Ex post evaluation – Nigeria

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Sector: Sustainable economic development, CRS 2403000
Project: Establishment of a micro-finance bank, BMZ no. 2010 67 255* and BMZ no. 1930 04 710 (training component)
Implementing agency: Newly created Nigerian micro-finance bank

Ex post evaluation report: 2018

		Project (Planned)	Project (Actual)	Training component (Planned)	Training component (Actual)
Investment costs (total)	EUR million	2.00	1.15	1.00	0.55
Counterpart contribution	EUR million	0.00	0.00	0.00	0.00
Financing	EUR million	2.00	1.15	1.00	0.55
of which BMZ budget funds	EUR million	2.00	1.15	0.00	0.55

*) Random sample 2015

Summary: The programme is part of Nigeria's micro-finance programme (MINGA). To complement the creation of another micro-finance bank and the regional MSME investment fund for Sub-Saharan Africa (REGMIFA), a micro-finance bank (MFB) was established in the state of Oyo. This programme includes the investment in the bank's share capital (EUR 2 million) and the implementation of a training component (EUR 1 million). The majority (50.1%) of the share capital of NGN 1 billion is held by an international banking group; other shares were purchased by FC (17.5%), IFC (17.5%) and the Dutch FMO (15%). In addition, EUR 1 million was provided for further increases in equity capital as part of an anticipated appraisal. A total of EUR 150,000 was paid in at the end of 2017, whereas the remaining EUR 850,000 will be paid in during 2018. Apart from the IMF, the other donors also increased capital at the same time, meaning that the FC's share is now around 20%.

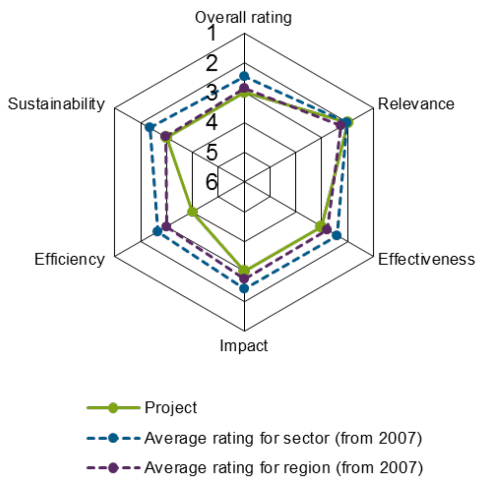
Development objectives: Programme objective (overall programme): contribution to improve the underlying conditions for MSMEs and to integrate poorer social strata into a sustainable growth process. Module objective: expand the sustainable offering of market-oriented and needs-based financial services for MSMEs in urban and rural areas of Nigeria (including micro-loans, savings products and payment transaction services).

Target group: The target group is MSMEs and the poor, economically active households behind these businesses.

Overall rating: 3

Rationale: The foundation of a new micro-finance bank outside the Lagos metropolitan area but still in an economically active region was well tailored to the needs of the target group and the country. However, the establishment of the bank was delayed and the country was hit by an economic crisis just as the bank started to grow out of the start-up phase, which impacted the project. Despite the strong approach, the bank has been unable to make its business activity economically sustainable, where its high operating costs could be covered. The management team is attempting to deploy an expansion strategy to solve these problems.

Highlights: Despite the difficult environment, the bank has shown considerable growth in some areas. A significant portion of the losses sustained to date were caused by exchange rate risks because some refinancing funds have to be paid back in US dollars while funds are loaned in local currency.



Rating according to DAC criteria

Overall rating: 3

Ratings:

Relevance	2
Effectiveness	3
Efficiency	4
Impact	3
Sustainability	3

Relevance

The target groups of micro-, small- and medium-sized businesses and poorer sections of the population lacked access to financial services that would enable them to integrate into and benefit from growth processes in the Nigerian economy. As was previously the case, financial services and the regulatory environment are not oriented enough towards the target group. Furthermore, the country's micro-finance sector is also highly fragmented with over 1,000 low-performance, unprofessional MFIs. With the original three components of the “Nigerian micro-finance programme”, the programme was geared explicitly towards this core problem. However, only two of the three intended components (establishment of a new micro-finance bank[1] and the project at hand) were actually implemented. From today's perspective, the identical chain of cause and effect applied to all three components remains plausible. This chain is based on a quantitative and qualitative expansion of the range of financial services offered to poor, economically active households and MSMEs in Nigeria and aims to reinforce the performance capacity of the promoted micro-finance institutes. Consequently, the programme was designed to make an important contribution to solving structural deficits in the Nigerian micro-finance sector. Taken as a whole, this also helps to integrate poor parts of Nigeria's population into a sustainable growth process, also by creating jobs at the financed MSMEs. This fits in with the central bank's Nigeria Financial Inclusion Strategy 2020, which aims to expand access and use of regulated financial services, and also complements the financial sector concept of the Federal Ministry for Economic Cooperation and Development's (BMZ), which comprises the expansion of professional financial institutions as a tool for increasing economic participation among excluded population groups. It is also blends well with the activities of other public (IFC, ADB, REGMIFA) and private investors in Nigeria. Through its joint partnership in the bank, the programme also represents a direct cooperative relationship with other development institutions and complements measures related to micro-finance capacity support applied by German TC (“Broad-based growth and employment promotion in Nigeria”, SEDIN) and other donors. The recent establishment of a “Development Bank of Nigeria”, driven primarily by the World Bank, is a logical enhancement and potentially very important in view of the refinancing opportunities for MFIs.

The creation of a micro-finance bank with a professional management team with international experience, credit technology adapted for the nature of MSMEs and a solid capital basis is generally a logical addition to the existing market structure in view of the existing fragmented environment. Therefore, the micro-finance bank – like the micro-finance bank already evaluated – fills an important gap in the market between micro-loans and informal financing sources on the one hand and corporate financing from commercial banks on the other. In view of the already fragmented micro-bank market, it would have been advisable to consider supporting an existing bank instead of setting up a new one. However, a very large majority of MFBs are exceptionally small. In terms of size, only six (or based on structure, only two or three) existing MFBs would have come into question and it is uncertain whether they would have been interested in cooperating in the project and, more importantly, adjusting their style of work accordingly. However, in view of Advans MFB's regional focus on the state of Oyo – where there is actual demand for a larger, professional MFB – and in light of the fact that a new bank will enable a suitable strategy to be

[1] BMZ no. 2010 67 263, evaluated in 2015 with an overall rating of 2

implemented in a much more stringent manner by the internationally experienced Advans group, it appears completely reasonable to enter into the risk of setting up a new bank. In this context there are two key factors to consider: the transfer of knowledge through the training component and the support provided by an internationally experienced executing agency like the parent banking group, who can provide the country's economy with important impetus for a professionally structured micro-finance sector. More importantly, the parent banking group can also contribute to loans being issued using internationally recognised methods and on a rational, verifiable basis, while also making it more difficult for personal and relationship-driven criteria to be used for decision-making. This argument also favours the creation of a new bank over cooperating with an existing one which may have less transparent structures.

Relevance rating: 2

Effectiveness

The goal of the programme was to develop a sustainable offering of market-oriented and needs-based financial services for SMEs, including micro-loans, savings products and payment transaction services. The project objective was designed to address the poor performance capacity in the financial sector and thus contribute to the achievement of the ultimate objective. The target group is small and micro-enterprises and the poor, economically active households behind these businesses.

Indicator	Status PA, Target value PA	Ex post evaluation
Loan portfolio by the end of the fifth financial year*	At least EUR 15 million with at least 18,000 loans	Not formally achieved (EUR 9.5 million / 10,632 loans; if the exchange rate at PA had been set as a basis then the volume target would have been achieved with EUR 18.3 million)
Deposits by the end of the fifth financial year*	At least EUR 5 million with at least 35,000 deposits	Amount not achieved (EUR 2.2 million or EUR 4.1 million (exchange rate 2010)); quantity exceeded with 37,204 accounts but only with 21,907 deposit accounts.
Proportion of non-performing loans (payment default > 30 days)	Annual average < 3%	Achieved (2.65%)
Operating self-sufficiency by the end of the fifth financial year*	>100%	Achieved apart from 2016 (2017: 101.1%)

* The end of the fifth financial year occurred in 2017 as the bank did not receive its licence until 2013.

** = Operating self-sufficiency = (Net financial income + loan loss provisions) / Operating expenses > 100%.

The indicators applied to assess target achievement were not fully achieved. The quantity of loans was a long way from the target. The anticipated amount in the loan portfolio was achieved when the exchange rate from the project appraisal is applied but missed when the current exchange rate is used (see table). Due to the general difficulty in acquiring deposits in Nigeria, the total holdings were below expectations using both the current and previous exchange rates; the number of deposit customers, on the other hand, exceeded expectations. At 2.65%, the indicator for the proportion of non-performing loans (PAR 30) was more than met, which is a very important indicator and reflects professional standards of bank management. Apart from the crisis year 2016, the operating self-sufficiency target was also met, although it was always only just over the 100%-mark. Depreciations on non-performing loans lay between 1.7 (2015) and 3.3% (2017), though increased to 6.5% in the crisis year of 2016.

