Ex post evaluation – Nigeria

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Sector: Sustainable economic development, CRS 2403000
Programme/Project: Promotion of a microfinance bank, BMZ No. 2010 67 263, Basic and advanced training measure BMZ No. 1930 04 116
Implementing agency: New Nigerian microfinance bank

Ex post evaluation report: 2015

	(Planned)	(Actual)
Investment costs (total)	1.40	1.23
FC fiduciary holding	0.83	0.66
KfW investment holding	0.57	0.57
Basic and advanced training measure	0.67	0.67

*) Random sample 2015

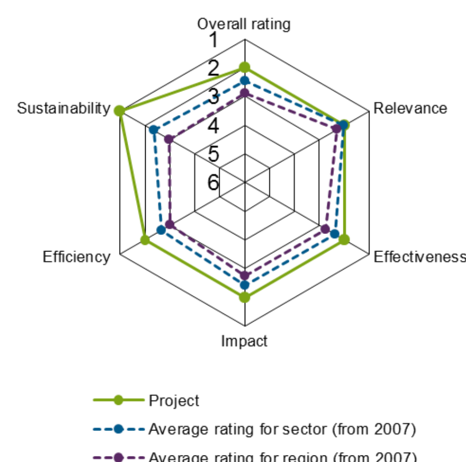
Summary: The Nigerian financial sector was not efficient enough to offer adequate target-group-specific financial services (FS) to the poor population as well as micro, small and medium-sized enterprises (MSMEs). The development deficits were to be made up by means of various individual projects in the Nigerian microfinance programme (MINGA), including the FC project "Promotion of a Nigerian microfinance bank", which was designed to further increase the supply of sustainable FS for Nigerian MSMEs.

Objectives: The overarching development objective of MINGA was to help improve the framework conditions for MSMEs as well as integrate poor parts of the population into a sustainable growth process. The aim of the FC measure was to increase the sustainable supply of market-oriented financial services for MSMEs in urban and rural Nigeria, including microloans (ML), savings products and payment transactions.

Target group: The target group was ultimate borrowers in urban and rural Nigeria. This included MSMEs as well as the poor, economically active households behind the companies. The target group was reached indirectly via the promoted microfinance institutions (MFI).

Overall rating: 2

Rationale: The project approach (supporting the establishment of the MFI) was tailored well towards the requirements of the target group in light of the target group's poor access to needs-based financial services as well as the fragmented and weak microfinance sector. Since its foundation the MFI has established itself as one of the leading microfinance institutions in the sector. The introduction of electronic banking services and the increased harnessing of potential to reduce operating costs will further boost the appeal and the efficiency of the services. It is assumed that the bank's earnings position and operational resilience mean it can run sustainably without further donor support.



Highlights: By focusing on the gap in supply between informal financing and microloans on the one hand and corporate finance from commercial banks on the other, the establishment of the MFI – like the cash-flow based lending technology – constitutes a meaningful addition to the Nigerian microfinance sector.

KFW

Rating according to DAC criteria

Overall rating: 2

General conditions and classification of the programme

The FC investment in the foundation phase of the Nigerian microfinance institution (MFI) was one of three investment components of the FC microfinance programme in Nigeria, which also provided for the creation of another microfinance bank (BMZ No. 2010 67 255, in operation since 2013), the establishment of a Nigeria window in the microfinance (MF) fund REGMIFA (BMZ No. 2009 67 174) and personnel support measures for the various components.

Relevance

Although access to financial services in Nigeria has improved significantly since the project appraisal, lack of access continues to be a major obstacle to the economic activity of small businesses and the financial management of households. Informal financial instruments (moneylenders, savings clubs, neighbourhood assistance) result in higher borrowing costs and erratic availability, the reduced risk and income diversification of savings, or an insufficient ability to hedge life or business risks. Furthermore, in Nigeria it has been possible to confirm the results of international studies which find that households with access to financial services are less compelled to restrict their consumption patterns in the event of income-related shocks (smoothing effect).

The microfinance sector in Nigeria was very fragmented at the time of the project appraisal, with more than 900 largely underperforming institutions with small reach and non-transparent ownership structures and interests. The establishment of a new bank, equipped with a strong capital base, professional and internationally experienced management, a growth-oriented approach and, most importantly, lending technology which is adapted to the characteristics of micro, small and medium-sized enterprises, was a useful complement to the existing market structure. The bank is focused on a particularly serious and – given the employment effect of SMEs – developmentally relevant market gap between microloans and informal sources of financing on the one hand and the corporate financing of commercial banks on the other. For most microloan (ML) and many SME customers, the bank is their first point of contact with formal financial services.

