Ex post evaluation – Tajikistan

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Sector: 2403000 Formal sector financial intermediaries
Project: Supporting Rural Financial Services I and II, BMZ no. 2008 66 434* / 2008 70 220 (AM), BMZ no. 2010 65 598 / 2010 70 135 (AM)
Implementing agency: Republic of Tajikistan, Ministry of Economic Development and Trade

Ex-post evaluation report: 2017

	Project I (Planned)	Project I (Actual)	Project II (Planned)	Project II (Actual)
Investment costs (total) EUR million	5.50	5.29	13.00	12.81
Counterpart contribution EUR million	-	-	-	-
Funding, of which BMZ budget funds EUR million	4.50	4.50	12.00	12.00
Accompanying measure (AM) EUR million	1.00	0.79	1.00	0.81

*) Random sample 2016

Summary: Within the scope of the two projects, grants of €4.5 million and €12 million were provided to the Ministry of Economic Development and Trade of the Republic of Tajikistan from Germany's Federal Ministry for Economic Cooperation and Development (BMZ) budget funds. The Tajik Ministry directed the funds to qualified financial institutions (FIs) as local currency loans for refinancing. These, in turn, provided the funds as credit to micro and small enterprises (MSEs). In addition, accompanying measures amounting to €0.79 million and €0.81 million respectively were implemented at the FIs.

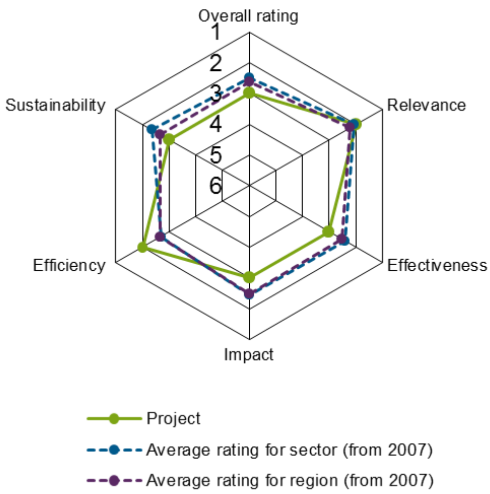
Development objectives: The objective of the programmes was to make the access of MSEs in rural areas to the financial services of private and sustainable FIs more accessible.. The projects' overarching developmental objective was to contribute to creating and securing employment and income by deepening and broadening the Tajik financial sector in rural areas.

Target group: Micro and small enterprises (MSEs) in rural areas.

Overall rating: 3 (both measures)

Rationale: Overall, the programmes had a positive effect on lending in rural areas. The quality of the participating FIs was and continues to be above the Tajik average, even though their situation has worsened during the country's most recent economic crisis. Innovative approaches to create new lines of business could not be put into practice as part of the projects. The FIs' local currency loans have become more expensive again after the FC refinancing provided in the local currency was fully utilised.

Highlights: -



Rating according to DAC criteria

Overall rating: 3 (both measures)

Relevance

The measures were highly relevant for the Tajik financial sector at the time of the programme appraisal. From the start of the measures to this day, there has been a liquidity shortage in local currency in Tajikistan's financial sector, stemming from the macroeconomic context. The prevailing high interest for loans in the local currency was also attributable to the insufficient refinancing options in the local currency. This made it impossible for many potential borrowers to achieve worthwhile results by financing investments with loans in the local currency.

A number of financial institutions (FIs) therefore proceeded to provide loans in foreign currency according to their refinancing structure (mostly in US dollars). Many borrowers were attracted by lower interest for loans in USD and accepted the exchange rate risk, even though their income was frequently denominated in the national currency. Refinancing was provided to the participating FIs in local currency as part of the measures to avoid these risks for the borrowers and to promote lending in local currency. The promotion of lending to borrowers in rural areas, particularly in the agricultural sector, was in line with the nation's strategy which views agriculture as a key sector for the development of the Tajik economy. Likewise, it adhered to the strategy of the Federal Ministry for Economic Cooperation and Development (BMZ).

