impact**. The ratings are also used to arrive at a **final assessment** of a project's developmental effectiveness. 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 effectiveness of the project (positive to date) is very likely to continue undiminished or even increase.

Sustainability level 2 (good sustainability): The development effectiveness 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 effectiveness of the project (positive to date) is very likely to decline significantly but remain more or less 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 effectiveness.

Sustainability level 4 (inadequate sustainability): The developmental effectiveness 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 development objective ("impact") **and** the sustainability are rated at least "satisfactory" (level 3).