Ex Post-Evaluation Brief
MOZAMBIQUE: Rural Microfinance Bank

Sector	24030 – Financial intermediaries of the formal sector	
Projects/ commissioning parties	I) Rural microfinance bank (MFB), BMZ No. 2005 666 95* II) Accompanying measure Rural MFB, BMZ No. 2005 70 507 III) Credit lines to MFB, BMZ No. 2005 65 804 IV) Accompanying measure local development financer, BMZ No. 2005 705 23 V) Rural MFB II, BMZ No. 2008 66 699*	
Project-executing agency	MFB under private law	
Year of population/year ex-post evaluation report: 2011/2013		
	Project appraisal (planned)	Ex-post evaluation (actual)
Investment expenses (total in million)	I) EUR 1.00 (MFB) II) EUR 1.00 (AM) III) EUR 7.36 (credit l.) IV) EUR 1.20 (AM) V) EUR 3.00 (MFB II)	I) EUR 1.0 (MFB) II) EUR 1.0 (AM) III) EUR 7.24 (credit l.) IV) EUR 1.2 (AM) V) EUR 2.8 (MFB II)
Own contribution	-	-
Total financing (m), thereof BMZ funds	EUR 13.56 EUR 13.56	EUR 13.24 EUR 13.24

* Projects in random sample 2011

Short description: The rural microfinance bank (MFB) was established in the mid-2000s in Maputo, but only commenced operating about 2 years later. On its foundation, the owners were the German FC (20%), a local development financer and other international donors and financial institutions. As a full bank, the MFB was intended to provide financial services to micro, small and medium-sized companies (MSMEs) preferably in rural areas, while the lending portfolio of the participating local development financer was to be taken over by the MFB. Initially, EUR 1.0 million was set aside for the fiduciary equity capital contribution of the FC. The management of the bank, provided by the consulting arm of one of the participating owners, was initially co-financed by an accompanying measure (AM) (EUR 1.0 million). Moreover, the MFB was to function as an apex institution for small microfinance institutions (MFI) in rural areas. Through a AM of EUR 1.2 million, the participating local development financer was to be restructured to create a purely SME consulting institution. Due to the MFB's performance, which was far less successful than planned, at the end of the 2000s EUR 2.8 million of additional equity was made available by the FC by means of an equal capital increase of all shareholders. The MFB was also supported indirectly via a subsidy (totalling EUR 7.24 million), the majority of which (EUR 6.36 million) went to the Mozambican central bank as the recipient. EUR 3.36 million of this amount was passed onto the MFB in the form of credit lines for other MFIs and EUR 3.0 million for SMEs. The credit lines were converted into equity (EUR 3.68 million) partly for the financing of the share of the local development financer in the MFB capital increase. The remaining EUR 0.89 million of the subsidy was allocated to covering consulting costs and primarily to a fund that provides consulting services to MFIs, which is supported from other sources by the FC. The latter funds are not evaluated here, since the project has not yet been completed.

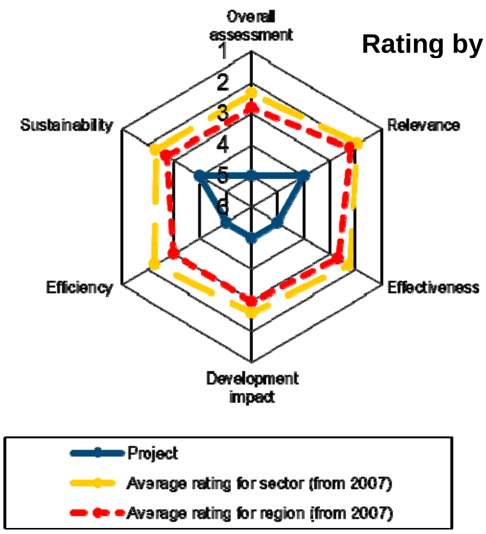
Objectives: In real terms, the aim of the projects was to improve the access of MSMEs to financial services, particularly in rural areas (project objective) and thus promote the creation of jobs and the reduction of poverty (primary development goals). At the financial sector level, the projects were intended to lead to the creation of innovative financial products for agricultural companies and thus to a deepening of the financial sector (primary objective). **Target group:** MSMEs in rural and urban areas as well as economically active, relatively poor households.

