Ex Post-Evaluation Brief

SENEGAL: Supply of credit to promote the development of the financial system - SME upgrading

Sector	Informal/semi-formal finan. intermediaries (2404000)	
Programme/Client	Supply of credit to promote the develop. of the fi-nanc. system – SME upgrading phases I & II - BMZ nos.: 2004 65 500 + 2006 66 503* , related training measures BMZ nos.: 1930 03 837, 1930 04 603	
Programme executing agency	Three Senegalese microfinance institutions	
Year of sample/ex post evaluation report: 2011/2013		
	Appraisal (planned)	Ex post-evaluation (actual)
Investment costs (total)	EUR 14.7 million	EUR 12.7 million
Counterpart contribution (company)	-	-
Funding, of which budget funds (BMZ)	EUR 14.7 million EUR 12.7 million	EUR 12.7 million EUR 12.7 million

* random sample 2011

Short description: To provide a broad-based supply of credit to small and medium-sized enterprises (SMEs) predominantly in cities, the credit departments of three Senegalese microfinance institutions (MFIs) will be set up (upgrading approach). In phase 1, EUR 8.0 million of refinancing lines for the three MFIs will be made available; in phase II, EUR 4.0 million will be provided to cover the additional refinancing needs of one of the three MFIs. In addition to credit lines, measures will be put in place to develop lending technology geared to SMEs at the partner MFIs.

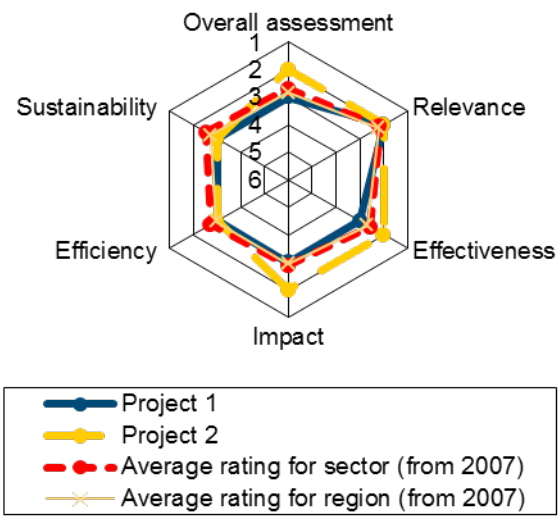
Objectives: The overall development objective of both phases of the programme in the beginning was to improve the employment opportunities for young people in SMEs in the formal and informal sector. Since 2008 the programme's objective has been changed (1) to help fight poverty by creating and securing jobs (particularly for young people) in SMEs and (2) to assist in the expansion and consolidation of the Senegalese financial sector. The German Financial Cooperation module objective was to improve access of SMEs to financial services with the help of selected private MFIs.

Target group: entrepreneurs and employees in SMEs

Overall rating: 3 (phase I), 2 (phase II)

It was correct to focus on expanding the SME business of the leading MFIs in the country as this target group was not served by the banking sector at the time. The three partner MFIs chosen were also suitable. The programme's success in phase I was mitigated by the fact that, at the outset, the capacity development needed to expand the capacities of the SME lending business were brought in much too late for them to help build up a high-quality SME loan portfolio. Currently the SME business in two of the three MFIs is still at a very low level.

Rating by DAC criteria



EVALUATION SUMMARY

Overall rating

Rating: 3 (phase I), 2 (phase II)

Relevance

The objective of the programme is to create broad-based access to financial services (loans, saving deposits and restricted payments) for SMEs by developing SME business at leading MFIs in Senegal (upgrading approach). Due to the high proportion of informal SMEs and only slowly diminishing reluctance of predominantly foreign-owned banks to do business with this client group, the microfinance sector was the correct starting point at an institution level for the programme. MFIs in Senegal have successfully served micro-enterprises for many years, and the approach to develop the SME client group was not just what the MFIs wanted, but it was also plausible and therefore the reasonable choice.

Instead of the approach taken – upgrading the three strongest MFIs in terms of SME financing – the German Financial Cooperation could have theoretically also tried to encourage commercial banks to expand their smaller client base ("downscaling"). However, when the programme was being appraised there was little interest from these banks.

The political partners also considered the programme's relevance to be high. The programme fits in well with Senegal's poverty reduction strategies, which also considers inadequate availability of credit to SMEs to be an issue, with the national SME promotion strategy and the microfinance strategy.

The programme was also compatible with the approach taken by German Technical Cooperation (TC) to promote the microfinance sector. Currently the objective of the German TC's approach taken through the microfinance association and the ministry in question is to raise the financial literacy of MFI clients and improve the monitoring of risks in the sector.

Overall we therefore classify the programme as relevant in respect of both phases.