Despite this mixed picture, which is unfortunately also marred by ongoing negative interest on equity and very high operating costs (see Efficiency), there are also signs of positive development. In recent years, the number of borrowers and the portfolio have grown significantly. Despite a slight downturn in 2017, deposits have more than doubled since 2015, even when faced with an economic crisis. At 62%, the proportion of repeat loans also reflects a highly consistent business. Despite not reaching its target indicators, which were very ambitious for a new institution, the bank is still on a stable growth trajectory. In view of the professional management team, who are very familiar with the difficulties affecting MFBs, the bank can expect to meet all target indicators within two to three years.

Effectiveness rating: 3

Efficiency

The efficiency of the programme is evaluated based on the bank's productivity and profitability as well as on transaction costs from the target group's perspective.

Since operations began in 2013 following an approximately 9-month delay, the MFB has only recorded a balance sheet profit once, in 2015. The NGN 280.6 million (EUR 1 million) loss in 2016, caused by exchange rate problems2, was particularly bad, with both exchange rate losses of NGN 258 million (EUR 0.92 million) and the economic crisis making their mark. Although a slight profit is expected in 2017, it must be stated that the bank is worse off now than it was at the beginning, even after a recent capital increase. It is also important to note that the bank has yet to become economically sustainable, whereby at least the real value of equity is retained. The cost-income ratio is very high, partially more than 100%, which is a result of the high administrative costs within the staff-intensive micro-banking business. The bank is probably still too small to achieve the urgently needed economies of scale. However, credit must be given to the management for the fact that the MFB was immediately hit by the economic and currency crisis just after its first year in profit (2015), meaning that there is a good chance the institute can still achieve a turnaround in a calmer economic environment and with a larger regional sphere of action. The bank is also working hard to reduce its operating costs by using more digital instruments, although the target group has yet to make sufficient use of these offerings.

One problem affecting all MFIs in Nigeria is the lack of customer deposits, which means that the majority of borrowings have to be covered by bank loans and loans from national and international funds and shareholders. This is not only a cost problem, but also a significant source of risk. On the one hand, the interest costs for these loans are around three times as high as for deposits, at an average of 21.3% p.a., with weighted borrowing costs of 15.5% p.a. However, the fact that large bank loans to the MFB are tied to the USD exchange rate presents an even bigger problem. When the naira dropped sharply in value in 2016 and foreign currency availability was restricted, the bank's liabilities increased, it encountered a liquidity problem and it became “technically insolvent” due to a lack of foreign currency. The MFB was not the only bank affected by this issue. Since then, the availability of foreign currency has improved and the creditor banks have become more willing to extend the repayment period and lift their penalties, which has relieved the strain. Nevertheless, the problem will keep occurring for as long as the bank keeps failing to acquire more deposits because loans are primarily available in USD on the Nigerian capital market. Although these loans have recently been hedged with financial futures, this created another costing problem of up to 10% of the hedged total per year. This has the potential to become more serious if the volatility of the local currency increases again, making hedging more expensive or even impossible. The new Development Bank of Nigeria offers a certain amount of hope as it will provide refinancing opportunities especially for micro-finance banks.

The bank's interest margin is almost 40% p.a., though this is not unusual for a micro-finance institute of this size. For clients, on the other hand, interest rates of up to 72% p.a. (even at an inflation rate of around 15%) present a costing hurdle (and not a small one at that), although there are not many more affordable

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[2] Due to a lack of deposits, the bank had to take out loans from other banks, which were issued nominally in the national currency (naira) but then had to be paid back to a Dutch account in US dollars. Due to the fall in oil prices and the resulting economic crisis, the rate for the Nigerian naira fell, resulting in an extraordinary loss for the MFB. This was also linked to a technical insolvency because the bank was unable to access any US dollars on the official market. The problem was defused during negotiations but the MFB ultimately had to bear the exchange rate losses.

alternatives. A reduction of refinancing costs by increasing deposits first and foremost and a reduction in operating costs would therefore be favourable for loan customers as well.

In spite of expectations for future improvement through better refinancing opportunities and cost reductions through business expansion, efficiency targets have not been reached yet.

Efficiency rating: 4

Impact

The overarching development goal was to improve the underlying conditions for MSMEs and to contribute the integration of poorer parts of the population into a sustainable growth process.

