Ex post evaluation – India

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Sector: Financial sector (CRS Code 2404000)
Project: Capitalisation programme for microcredits BMZ No.1998 66 872*
Programme-/Project executing agency: Indian cooperative bank

Ex post evaluation report: 2014

		Capitalisation fund (Planned)	(Actual)	Development fund (Planned)	(Actual)
Investment costs (total)	EUR million	3.19	6.68	1.23	0.91
Counterpart contribution	EUR million	0.33	3.82	--	--
Funding	EUR million	2.86	2.86	1.23	0.91
of which BMZ budget funds	EUR million	2.86	2.86	1.23	0.91

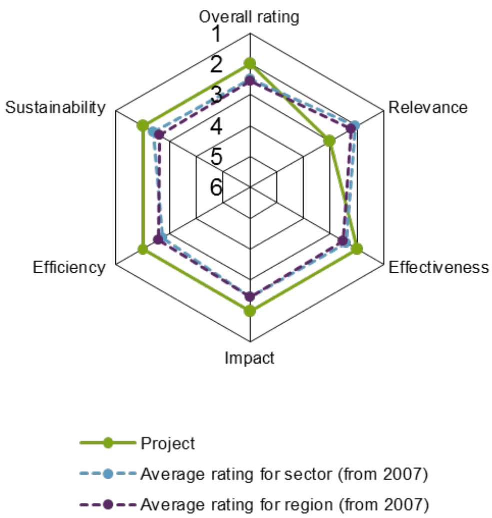
*) Projects in the 2014 random sample

Description: The FC measure comprised two components: a non-repayable financial contribution amounting to EUR 2.86 million for the project executing agency (PEA) - an Indian cooperative bank - to co-finance the credit portfolio in rural and urban areas (Capitalisation Fund) and advisory services totalling EUR 1.23 million to improve the institutional capacity of the Bank (Development Fund). The FC contribution was received by the state-owned National Bank for Agriculture and Rural Development (NABARD) which forwarded the funds in form of a grant to the project-executing agency after deducting a commission of 1%.

Objectives: The aim of the project was to bring about a sustainable improvement in the access of poor women to microcredit in rural and urban areas of the federal state of Gujarat, as provided by the PEA and Rural District Associations (RDA). The overall developmental objective was to contribute to improving the income situation and the living conditions of the target group as well as support the structural development of the financial sector in Gujarat.

Target group: The project's target group was poor women in rural and urban areas of Gujarat, who earn their living as micro-entrepreneurs.

Overall rating: 2



Rationale: The project successfully supported the cooperative bank in widening its financial services from urban to rural and semi-rural areas in the Indian federal state of Gujarat, as well as putting sustainable structures and processes in place for this purpose. By setting up a revolving fund and thanks to the improved quality of the Bank's loan portfolio, borrowers continue to benefit from the micro loans even after the end of the project. The establishment of three rural branches in the districts of Ahmedabad, Gandhinagar and Mehsana also improved the access of the rural target group to savings products.

Highlights: In 2014 the project-executing agency received authorisation from the Indian Reserve Bank to expand its activities to the whole of the Gujarat federal state. The Bank's financial services contain a wide range of loan, savings, insurance and pension products covering the life cycle needs of its exclusively female clientele. As part of a cooperative movement, the Bank places particular emphasis on working together with customers as partners and on comprehensive financial literacy measures for the target group.

Rating according to DAC criteria

Overall rating: 2

Note: The project implementation was delayed for approx. eight years. Following the temporary suspension of Indo-German cooperation, the overall conditions had changed due to the severe earthquake in Gujarat in 2001 and growing requirements regarding the professionalism of intermediaries in micro-financing. The original project design, which provided for the refinancing of micro-credits solely through the institutionally weak Rural District Associations (RDA), no longer seemed appropriate. This resulted in a comprehensive re-design of the project in the years 2003 to 2007. The adapted concept serves as the basis for this evaluation.