Sub-ratings: 2 (phase I), 2 (phase II)

Effectiveness

The objective of the programme defined during the programme appraisal stage was to improve access of SMEs to the financial services they need through selected private MFIs (micro-enterprises were already successfully served by the MFIs). The following indicators were used to measure whether the objective had been achieved: (1) Quality of the SME loan portfolio: Portfolio at risk greater than 90 days < 5%; (2) Outreach to the target group: (annual) number of loans to SMEs increases; (3) Financial sustainability of the institutions: operating profit/ (operating costs + cost of refinancing the portfolio) > 100%.

Indicator (1): None of the three MFIs achieved this measure. In 2011 the average value for all three MFIs was 8%. In 2011, however, the proportion of non-performing loans (PAR > 90 days) of the total portfolio of the three institutions was only 3.4% (PAR > 30 was 4.8%) as the dominant microloan portfolio in all three institutions was of significantly higher quality. All three MFIs therefore had to accept a deterioration in credit quality as a result of the SME credit programme. By comparison, the Senegalese banking sector, which still invests heavily in public enterprises, has a significantly higher non-performing loan ratio of about 17.5%.

Indicator (2): Two of the three partner MFIs did not request additional funding from the programme beyond the EUR 2 million each taken in 2006 and repaid by 2010. They also submitted for the ex-post evaluation (EPE) only very crude data on their SME loan portfolios. According to the findings, at the end of 2012, one of the MFIs still had 273 SME loans with an average outstanding volume of around EUR 40,000; the other had about 1,600 outstanding loans issued by its "SME department", but with an average volume of just EUR 7,000, with most in the region of about EUR 5,000. Only 20 loans in the portfolio were > EUR 10,000. However, the third MFI achieved a sustained increase in the number of SME loans, even against the institution's total (micro) loan business. Overall the indicator for outreach to the target group ("increase in annual loans to SMEs") in phase I was not achieved. It was achieved in phase II.

Indicator (3): In 2010/2011 the indicator was met by all three MFIs. They all work with the appropriate financial and operational sustainability.[1] This is often not a given in the initial phase of a programme. However, one of the MFIs would not meet the indicator if reasonable risk provision were taken into account.

In phase I we classify the programme as satisfactory in terms of its effectiveness due to the fact the outreach to the target group was only partially achieved, portfolio quality was below target, while the financial and operating sustainability of two of the three MFIs was good. Phase II is rated as good due to the better results in achieving the target group.

Sub-ratings: 3 (phase I), 2 (phase II)

Efficiency

All three institutions operate without ongoing subsidies and therefore achieve an adequate return on equity of between 5 and 11% (2011). Micro-enterprises and SMEs are therefore being served without the need for subsidies. The three MFIs also have acceptable cost-income ratios of between 65% and 88% (2011).

[1] Financial sustainability: [operative income] / [operating costs (e.g. for staff and administration) + costs for refinancing the portfolio (cost of equity, interest expenses)]. Operating sustainability: the same as financial sustainability but not adjusted for refinancing costs

In the ex-post analysis it appears that credit lines certainly need to be adequately linked to human capacity development, particularly when refinancing new client segments or if MFIs have deficiencies in loan technology and risk management. The delayed preparation of training measures compared with credit lines in this programme, despite the deficiencies being known during the appraisal stage, is a result of the lack of acceptance of training measures by the MFIs at the start. Although credit lines were made available already in mid-2006, training measures were implemented from 2007 due to acceptance in one of the three MFIs and from 2009 in the case of the others. Although overall the training measures were carried out too late to build a high quality SME portfolio from the credit lines made available, they did contribute to professionalising the MFIs, particularly in the case of the MFI that had implemented from 2009 the training measures developed in 2007.[2] We consider the production efficiency of the programme to be, however, only satisfactory due to the deterioration in the portfolio quality of the partner MFIs as a result of the programme (see Effectiveness).

Even allowing for the fact that problem loans make up about 8% of the SME credit business, it can be deduced that about 92% of the funded SMEs successfully expanded their business by being granted loans. Also at least 40% of MFI clients are repeat clients that in most cases are requesting follow-up loans with a higher volume. Even though only a few SME loans were granted, financial services were provided to SMEs and long-term business relationships forged between SMEs and MFIs. We therefore consider allocation efficiency to be satisfactory.

Overall we rate the efficiency of the programme as satisfactory.

Sub-ratings: 3 (phase I), 3 (phase II)

<u>Impact</u>

The programme's overall objectives have been (1) to help fight poverty by creating and securing jobs (particularly for young people) in SMEs and (2) to assist in the expansion and consolidation of the Senegalese financial sector.