The project forms part of the Nigeria Financial Inclusion Strategy 2020 of the central bank, which seeks to expand access to and the use of regulated financial services, as well as part of the financial concept of the BMZ, which includes the creation of professional financial institutions as a means of increasing the economic participation of excluded sections of the population. The project, as a co-financing measure, is harmonised with the activities of other public (IFC, AfDB) and private investors in Nigeria and is complementary to microfinance (MF) capacity support by TC and other donors (especially DFID).

Relevance rating: 2

Effectiveness

The project objective was to increase the sustainable range of market-oriented and needs-based financial services available for micro, small and medium-sized enterprises in urban and rural areas of Nigeria, including microloans, savings products and payment services. At the time of the ex-post evaluation, the programme objectives – measured against the indicators defined at the programme appraisal – had either been met or exceeded. Indicators 3b and 4b were added at the ex-post evaluation to complement the respective underlying indicators.

Indicator	Status PA	Ex post evaluation
(1) Credit portfolio (volume, number of loans), end of 5th financial year	Status at PA - volume: EUR 4.36 million, number: 6,177 Target value at PA - volume > EUR 15 million, number > 18,000	Credit portfolio: EUR 39.8 million, > 37,500 outstanding loans
(2) Deposits (volume, number of accounts), end of 5th financial year	Status at PA - volume: EUR 0.69 million, number: 13,062 Target value at PA - volume > EUR 5 million, number > 35,000	Deposit volume: EUR 4.6[1] million, approximately 81,000 accounts
(3) Annual average proportion of non-performing loans (default in payment > 30 days) < 3 %	Status at PA: PAR30: 0.46 % Target value at PA: < 3 %	PAR30: 2.0 %
(3b) Depreciation rate	Target value: < 2 %	Write Off Rate: 0 %
(4) Operational Self Sufficiency (OSS)[2], end of 5th financial year	Status PA: 69 % Target value at PA: > 100 %	OSS: 112.7 %
(4b) Return on equity	Target value: > 15 % p.a.	Return on equity: 18.6 %

The MFI was founded in 2008 and at the end of 2014 had more than 100,000 customers, of which 59 % are female, with an average age of 40. Of these, 40,000 are microloan (ML) customers, 100,000 hold a savings account and approximately 20,000 use loan and savings products. Micro and SME loans (ML Ø EUR 955, SMEs Ø EUR 13,750) are largely used to finance ongoing business operations. The bank is constantly adding to its product range and preparing the introduction of new technologies geared towards customers’ needs (e-banking). Processes and products are made transparent for customers. Prior to the conclusion of a loan agreement, as well as at the point of disbursement, payment obligations are discussed intensively with customers, spouses and guarantors. These groups are also provided with account balance information on a regular basis.

Around 60 % of current borrowers were existing customers, which suggests good customer loyalty given the strong growth of the portfolio. While credit customers want lower interest rates and more flexible repayment plans, they also value the rapid and reliable processing of loan applications. The branch locations and presence are well aligned with the target group.

Since its foundation, the MFI has expanded its business along a stable growth trajectory and increased lending by approximately 30-40 % p.a. With a gross loan portfolio of EUR 39.8 million at the end of 2014, the MFI is one of the largest banks in the microfinance sector. It is, however, significantly smaller than the market leader, which had a loan portfolio of EUR 176 million and 720,000 borrowers at mid-2014 (most recent public figures) and offers group loans in the lower ML segment (ML ø EUR 244).

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[1] The indicator is considered achieved since when the exchange rate at the project appraisal (NGN 194/EUR) is used, the deposit volume at the end of 2014 amounts to EUR 5.3 million. If the exchange rate at the ex-post evaluation (NGN 225/EUR) is used, the target level of EUR 5 million by February 2015 has been exceeded.

[2] OSS = financial revenue / (financial expense + loan loss provision + operating expense)

When it comes to reducing financing costs and stabilising sources of funding, the MFI attaches a great deal of importance to mobilising deposits. However, in an environment dominated by the distrust of microfinance banks, the bank has not yet developed a resoundingly successful approach. At the end of 2014, deposits made up less than 12 % of the loan portfolio and just under 10 % of total assets. Through the introduction of mobile transaction options, the bank expects to be able to make its range of savings products more attractive for customers thanks to the improved availability of savings contributions and the reduction of transaction costs.

In the lending business, the bank prioritised credit quality over growth and the reduction of operating costs. This quality is reflected in the relatively low rate of late repayment for the loan portfolio (Portfolio at Risk 30 days, PAR30), which has, however, increased slightly since early 2015 as a result of external factors (2 % at the end of 2014). No receivables were written off in 2014.

The basic and advanced training measure has made an essential contribution to the achievement of objectives through capacity support and the training of key staff. The Management Service Contract (MSC) between the bank and a consulting firm in the banking network was financed on a proportional basis. The consultant team occupied key management positions in the foundation phase, trained the first generation of local staff (the majority of whom still work at the institution) and selected employees to fill numerous middle management positions (branch manager, department head at the head office). Since 2012, the bank has financed the MSC with a limited range of services from its own income.