Relevance

The Indian microfinance sector was experiencing strong growth at the time of the project re-design. Both the number of Self Help Groups (SHG) supported by banks as well as the population reached by Microfinance Institutions (MFI) were rising fast. At the same time, the regional distribution of financial inclusion was very uneven. While southern federal states were well covered – and in subsequent years even oversupplied – other parts of the country lagged far behind. In Gujarat, only 8% of households had loans via SHGs and 2% via MFIs in 2010, low figures compared to both the region and the national average. Gujarat also lagged behind the national average according to the Financial Inclusion Index (CRISIL), which surveys the bank branch, credit and deposit penetration. The supply further varied strongly between the districts of Gujarat, with the Project districts Ahmedabad and Gandhinagar ranked fifth and fourteenth out of 26.

At the time of the re-design, the project executing agency (PEA) was a pioneer in the provision of financial services for the poor urban population in Gujarat. All told the Bank had gathered more than 30 years of experience as a micro-finance bank for poor women in Ahmedabad. Activities in rural areas, by contrast, were still in its infancy. While the Bank currently offers a wide range of financial services for all life cycle needs of the target group, the focus at that time was clearly placed on savings products. Structures and processes for the efficient and financially sustainable processing of lending were weak.

The basic concept of the project to support the Bank in expanding its portfolio, particularly in rural areas, is still considered relevant today. While the districts of Ahmedabad and Gandhinagar do not comprise the greatest demand within Gujarat, this choice is nevertheless understandable in light of accessibility and available supporting structures (District Associations). However, it should be noted that the bank had sufficient savings deposits – even after taking regulatory requirements on liquidity reserves into account – to finance the targeted growth using own funds. At the same time, however, the capitalisation of the project-executing agency offered an opportunity to relieve the pressure on the tight earnings position of the Bank markedly, thereby facilitating financially sustainable growth. The funding was also relevant for the Bank for reasons of maturity transformation, since some 50% of its savings deposits can be called by customers at any time. Additionally, the provision of technical advisory services was designed to create the institutional requirements to shape the new rural business in a sustainable and efficient manner. Looking back, however, this became so extensive that the management and personnel of the Bank were pushed to the limits of their absorbing capacity. Yet these measures can also be considered relevant.

The project focused on the BMZ sector strategy and is consistent with the goal of the old and new Indian government to give all sections of the population access to formal financial services. Consequently, we deem the relevance to be satisfactory.

Relevance rating: 3

Effectiveness

The aim of the project was an improved and sustainable access of poor women in rural and urban areas of Gujarat to micro-credits. To this end, the Bank was to be supported in expanding its credit portfolio, particularly in rural areas.

To track the target achievement, four indicators were defined for portfolio growth during the project re-design, of which indicators 1 and 3 are applied in the same form (see table). For the evaluation, indicator 2 is expanded with the number of loans disbursed to Joint Liability Groups (JLG), since these were additionally introduced during the term of the project. The fourth indicator was deleted since it related to a programme component that was not implemented – the funding of SHGs organised under NABARD. It was originally planned as a supplementary component in the event of inadequate absorption capacity of the SHGs under the PEA. Furthermore, the project design focused on the financial sustainability of the Bank and the profitable operation of its rural branches. Both will be used in the evaluation to assess the criteria of efficiency and sustainability and are therefore transferred to respective sections (see below). By contrast, an indicator was added for the development of savings to take account of the integrated range of the Bank's financial services and the particular importance of savings for the rural population. Furthermore, an indicator was included on the quality of lending (portfolio quality and compliance with responsible finance principles), which certainly seems essential after the Indian microfinance crisis, even if it had no direct impacts in Gujarat.

The achievement of the indicators can be summarised as follows:

Indicator	PLANNED	ACTUAL	
(1) Number of outstanding loans to SHG per extension counter (branch)	Year 1: -- Year 2: 160 Year 3: 224 Year 4: 288 Year 5: 352 Year 6: 416	Gandhinagar: Year 1: 302 Year 2: 244 Year 3: 329 Year 4: 289 Year 5: 241 Year 6: 155	Ahmedabad: Year 1: 166 Year 2: 242 Year 3: 385 Year 4: 404 Year 5: 492 Year 6: 405
(2) Number of active borrowers with individual loans + number of active borrowers of JLGs per extension counter (branch)	Individual loans: Year 3: 240 Year 4: 660 Year 5: 1,020 Year 6: 1,222	Gandhinagar: Year 3: 7 + 0 Year 4: 148 +1700 Year 5: 575 +1330 Year 6: 644 + 1774	Ahmedabad: Year 3: 9 + 0 Year 4: 314 + 2025 Year 5: 936 + 480 Year 6: 714 + 375
(3) Increase in outstanding loan portfolio by 20% per year.	20% p.a.	Year 1: 7% p.a. Year 2: 36% p.a. Year 3: 6% p.a. Year 4: 11% p.a. Year 5: 9% p.a. Year 6: 25% p.a.	

(4) Quality of lending	NPL, net (90 days) < 5%* Central principles of responsible lending are complied with (qualitative estimate)	NPL: Year 1: 5.61% Year 2: 4.12% Year 3: 4.98% Year 4: 3.03% Year 5: 1.63% Year 6: 2.40% Responsible Finance: The bank is implementing a comprehensive Financial Literacy programme. The customer focus as regards product design is good and the customer care for a bank is intensive.	
(5) Number of customers with savings in rural areas (including pension scheme)	---	Gandhinagar: Year 1: 4,347 Year 6: 21,887	Ahmedabad: Year 1: 4,810 Year 6: 24,206

*The target of 5% (NPL, net) has been adopted from the original indicator.

With the help of the project, the PEA opened two new rural branches in Chiloda (Gandhinagar District) and Sanand (Ahmedabad District) in October 2009. This enabled the Bank to broaden its loan portfolio in semi-rural and rural areas. Alongside the increase in the number of group loans to SHGs, which previously could only be disbursed through RDAs, the Bank introduced secured individual loans based on the urban business example. While the indicator for the SHG loans (Indicator 1) was achieved in nearly every year, the number of individual loans (Indicator 2, Part 1) fell markedly short of expectations. Yet if we also take into account the loans to members of JLG introduced in 2011, the total number of loans disbursed by the branches increases to the expected level again. Only in the last project year did the Ahmedabad branch just fail to reach the target. Indicators 1 and 2 can therefore be considered adequately fulfilled.

The overall loan portfolio of the Bank rose by an average of 15% p.a. during the project term, and is therefore below the expected figure of 20% p.a. (Indicator 3). Yet since more value has to be placed on quality growth in the context of the Indian microfinance sector, we deem the growth to be adequate.

The quality of the Bank's loan portfolio has improved markedly since the start of the project. The share of non-performing loans (NPL, 90 days) in the overall portfolio fell - net of provision made - from 5.6% to a good 2.4%. In the new branches, the ratio by the end of the project stood at 0.75% (Gandhinagar) and 0.65% (Ahmedabad). This can be considered a sign that the loan appraisal processes and customer relations at the Bank are appropriate. With 6.3% NPL gross - that is without deducting provisions appears slightly elevated, but corresponds with industry average. The Bank generally does not undertake any write off, wherefore bad loans remain on the bank's balance sheet. Bad and doubtful debt provisions stand at 56% of NPL. Although the Bank is a member of the High Mark credit bureau, use thereof has been limited since the database has so far not covered loans to SHGs. As part of the social cooperative movement it lays great emphasis on a responsible approach with its customers and on financial literacy. It is mandatory for borrowers to complete a comprehensive training programme, which goes far beyond providing bank and product-specific information. Improvements can still be made by establishment of a clear grievance mechanism and discussion of Responsible Finance on the policy level, e.g. by formulation and dissemination of working principles and guidelines for the staff. Indicator 4 is thus considered fulfilled.

Alongside the loan portfolio, the Bank also expanded its savings products (short and long-term deposits) in rural areas. The total number of saving accounts, including the public pension product (National Pension Scheme, NPS) introduced in 2012, rose five-fold during the project duration, while the volume of savings deposits rose six-fold – and the trend is still rising. The Bank's product range also includes insurance and pension products, which take account of customers' needs in different phases of their lives. Indicator 5 is thus considered fulfilled.