Overall rating: : I) 5, III) 5, V) 5

Over the period until 2012 covered by the evaluation, the MFB did not succeed in passing the threshold for financial sustainability. In the period covered, there were high levels of investment in infrastructure without an appropriate number of clients. In light of this development being far below that originally planned, the value of the equity shares fell rapidly. The shares held by the FC were finally transferred to the local development financer almost free of charge in 2012.

Points to note: In light of the competition situation in urban areas and the barriers to providing services to rural areas, the stated objectives were too ambitious from the outset. Disagreements within the MFB regarding strategy made it more difficult to adapt the strategy to the unexpectedly sluggish performance.

Rating by DAC criteria



EVALUATION SUMMARY

Overall rating:

By the time the decision was taken to transfer the FC shares at no charge, the rural micro-finance bank (MFB) promoted with FC funds had not succeeded in developing a sustainable business strategy and achieving cost recovery.

The great loss in value of the shares originally acquired for about EUR 3.8 million in total, which did not bring about any appropriate effects neither in the area of developing the institution nor supplying services to clients, results in the trustee participations (equity capital contribution at foundation and capital increase) being rated overall as clearly inadequate.
Rating: I:5, V:5.

In the period under review, about EUR 3.68 million of the subsidy funds of EUR 6.36 million that, via the Mozambican central bank, were to indirectly benefit the MFB as refinancing for SME and MFI loans, were converted into equity and used to fund the participation of the local development financer in the capital increase of the MFB. Although microfinance banks and MSMEs that operated sustainably were also funded by this refinancing, ‚the effect of the subsidy, in so far as it benefited the MFB indirectly, is rated as clearly inadequate due to the great decline in value of the shares and the development of the MFB being far below expectations.

Rating III: 5

Relevance

The provision of the rural population, and in particular of MSMEs, with financial services is of great importance to the Mozambican economy. Access by MSMEs to financial services can promote the economic development of these companies. They gain the opportunity to engage in investments that boost their productivity and may have a positive impact by increasing incomes and reducing poverty.

The objective of improving access to financial services for MSMEs corresponds to the goals of German-Mozambican development cooperation and its focus on "sustainable economic development". In the financial sector, German FC took on a leading role in donor coordination. Cooperation between the donors is good.

However, from today's perspective, the specific design of the project exhibits some weaknesses. The MFB was conceived as an agriculturally-oriented bank and was consequently to expand rapidly into rural areas. As business operations in rural areas are far more costly and complicated, while the economic performance of the population, which mainly engages in subsistence farming, is only very weak there, it was from the start, in our opinion, open to question as to whether the rapid establishment of an expensive network of branches with only moderate economic activity could succeed sustainably. An alternative way of gaining a foothold in rural areas would have been first to create a solid basis in the economic centres and then, with stable foundations, to expand into rural areas by cross-subsidising rural expansion for a time with the proceeds from urban business operations. Against this backdrop, it is necessary to ask whether expansion into the rural areas might not have been better achieved by an existing bank rather than a newly-established one.

Furthermore, the provisions for restructuring the local development financer to create an MSME consulting organisation and the spin-off of the credit business to the newly-created MFB were insufficient. The local development financer was under no clear obligation to transfer the entire portfolio. Even though the restructuring of the institution was supported by an accompanying measure, the conception of the MFB project appears to follow, above all, a classic 'greenfielding' approach, while the specific stakeholder configuration and related incentive mechanisms were more complicated than in the case of the simple establishment of a new bank. The project conception in which, together with a new partner, an innovative bank for rural areas was to be developed on the basis of an already existing external lending portfolio, appears overambitious from today´s perspective: the complexity of the project with its multidimensional system of objectives (restructuring of the existing local institution, development of the MFB and of innovative products for the rural areas) was underestimated ex ante.
Despite essentially reasonable objectives, due to the less than optimal conception of the project we arrive at a rating of the project's relevance as just below satisfactory.