The main client group for partner MFIs is micro-enterprises mostly engaged in trading. Other sectors are, however, served, though to a lesser extent. Manufacturing makes up around 5% on average. All surveyed MFI clients confirmed in the EPE that they were taking on more staff in proportion to the growth of their (trading) company and were also training them in-house. Around 35% of the population is aged between 15 and 35, so it is assumed the programme will have a positive impact on the employment and incomes of this demographic. In Senegal overall, per-capita income measured using purchasing power parity hardly changed over the observation period as economic growth has barely kept pace with population growth.[3] The programme's positive impact on employment and incomes is therefore particu-

[2] Training measures were started at the end of 2010 in the other two MFIs

[3] 2005: USD 1.650; 2012: USD 1.653

larly important. However, the employment-enhancing SME loan business was not built up as strongly as intended in the programme, at least in phase I. We consider though that the first overall objective has been achieved as we can assume that there has been a positive impact – at least in terms of stabilisation – on employment not only from the SME loans formally defined as such, but also smaller loans.

For the second overall objective (expand and consolidate the financial sector), the programme's contribution is assessed using the financial intermediation rankings (loans to the private sector in relation to gross domestic product) and the importance of partner MFIs in micro and SME financing.

The population's access to financial services has been significantly improved by the dynamic growth in the partner institutions' branch network. Since the programme appraisal the number of branches operated by the three partner MFIs has nearly doubled and the outstanding loan portfolio heavily expanded (by a factor of 1.8, 2.3 and 3.2). As a whole the Senegalese microfinance sector, about 80% of which is dominated by the three partner MFIs, now has around 1.7 million clients (banking sector: 0.8 million clients). The microfinance sector has therefore achieved a penetration rate (clients/overall population) of 13.2% (2005: 6%); in the capital Dakar, the rate is actually 24.8%. The microfinance sector made an important contribution to increasing financial intermediation (loans to the private sector/gross domestic product) from 23% in 2005 to about 30% in 2012, the fifth highest level in Sub-Saharan Africa. Although only one MFI has a significant SME business, we assume the programme would provide a model for the Senegalese financial sector to follow. In the meantime, some banks have opened SME client segments. Taking into consideration the overall role of the three MFIs in the Senegalese financial sector, we consider the second overall objective as just achieved.

At the time of the appraisal MFIs could only be refinanced to a limited extent because, for example, the regional microfinance fund REGMIFA was not set up until a few years later. The MFIs therefore actually did need the refinancing line. Overall we rate the achievement of the overall objective as satisfactory (phase I) and good (phase II) due to the positive impact on employment, the large contribution of the funded MFIs to the general expansion and consolidation of the financial sector, but small contribution of the programme to the expansion and consolidation of the financial sector to the benefit of SMEs in phase I.

Sub-ratings: 3 (phase I), 2 (phase II)

Sustainability

The three MFIs have established themselves as stable partners, particularly to microfinance clients, across the country, with the exception of a few regions. The financial structure of the three MFIs shows, with the exception of one MFI, that even prior to the German Financial Cooperation measures the microloan business continues to dominate despite marked potential in the SME business. According to a 2010 study[4] the MFI sector covers almost all micro-enterprises (55% with average credit needs of EUR 4,000 to 8,000) and, in competition against some banks, also small enterprises (20% with average credit needs of about EUR 28,000). However, there are external risks. For example, the lack of a long planned-for centralised credit agency results in costly and lengthy verification checks and encourages risky multiple lending, and this can negatively impact the portfolio quality of partner MFIs. The same is true for the concept of a deposit guarantee fund which is now at an advanced stage, but has not yet been implemented[5]. However, we consider there to be no acute danger from these external risks and conclude for now that the current sustainability of the partner MFIs would only be marginally compromised if these risks materialised.

In their core microfinancing business, the MFIs are operating in a sustainable manner. They have given micro and small enterprises sustainable access to a broad range of financial services by continually developing their financial products over the past few years, tailoring them to the needs of their client group (primarily lending working capital to enterprises focused on trading). They plan to extend their branch network into the as yet untapped regions of the country. They also have at hand the microfinance association. This is an effective umbrella organisation that represents the interests of a large number of MFIs and supports in particular the long-term strengthening of smaller institutions in the market to achieve a levelling out of market power. The programme will therefore continue to positively impact the finance sector in future, and we assume that the expansion of the branch network and product development by the partner MFIs will further increase the impact of the programme. The quality of the portfolio of the three institutions which is predominantly composed of microloans is good. The ratio of non-performing loans is only at about 4-5% (banking sector: 17.5%). The regulatory environment in which the three larger MFIs are monitored by the regional central bank is good. Although the central bank has set an interest cap for the microloan business at 27% p.a., it is high enough for most MFIs. The banking sector is also now prepared to a relatively large extent to provide MFIs with long-term credit lines to refinance their long-term credit business at matching maturities.

All in all, we rate the sustainability of the programme as satisfactory in both phases.

Sub-ratings: 3 (phase I), 3 (phase II)

[4] Conseils (2010), Accès au financement des PME au Sénégal - Etude sur les contraintes [Access to SME financing in Senegal - study on the constraints]

[5] IMF Country Report no. 12/337, Senegal, November 2012

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).