Indicator	Variable	Status PA	Target value	Ex post evaluation
Nigeria's position in the World Bank's Doing Business report	Ranking	125	99	145
Proportion of Nigerians with a bank account	%	21%	25%	38.3%*
Proportion of Nigerians with access to formal financial services	%	26%	35%	48.6%*
Nigeria's score in the Global Microscope on Microfinance Business Environment	Score	39.4	50	46

* Source: EFInA (Enhancing Financial Innovation and Success, UK-Aid) 2017

From all the impact indicators, only the two relating to the financial sector were met and even significantly exceeded: access to financial services (although not necessarily via a bank account) and the proportion of Nigerians with a bank account have improved markedly. The other two indicators were not met, though this is understandable given the political and economic situation. Nigeria has actually dropped in the rankings in the Doing Business report. However, there are also negative sides when it comes to access to financial services. For instance, while Nigeria has more bank account holders than its neighbours at 38.3%, the proportion of those who are financially excluded[3] is worse, for instance, than Ghana (25%) or Kenya (17.4%) at 41.6%. In recent years, the economic crisis has even caused the percentage of those financially excluded to increase by around 2 percentage points, particularly in rural areas and the crisis regions in the north-west. While the number of excluded groups has fallen from 25% to 18% in the MFB's region and in the area around Lagos, it has risen from 66% to 70% in the north-west, since 2012.

When tracking the overall development goal, it is certainly sensible to track the general chain of effects using quantitative national indicators. However, it is important to state that in light of the MFB's 0.6% share of loan customers and 2.6% share of the lending from only the country's eight largest micro-finance banks, the programmes quantitative contribution is too small to have a significant impact on these indicators in view of the many other influencing factors. A geographically focused indicator (e.g. only access to financial services in the state of Oyo) could have recorded the effects of the programme more precisely. According to the bank's management team, the programme was not only able to satisfy previously uncovered demand for financial services, but has also managed to inspire imitations. However, it is important not to neglect the qualitative development policy effects, generated by the fact that the training component fostered the preconditions for professional management, that the development of the institution and its

[3] "Financially excluded": people with no access to formal or informal financial services or who keep any savings at home or borrow money from friends or family members

operations has been supervised and monitored by members of donor agencies appointed to the supervisory board, and that the international institutions' involvement in Nigeria's unstable environment also provides a certain level of protection against state intervention. However, these effects will only apply over the long term if the MFB is able to generate operating income that enables it to be self-sufficient at the very least.

The bank complies with nearly all of the principles of “responsible finance”. According to the information from a “smart campaign” initiative run by the African Development Bank and the IFC, the bank meets six of the seven criteria (adapted product design, transparency, avoidance of excess debt, responsible pricing, respectful treatment of customers, and presence of a complaint mechanism) but still has a need for minor improvements in the area of “confidentiality of customer data”.

Since the measure was able to exert little or no influence on the business climate indices and because these were overshadowed by other developments, they should be neglected for the assessment of the programme´s impact. With regard to access to financial services and bank accounts, the MFB's figures and development suggest that the measure has made a noticeable contribution to access to financial services at regional level, even though this effect is difficult to detect in the context of Nigeria as a whole.

Impact rating: 3

Sustainability

The programme´s sustainability is determined by the bank's economic situation (financial sustainability) and the resistance of its operations (self-sufficiency of operations).

Although a slight profit is anticipated for 2017, the MFB's balance sheet is worse than it was at the beginning, even after a recent capital increase. Furthermore, the bank has yet to become economically sustainable, whereby at least the real value of the equity is retained. At 15.3%, capital adequacy is now in the lower range; a second capital increase is planned for 2018.

In view of the staff-intensive business of a micro-finance bank and the bank's small size, the cost-income ratio itself is still very high, partially over 100%. The bank is working hard to reduce operating costs by increasing its use of digital instruments; the planned regional expansion due to take place after a further capital increase also gives the bank the opportunity to make use of cost-reducing effects and, as a result, decrease its share of operating costs. Another critical factor is the relatively high staff turnover and the lack of specialists, a situation that micro-finance institutions have to combat with a salary structure that is restricted at the top end. In risk terms the bank is in a good position with a rate of non-performing loans at less than 3%. The support that the bank receives from the parent banking group also generates additional quality assurance. Also, the management is able to respond flexibly to market changes in this difficult environment.

From both a financial and operational perspective, the sustainability of the effects generated by the bank is not yet secure. However, there is the potential that the planned expansion, the opening-up of local refinancing options, and the experience now gained will take the bank to a sustainable stage, provided that the economic situation does not significantly deteriorate again.

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).