Sub-Rating: I: 4, III: 4, V: 4

<u>Effectiveness:</u>

The programme objective was to develop a microfinance bank (MFB) that operated sustainably and served particularly those customers in rural areas.

The selection of the indicators and assignment of benchmarks to them for the achievement of the project objective did not correspond to the "state of the art" customary in the financial sector in all respects. For indicators such as the target number of customers or the lending volume, unrealistically high target values were established ex ante and no indicators were defined that evaluate the quality of the activities or the operational and financial sustainability. Therefore, a portfolio at risk > 90 days of less than 5% and a positive real return on investment were defined as additional indicators for the purposes of the evaluation.

Several Indicators fell considerably short of their target value. The number of customers reached in 2010 was only a third of the planned figure. At no time before 2011 did the bank achieve a positive real return on equity. Due to personnel and material costs, the administrative expenses repeatedly exceeded the bank's income. The high losses eroded the MFB´s own capital. Overall, prior to the transfer of the FC shares[1], the equity had to be increased twice (on the second occasion without the participation of the German FC) to secure the continued existence of the bank. The portfolio at risk (PaR) of the MFB disclosed in the financial

[1] In legal terms, this was a sale at the symbolic price of USD 10

statements remained below the required benchmark for the portfolio as a whole. Nonetheless, it is impossible to make precise statements regarding the indicator PaR > 90 days, since in Mozambique it is lawful to convert defaulting loans into overdrafts, meaning that comparability with the indicators that are otherwise customary in FC cannot be achieved.

Among the reasons for the poor performance of the bank were the deficiencies in its strategic orientation, which have already been addressed under Relevance, and which resulted in a fast expansion into rural areas that was associated with correspondingly high costs. The management team possessed many years of professional experience. This was, however, not enough to make up for a lack of practical experience in the context of a developing country and insufficient familiarity with the local circumstances. The problems encountered when developing the bank also led to the local shareholder not transferring the whole of its existing lending portfolio to the MFB and continuing to operate part of its loan business. Despite the endeavours of FC to bring about changes in the strategic orientation and to create a business plan with realistic figures and targets, it was not possible to achieve agreement on this.

The clear failure to fulfil the targeted project objectives means that the effectiveness of the projects can only be rated as "inadequate".

Sub-Rating: I: 5, III: 5, V: 5

<u>Efficiency</u>

As the FC involvement in the MFB is set against effects that are rated as inadequate, and since it moreover seems plausible that a comparable involvement in an existing (microfinance) bank would have offered a, by comparison, better basis for creating access to financial services in rural areas, both the production and allocation efficiency are also rated as inadequate.

Sub-Rating: I: 5, III: 5, V: 5

<u>Impact</u>

Prior to the withdrawal of FC, the MFB made no significant contribution to the development and expansion of the financial sector. Until then, the bank's operations were not financially sustainable. Nor did it introduce any innovative financial products tailored to the needs of the target group consisting of rural MSMEs.

The limited positive impact of the bank is also reflected in the high average volume of lending and comparatively small number of loans overall. Further evidence that the target group of MSMEs was not reached is provided by the fact that in 2009 the 10 biggest loans made up 50% of the lending portfolio as a whole.

Nor was the intended separation of the lending business and consulting activity of the local development financer and shareholder achieved. It continues to offer both services.

These findings lead us to conclude that the primary development impact must be rated as inadequate.

Sub-Rating: I: 5, III: 5, V: 5

Sustainability

The shares held by FC were transferred to the local shareholder at (almost) no charge. At the time of the transfer, it could not be foreseen whether the development of an institution, which can sustainably serve rural areas without ongoing support, would yet succeed. For the FC involvement, the sustainability of the effects achieved is therefore classified as unsatisfactory.

Sub-Rating: I: 4, III: 4, V: 4

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:

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

Ratings 1-3 denote a positive or successful assessment while ratings 4-6 denote a not positive or unsuccessful 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).