Effectiveness rating: 2

Efficiency

The efficiency of the project in the provision of financial services to the target group is assessed on the basis of the productivity and profitability of the institution as well as on the basis of the transaction costs from the perspective of the target groups.

The MFI achieved a positive result in its third full year of operation (2011). Since then, the earnings situation has been positive but volatile due to the institution's early growth phase. The bank's earnings situation is affected by a high cost base, but seems justifiable against the backdrop of its foundation and the nature of its core business. In addition to a significant equity share (year-end 2014: 23.4 %), the bank is largely funded by international MF funds and shareholder loans (54.4 %), which results in considerable financing costs (weighted cost of capital around 20 % p.a.). These costs are, however, in line with market levels[3]. In light of the low mobilisation of deposits, the bank continues to rely on international sources of debt capital to finance portfolio growth. Deposit mobilisation and local capital market instruments will only have a significant cost-saving effect in the medium to long-term.

The bank is endeavouring to reduce its operating costs. In 2014, for example, more use was made of existing resources (e.g. no new branches), with the result that the cost-income ratio fell to a still high 77.2 % (end of 2014) and a good return on equity of 18.6 % was achieved (taking into account the inflation rate of around 8 % in 2014). Profitability is expected to decrease significantly in the short term as the result of the current deterioration of portfolio quality, the regional expansion process, and capital-intensive investments in internal systems and technologies. Due to the regulatory restrictions of the microfinance banking licence, the MFI cannot reduce operational costs by significantly increasing the average volume of loans. However, even if the product focus remains unchanged, the bank has unused productivity potential which could be enhanced by more intensive use of the increasingly robust IT infrastructure and of electronic transaction technologies, for example by means of a shift from bank counter transactions to mobile devices or the use of ATMs. Due to low levels of competition, the bank has thus far been able to compensate for the high cost base through relatively high interest rates on loans (annual percentage rate of around 40 % in the SME segment and 65-80 % p.a. in the microloan segment). The bank's interest rates on loans are, however, comparable to those of its national competitors.

The bank is sufficiently capitalised with a capital adequacy ratio of 24.9 % (end of 2014) and is well above the regulatory capital requirement of 10 %. The bank achieved a 3.3x leverage of the equity capital (debt to equity) through mostly public funds, and thus also of the FC contribution. In the further growth process,

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[3] in particular USD/EUR (covered against exchange rate risks), duration 2-4 years, 16-21 % p.a.

the equity capital can be leveraged even further for the additional provision of services and development effects.

Transaction costs are still high from the customer's perspective, which is typical of microfinance markets in the early stages of development. Loan disbursements, monthly interest payments, principal payments, deposits and savings withdrawals, for example, all require a branch visit, and therefore result, among other things, in time losses (loss of income) and travel expenses. The short to medium-term introduction of mobile payment options is therefore also important from the point of view of efficiency, and will contribute to the reduction of transaction costs for all involved.

This means in future that the bank can reduce operational costs by expanding its operations and through more efficient processes and increased IT usage, as well as reduce financing costs in the medium-term through the diversification of its liabilities structure (increasing funding through customer deposits and the local capital market) in order to further increase efficiency in the achievement of the project objectives.

Efficiency rating: 2

Impact

The overarching development objective was defined as helping to improve general conditions for MSMEs and integrate poorer segments of the population into a sustainable growth process. Although Nigeria's economic development has been positive since the project appraisal, it remains significantly below its potential. The lack of economic infrastructure, limited financial intermediation, inadequate social infrastructure and the state's low ability to exert control are all obstacles to development.

Indicator	Status and target value at Project appraisal	Ex post evaluation
(1) Nigeria's ranking in the World Bank's Doing Business Report	Status at PA: 125 Target value at PA: < 100	Status at EPE: 170
(2) Proportion of the Nigerian population with a bank account	Status at PA: 21 % Target value at PA: ≥ 25 %	Status at EPE: 48.6 %[2]
(2b) Private sector liabilities due to local financial institutions in relation to GDP	Status at PP: 15.4 % Target value: increasing	Status at EPE: 14.6 %
(3) Nigeria's score in the Global Microscope on Microfinance Business Environment	Status at PA: 39.4 Target value at PA: ≥ 50	Status at EPE: 50

[2] 48.6 % of the adult population have, or have indirect access to, a bank account and are therefore categorised as 'financially included' (EFInA 2014)

The indicators for the overall developmental objective have largely been met. The challenging conditions for investment are reflected in the Doing Business Report (DBR). In 2010, Nigeria was significantly below (better than) the average for sub-Saharan Africa (125/139), while in 2014 it was significantly higher (worse) at 170/142. Due to its methodology, however, the DBR is of limited use when it comes to assessing the business climate for micro-enterprises. Financial intermediation of private business relationships through the local financial sector is low, at approximately 15 %, and well below the SSA comparison value (47.7 % in 2014).