Established and privately held microfinance institutions were primarily selected, along with a bank active in the micro-finance markets in Phase II[1]. This selection was in line with the measures' objectives of boosting income and employment in rural areas (as opposed to increasing overall production in the agricultural sector, which would have especially required the financing of large companies). When the selected FIs were appraised for the measures, they already had a network of branches in rural areas and lending technology for awarding smaller loans, which however still had room for improvement. This remained the case prior to Phase II.

Relevance sub-rating: 2 (both measures)

Effectiveness

The attainment of the objectives defined in the measure's appraisal can be summarised as follows:

Indicator							
(1) The growth in the loan portfolio is at least 20% per year following the loans' disbursement	**Partially achieved**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
	FI1	68%	57%	28%	41%	8%	0%
	FI2	47%	52%	46%	48%	8%	-22%
	FI3	52%	47%	35%	32%	15%	-6%
	FI4	65%	68%	34%	38%	17%	-6%
	FI5	52%	30%	46%	49%	8%	12%
	FI6	43%	25%	10%	-	-	-

[1] For ease of reading, the evaluation report labels the follow-up measure with BMZ no. 2010 65 598 as Phase II, even though this was a separate measure with its own BMZ number.

Indicator							
(2) The award of loans in rural areas increases above average in proportion to the overall loan portfolio (during the duration of the measures). (Here: growth of lending in rural areas)	**Partially achieved**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
	FI1	54%	57%	46%	5%	7%	-4%
	FI2	-	-	-	65%	-7%	-38%
	FI3	52%	47%	36%	30%	80%	-3%
	FI4	65%	68%	69%	-9%	182%	-21%
	FI5	-	-	-	-	-	2%
	FI6	37%	27%	15%	-71%	-	-
(3) The proportion of impaired loans (portfolio at risk > 30 days) remains below 4%	**Partially achieved**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
	FI1	1%	1%	1%	1%	4%	7%
	FI2	2%	2%	2%	2%	4%	7%
	FI3	1%	1%	1%	2%	5%	9%
	FI4	1%	1%	1%	3%	7%	7%
	FI5	3%	2%	1%	4%	6%	8%
	FI6	1%	1%	1%	1%	-	-
(4) The volume of lending that the refinanced FIs grant to women is at least 40% on average.	**Partially achieved**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
	FI1	43%	44%	43%	40%	42%	42%
	FI2	-	-	-	35%	37%	37%
	FI3	-	34%	36%	35%	36%	37%
	FI4	-	45%	45%	44%	46%	46%
	FI5	-	-	-	35%	38%	38%
	FI6	-	43%	43%	42%	-	-

The FIs have achieved a noteworthy level of growth in the years since the measures began. The annual growth rates in the loan portfolios were in the mid double-digit percentage range. However, the growth could not be sustained, due to the poor economic situation in the last two years. Some FIs even report a clear downturn in the value of their portfolio and are struggling to cope with the difficult macroeconomic situation. Nevertheless, this evaluation overall rates the increase in lending as positive and, in any case, this is aimed at sustained growth rather than predefined growth each year. The FIs have expanded their loan portfolio since the start of the measure, despite the last two crisis years.

Overall throughout these years the granting of loans partially increased above average in rural areas. However, in evaluating the growth in rural areas, it must also be noted that all the FIs already had a strong presence in rural areas prior to the measures (between 40-70% of all loans). The current economic crisis is adversely affecting lending in rural areas in particular. The high growth rates in some years reflect business policy that sometimes involved heavily soliciting new customers. As regards portfolio quality, a significant increase in loans with payment delays in the last two years can be noted. A serious decline in migrant workers' payments from Russia is often the cause of payment difficulties, and has seen the disposable income of borrowers' families fall significantly. A more precise analysis of the overdue loans also demonstrates that particularly loans in foreign currency, or those combined with foreign currency, are either not being repaid on schedule or at all. The default rates at most of these FIs are a few percentage points above the loan default rates in the local currency. From the FIs' point of view, the exchange rate risk passed on to customers is materialising in the form of an increased credit risk during the crisis. Nonetheless, overall it can be noted that the proportion of loans with payment defaults in the preceding years was below the level targeted in the indicators.