Effectiveness rating: 2

Efficiency

The provision of FC funds in the form of a non-repayable financial contribution meant the PEA was able to set up a revolving fund, which due to its equity capital nature will also be able to allocate micro-credits after the project ends. The volume of outstanding loans has more than doubled in the course of the project and risen seven-fold in rural areas. About half of the growth is attributable to the Capitalisation Fund, the rest stemming from the Banks own funds. The project's production efficiency is therefore rated good. In relative terms, the loan portfolio is still small, amounting to only 44% of the total balance sheet (2006/07: 32%). The rest of the assets are invested in government bonds and debentures of other banks.

The improvement in the portfolio quality (see above) indicates that the funds are awarded to creditworthy customers. Due to the mixed usage of credit products, it cannot be assumed that funds are always deployed at the most economically productive place. In fact, resource allocation follows the current needs of customers. Allocation efficiency is therefore considered to be appropriate. In the case of seasonal income fluctuations, the Bank now enables suitably adjusted repayment arrangements. The credit assessment process for SHG loans was placed within a systematic framework during the project and is rated as very good.

Relying on an expanded network of "progressive" female credit customers from the local community to acquire and support customers ("bank saathis") constitutes a cost-efficient way for the bank "to deliver at the doorstep". The operating expense ratio (OER), which is the ratio of operating expenses to the average credit portfolio, is at 14%, which appears to be average or slightly higher than the industry average. The ratio of operating expenses to bank business (average loan and deposit portfolio) sat below the targeted maximum of 6% in most years of the project (2013: 5.1%). No improvement trend is in sight, yet considering the fact that rural structures were completely reconstructed and the spending on IT investments was high, steady development also seems appropriate.

The interest rate of group loans amounts to 18.5% per year with a term of 24 months; the final interest on loans for SHG members totals 21% per year. Interest rates for individual loans total between 15% and 18.5% per year depending on their duration. Interest is calculated on declining balance respectively. Rates are therefore lower than those of commercial MFIs in India. Yet it has to be considered that loanees are required to save for a minimum period of three months at often negative interest rates (real terms) as well as to purchase share capital (100 INR or 5% of loan amount).

Overall, the efficiency of the project is still considered good.

Efficiency rating: 2

Impact

The overall developmental objective was to contribute to improving the incomes and the living conditions of the target group as well as support the structural development of the financial sector in Gujarat. An impact study was conducted among borrowers to assess the target achievements. However, due to methodology issues this study cannot be used to draw conclusions regarding any causal effect.

The project contributed to the improvement of living conditions among the target group by improving the supply of needs-based micro-credits to poor women in Ahmedabad and Gandhinagar. It is also now easier for them to access saving accounts. Since most of the PEA's deposit interest rates are below the inflation rate, the investment results in loss of value for customers in real terms. The advantage they gain is obviously the security of the investment and the saving discipline supported by the bank.

As to how much these credits created additional income can only be validated with reference to relevant literature, where limited access to loans is ranked as an important barrier to development for micro and small entrepreneurs (see for example: IFC 2012: Micro, Small and Medium Enterprise Finance in India). Acknowledging that not every self-selection influence can be ruled out, a quasi-experimental study (Duvendack: 2010) shows a quite significant income effect from the saving and credit activities of the Bank's members. Customers that were surveyed as part of the project-specific impact study also largely stated that their income has improved.

To what extend micro loans have been used to finance productive activities or consumption is difficult to say as the business and household budgets of customers typically merge. While SHG and JLG loans require productive purposes, which is verified after disbursement, other credit products – such as the much sought-after house construction or renovation loans – are given for consumption purposes or are only indirectly related to productive use. However, as customers' residences and workplaces are generally located in the same house, a housing loan (e.g. to install a power connection) can also generate a productive effect. Additionally, using funds for consumption purposes can produce positive effects on income equivalent to the difference in interest rates compared to alternative financing sources. Informal moneylenders in India are known for the fast provision of financial capital with interest rates above 100% p.a. Moreover, the interest rate charged by MFI, although hardly used by the Bank's customers - is higher than that of the Bank.