The microfinance sector in Nigeria has had a limited reach up to now, and is estimated at 2.6 million customers. However, many accounts are used as joint accounts, meaning that the population actually reached is greater than the number of individual customers. Furthermore, commercial banks and insurers

have expanded their customer numbers since the project appraisal, with the result that the access indicators have improved significantly.

By financing MSMEs and economically active households, the project contributes to the achievement of income and employment effects and to increasing the resilience of households to external shocks (the smoothing effect mentioned above).

The bank adheres to principles of responsible finance.

Impact rating: 2

Sustainability

The sustainability of the project is determined by the development of the bank's profitability (financial sustainability) as well as by its operational resilience (operational sustainability).

In the initial phase, the bank was supported by risk-bearing equity investments and grants for the MSC. While the shareholder structure has not changed since the foundation phase, the bank is – thanks to the profitability situation – no longer dependent on the shareholders' capital increases, and will instead be able to finance the organic growth of business activity and investments in internal systems and capacities internally in the coming years. In addition, the bank is becoming increasingly attractive for a wider range of investors, and so changes in the shareholder structure towards a more private sector-oriented composition are possible.

From an operational perspective, the internal systems and processes of the bank are solidly positioned and, in addition, are quality-assured by the parent holding company. The bank adapts its products on an ongoing basis and is therefore sufficiently able to react to market changes even without the institutionalisation of a product development/marketing team. This ability to react could be further enhanced by means of the systematic analysis of customer data. In terms of personnel, the MFI recorded a high number of sufficiently qualified candidates at the entry level who undergo well-structured introductory training and who to date have produced sufficient young talent for middle management. When it comes to top management and specialist positions, the bank is in intense competition with other employers for local staff. However, it is able to call on experts thanks to the MSC. Although risk management is currently spread across different functions and is focused on credit risk, it is still sufficient given the simple business model. Due to the growing diversification of the financing structure (e.g. deposit mobilisation) and increasing complexity of business activities, the planned creation of a comprehensive risk management process which includes holistic risk assessment is an important development. Internal systems are sufficiently robust to ensure the sustainable provision of demand-driven financial services.

From a regulatory perspective, the bank's business model is exposed to various risks. Consequently, specific exemptions are required from the central bank for deviations from the specifications of the MF banking licence, such as for the share of the SME loan portfolio in the total portfolio, for example. The bank's good standing with the central bank as a result of its solid financial positioning may reduce this risk to some extent.

The bank adheres to principles of responsible finance.

The sustainability of the effects achieved by the bank even after the direct donor support ends thus appears high, and will rise even further with the growth of the bank into new regions, and as the result of new products and banking technologies.

Sustainability rating: 1

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Notes on the methods used to evaluate project success (project rating)

Projects (and programmes) are evaluated on a six-point scale, the criteria being **relevance, effectiveness, efficiency** and **overarching developmental impact**. The ratings are also used to arrive at a **final assessment** of a project's overall developmental efficacy. The scale is as follows:

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

Rating levels 1-3 denote a positive assessment or successful project while rating levels 4-6 denote a negative assessment.

Sustainability is evaluated according to the following four-point scale:

Sustainability level 1 (very good sustainability): The developmental efficacy of the project (positive to date) is very likely to continue undiminished or even increase.

Sustainability level 2 (good sustainability): The developmental efficacy of the project (positive to date) is very likely to decline only minimally but remain positive overall. (This is what can normally be expected).

Sustainability level 3 (satisfactory sustainability): The developmental efficacy of the project (positive to date) is very likely to decline significantly but remain positive overall. This rating is also assigned if the sustainability of a project is considered inadequate up to the time of the ex post evaluation but is very likely to evolve positively so that the project will ultimately achieve positive developmental efficacy.

Sustainability level 4 (inadequate sustainability): The developmental efficacy of the project is inadequate up to the time of the ex post evaluation and is very unlikely to improve. This rating is also assigned if the sustainability that has been positively evaluated to date is very likely to deteriorate severely and no longer meet the level 3 criteria.

The **overall rating** on the six-point scale is compiled from a weighting of all five individual criteria as appropriate to the project in question. Rating levels 1-3 of the overall rating denote a "successful" project while rating levels 4-6 denote an "unsuccessful" project. It should be noted that a project can generally be considered developmentally "successful" only if the achievement of the project objective ("effectiveness"), the impact on the overall objective ("overarching developmental impact") and the sustainability are rated at least "satisfactory" (level 3).