Women represent a relatively high proportion of borrowers due to the absence of men who are abroad as migrant workers. The proportion of the FIs' entire volume of lending directed as loans to women has remained constant in recent years. Nonetheless, some of the FIs did not consistently achieve the indicator. Borrowing by women, however, is not a guarantee of equal social status in any case.

Despite the last two years of crisis, we rate the effectiveness as satisfactory due to the decent results at the beginning of the project. We also still rate the effectiveness of Phase II as satisfactory. Although this period coincided with the crisis years, the two institutions added in Phase II performed better than the others.

Effectiveness sub-rating: 3 (both phases)

Efficiency

The funds were provided as a grant to the executing agency, the Ministry of Economic Development and Trade. The Ministry directed the funds to the FIs as loans in a fast and efficient process. The FIs repay these loans to the Ministry over time. There are currently negotiations regarding the future use of the funds repaid to the Ministry. From the viewpoint of the evaluation, it is an essential prerequisite for the returning loans to be used effectively in terms of developmental impact to ensure continued efficiency of the measures and to justify awarding the funds to the executing agency as a grant.

The present economic crisis is increasingly affecting the Tajik financial sector. The reasons for the current crisis in the financial sector include external factors (downturn in migrant worker payments from Russia), some inadequate risk management by the banks in steadier economic times (currency risks being passed on to borrowers) and strong competitive pressure among some customer groups (for example, dealers). Furthermore, some FIs had business models that were not sufficiently diversified. In some cases, 30-40% of operating income came from fees for migrant workers' remittance transfers or monetary transactions.

A downturn in profit and return on equity is evident due to the persistent crisis. While average nominal returns on equity of 10% were evident in recent years (with an average inflation rate of approx. 6%), the nominal return on equity was even slightly negative at two FIs in 2016 (the inflation rate was also approx. 6% in 2016).

If one considers the number of loans per loan officer as a yardstick for efficiency, however, one can note an average improvement of 25% between 2010 and 2016, a period in which rural areas were also served. The key measure of financial self-sufficiency (FSS) was significantly higher than 100% at all FIs in recent years.[2] In 2016, however, only two of the five FIs assessed managed to reach a value exceeding 100%. The capital adequacy ratio has also fallen in the last few years, although it remains above 20% at all FIs assessed, emphasising the impression that robust FIs were successfully selected for the project. Overall, the participating FIs are working efficiently to the greatest possible extent despite the difficult economic situation, and the institutions' portfolio quality is still - in some cases substantially - above the Tajik average.

The demand for refinancing in local currency has particularly increased in the recent years of crisis. The higher default rates for foreign currency loans, however, demonstrate that providing local currency was also efficient in times of a more stable currency (and, in turn, when customer demand for local currency loans was lower). We still rate the efficiency of both programmes as good, because the projects' funds were disbursed promptly and even during the crisis, the selected FIs are in a better position than the rest of the country's financial sector.

Efficiency sub-rating: 2 (both measures)

Impact

The credit check process is similar at the participating FIs. The process is based on customer visits, a detailed analysis of the customer's financial situation and a credit scoring analysis. The larger institutions' systems are more professional than those of the smaller FIs.

All FIs follow the core principles of responsible handling of financial transactions. A spot-check of the credit files (within the audit of use of funds performed at the same time) found that there were only a small

[2] This key measure shows how much the FIs earn relative to the costs for operation, write-downs and financing (%).

number of cases where loans were not used for the specified purpose. Additionally, all the FIs use the established credit reference agency, although its structure (with two competing systems but no uniform database) is suboptimal, as is the system's coverage. The most recent crisis has increasingly led all the FIs to begin requesting collaterals from borrowers. Previously, some institutions had provided credit to small-loan borrowers without requiring collaterals. This is now disadvantageous to the borrowers who are under consideration for a loan based on their solvency but cannot provide any real collateral.