The descriptive results of the impact study also indicate that the project has achieved considerable socio-psychological effects. The majority of women surveyed report they enjoy greater respect in the community and more decision-making power within their household. It can also be assumed that consultation regarding entrepreneurial questions as part of the Financial Literacy programme will foster women's economic success. What cannot be expected from the programme are employment effects above and beyond the self-employment of the female customers.

Given the profile of the Bank's customers it is particularly important to comply with the basic principles of responsible finance in respect of transparency, information about risks as well as credit appraisal and monitoring. In addition to the inherent risk of over-indebtedness, the joint liability of group loans in particular can exercise social pressure on members. As explained above, the Bank confronts these unwanted effects and risks with an extensive Financial Literacy programme. The obligatory saving activity for credit customers also contributes to limiting the over-indebtedness risk.

A separate study was supposed to show the reinforcement of the Bank within Gujarat with regard to the structural development of the financial sector. This study was however not conducted. While the Bank was already considered a pioneer in lending to the urban poor before the initiation of the project, it now also offers its financial services in rural regions of Gujarat and is represented by local branches. The proportion of the rural credit portfolio rose from 6 to 19% during the project. The total credit portfolio more than doubled and saving deposits increased by fifty percent. Accordingly, the Bank's credit portfolio accounts for about 13% of MFI business volume and makes up one third of all bank loans to SHGs in Gujarat. As a customer-oriented agent bound to the principles of responsible finance, the growth of the Bank is also welcomed by NABARD. The project can therefore be considered to have a strengthening effect on the Bank and the Gujarat financial sector.

The overall developmental impact is hence considered good.

Impact rating: 2

Sustainability

The project has helped the PEA to establish a rural credit portfolio and create the necessary institutional structures and processes for the new business area. Two rural bank branches were opened as planned during the project that can be used as models for the future rural expansion of the bank. A third rural branch was established at the end of 2013 based on experiences from the pilot branches. The project has therefore generated structural effects within the Bank.

The mentality of the bank noted in the previous project to opt for the status quo in respect of organisational changes seems to have changed. The need for professionalization has been recognised and respective measures introduced, also with the support of this project. A weak point remains the strong focus of the bank on its top-management, in the shape of the managing director. The middle management level has to be reinforced to ensure the institutional sustainability of the Bank.

Except for the latest branch opened in Mehsana, all of the Bank's rural branches are already profitable and therefore meet the requirements of the Reserve Bank of India. In past years, the profitability of the entire Bank was low with an operational self sufficiency (OSS), the ratio of revenue to costs, of just above 100%, despite low funding costs (2013:109%). Yet an improvement of 2 percentage points per year, as originally intended, is considered unrealistic, especially against the background of reconstructing rural structures. The interest-free provision of FC funds made a significant contribution to the Bank's positive revenue during the project. The profit situation has increasingly improved during the project. The Bank's financing is largely secured thanks to high savings deposits.

Taking the low micro-finance penetration in Gujarat into account, the Bank can still look forward to good growth opportunities. In 2014 the Bank was authorised by the central bank to expand its activities throughout the entire federal state. The Bank is also an implementation partner of the Financial Inclusion Initiative of the new Indian central government, with the ambitious aim of providing every Indian household with a bank account allowing an overdraft by mid-2015. At the same time, competition is increasing for the cooperative bank as other banks as well as MFIs expand to Gujarat. Since the bank can draw on an extensive network of the cooperative movement to win customers – especially RDAs – and because it provides needs-based products for its target group, we do not see major problems regarding the Bank's competitiveness. The limiting factor for expansion may rather be the Bank's revenue situation. As in other states, there is a latent risk of overheating in the microfinance market in Gujarat. However, the risk is estimated low to medium due to the starting position (low market penetration) and experience with the microfinance crisis in Andhra Pradesh and subsequent awareness of stakeholders.

Due to the structural effects of the project on the project-executing agency as well as the positive growth perspectives of the Bank, the project's sustainability is considered good.

Sustainability rating: 2

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

Ratings level 1-3 denote a positive assessment or successful project while ratings level 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. Ratings 1-3 of the overall rating denote a "successful" project while ratings 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" (rating 3).