Within the scope of the projects, three FIs were able to record the obtained FC funds as subordinated loans, with an interest markup adequately reflecting risk. This had a positive influence on the capital base and therefore on the stability of the FIs. Loans made in local currency rose over the course of the measure, while those in foreign currency fell (proportion of local currency loans, 2015: 48%; 2016: 56%). The demand for USD loans was high at the start of the programmes due to the relatively attractive interest rate on loans in USD. In the volatile currency environment that has been prevailing for two years, the somoni has devalued heavily and the demand for USD loans has fallen (estimates state by up to 30%). The refinancing provision in local currency supported the FIs in strengthening local currency lending.

In recent years, the national strategy for the sector has focused more strongly on boosting agricultural output as part of an import substitution strategy for agricultural products. Financing small agricultural producers (borrowers from the participating FIs have farms 1-7 hectares in size) has a positive effect predominantly on the producers' household income in cases of worthwhile investment. However, we cannot assume that the financing of small farms causes a similar rise in overall agricultural production, or that it increases the export strength of Tajikistan's economy to the same extent as the financing of larger producers. In addition, the programmes did not involve any significant impetus towards innovative sectors.

A stronger focus on other areas of the national economy could have been examined to reduce the country's generally strong dependence on the non-processing agricultural sector. Individual measures to promote innovative credit products at the FIs were unsuccessful (for example, introducing a credit product for solar panels). Other smaller pilot projects – for example, to introduce value chain transactions and leasing – were implemented on a test basis. However, they could not be realised on a wider scale, partly because both measures address customers with small loan values, who rarely come into consideration for projects of this type.

The FC refinancing was passed on to the target group identified in the PP. The FIs selected individual borrowers. While the borrowers associated with the FC refinancing profited from the inexpensive refinancing, other customers of the FIs had to continue paying higher interest for their loans (the difference between the two customer groups was approx. 4-5 percentage points with credit charges of 30-40% per year). A reduction of the FIs' interest across customer segments was not achieved. Additionally, we can assume an increase in employment in the cases of successful investments. Aside from purely family businesses, the investments led up to an increase in the number of employees, in particular among the larger operations visited as part of the evaluation.

Altogether, we rate the impact of the projects as satisfactory. There was a positive impact on the income of the borrowers during the course of the programmes. However, there was not an impact beyond the target segments, and addressing small undertakings (including the smallest) in the agricultural sector did not help to achieve a major rise in overall production.

Impact sub-rating: 3 (both measures)

Sustainability

The most recent economic crisis is currently adversely affecting all the FIs. Despite this, none of the participating FIs appear to be in a situation that challenges their immediate stability. One of the participating institutions, however, is in a financial state that would pose an existential threat in the long term. Nevertheless, in terms of the performance capacity of the financial sector as a whole, some FIs are still clearly above average, which reflects the good choice of FIs. However, the potential success of the measures all the participating financial institutions took during the crisis depends on the ongoing development of the entire economic situation. These measures included increasing requests for collateral, restructuring the portfolio to local currency loans, limits for certain regions and early warning indicators. This is also true for the volume of lending, especially in rural areas. So far, the FIs have become significantly more risk-averse in their lending during the crisis.

The FIs were able to offer less expensive loans due to the refinancing on favourable terms in the local currency within the scope of the programmes. As a result, the projects have a sustainable, positive effect on the household income of these borrowers. However, the local currency loans have become more expensive again within the present situation, in which the FC refinancing is no longer available on favourable terms and refinancing in local currency continues to be very expensive on the market. This is a systemic problem within Tajikistan's financial sector that could not be solved within the scope of the programmes. The FC financing was not found to have a sustained effect on the terms for all final borrowers.

We only rate the sustainability of the projects as satisfactory, due to the lack of a sustained effect on the terms of all the final borrowers' loans.

Sustainability sub-rating: 3 (both measures)

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, effective-ness, 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 neg-ative 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 like-ly 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 ap-propriate 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).