Ex post evaluation – Uzbekistan

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Sector: Formal sector financial intermediaries (CRS Code: 2403000)
Programme/Project: Finance sector programme (SME-, micro- and mortgage financing) BMZ No.: 2005 65 242*
Implementing agency: Ministry of Foreign Economic Relations, Investment and Trade, Uzbekistan (MFERIT)

Ex post evaluation report: 2015

		Project (Planned)	Project (Actual)
Investment costs (total)	EUR million	17.30	17.30
Accompanying measure	EUR million	1.50	1.50
of which BMZ budget funds	EUR million	18.80	18.80

*) Random sample 2015

Summary: As part of the programme, two private Uzbek banks were refinanced (each SME [small and medium-sized enterprises] and microloan component, roughly EUR 12.3 million in total) along with a state-owned Uzbek bank (housing finance component, roughly EUR 5 million). After initial delays during the contract negotiations, the funds disbursed in euros through the executing agency (Ministry of Foreign Economic Relations, Investment and Trade) were utilized rapidly from 2012 on. The funds were then used by the partner banks to provide loans in foreign currency (SME component) and local currency (microloan and housing finance component).

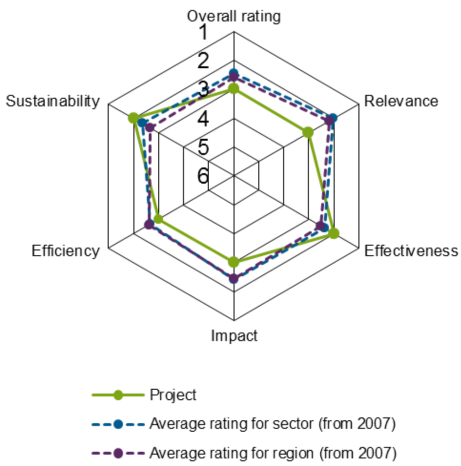
Objectives: The overarching objective of the programme was to contribute towards generating income and employment as well as to improving the housing situation by expanding and deepening the Uzbek financial sector. The programme objective was to make microloans and SME loans an integral part of lending at the Uzbek partner banks, and start disbursing mortgage loans efficiently on a pilot scheme basis.

Target group: The direct target group of the programme was the Uzbek partner banks. The indirect target group of the SME and microloan components was micro-, small- and medium-sized companies. The indirect target group of the housing finance component was private households who previously had no access to suitable financing opportunities.

Overall rating: 3

Rationale: The SME component had a positive growth impact on Uzbek SMEs because it provided urgently needed (due to foreign exchange controls) foreign currency for SMEs. At the SMEs visited during the evaluation the funds provided increased investment and the creation of jobs. The impact of the housing finance component cannot be measured because it was neither able to act as a "beacon" nor was it complementary to other FC activities in this segment of the market or an example of good practice. The use of foreign currency refinancing for microloans in local currency was not appealing for the banks because of the resultant exchange rate risk.

Highlights: --



Rating according to DAC criteria

Overall rating: 3

General conditions and classification of the project

Even today, Uzbekistan maintains a system of multiple exchange rates with strict de facto restrictions on foreign currency transactions. In addition to the official markets for foreign currency, the use of which is limited to companies in certain sectors, there is an illegal but lively black market for foreign currency. The discrepancy between the various official rates and the black market price for foreign currency is a measure of the unmet demand for foreign currency. At the time of evaluation, the excess demand is high: while you will get just under 3,000 Uzbekistani Som (UZS) for one euro at the official central bank exchange rate (October 2015), a euro will get you almost twice as much on the black market.

The project was preceded by three SME projects in Uzbekistan (referred to here as phases) with a total volume of EUR 13 million (BMZ Nos.: 1995 67 124, 1998 66 740, 2003 65 221). One of the supported partner banks was involved in these predecessor projects.

Relevance

The objective of the SME component of the project – to strengthen the private segment of the Uzbek financial sector through the promotion of SME lending – was relevant at the time of the programme appraisal (2008). Previously, the focus of the predominantly state-controlled financial sector was on large state-owned enterprises, which hampered the growth of the SME sector in 2008. SMEs were therefore rightly regarded as an important medium for creating jobs for the young and growing population of Uzbekistan. The support of private banks (which have less of a focus on state-owned enterprises) is complementary to the diversification of the Uzbek economy, which has accelerated since the early 2000s. Although one of the three partner banks had already been supported in the previous phases of SME development in Uzbekistan, at the time of the programme appraisal there was a continued need for support, also in the context of accompanying measures for the improvement of processes.

In addition to encouraging SME loans in foreign currency, the phase of the project evaluated here also attempted in particular to drive forward lending in the microloan segment and in housing finance (in each case in local currency). Microloans were rightly to be awarded in local currency, because the expected demand for microloans in foreign currency was significantly smaller than in the SME sector. Micro enterprises rarely import goods from abroad that they would have to pay for in foreign currency. The ultimate reluctance of banks to use foreign currency for the financing of microloans, however, could have been anticipated at the start of the programme. For the banks, the use of foreign currency funding for lending in local currency was associated with exchange rate risk. In addition, there was strong incentive to use the scarce foreign currency funding for SMEs which had a high demand for foreign currency loans.

The objective of the housing finance component of the project, to strengthen the market for mortgage loans in the lower income bracket of the population, was, in principle, relevant at the time of the programme appraisal. At the programme appraisal (and up to the present day) the Uzbek population was growing steadily and the expected demand for housing finance was high. At the time, the activity of international development finance institutions was still limited in this market. However, it was also already evident at the time that state-subsidised financing played and would continue to play an important role. The role of German Financial Cooperation (FC) in this highly subsidised market was not clearly defined at the start of the programme. In addition, the component was not complementary to other FC projects or to the FC's particular interest in this sector. The volume of the housing finance component was too small for a stand-alone flagship project, but it also lacked the innovative character of a pilot project.

From today's perspective, despite the high relevance of the SME component, we assess the relevance of the three components (SMEs, microloans and housing finance), only as satisfactory overall, as the components added in the current phase were significantly less relevant.

Relevance rating: 3

Effectiveness

The euro funding provided to the private banks in the SME component is mainly made available by them as loans in foreign currency (EUR or USD), which customers then pay back in UZS. The loans are not disbursed in cash, and are instead often forwarded directly to a (foreign) supplier. Thanks to a corresponding decree, the banks are able to exchange the UZS that they receive back into EUR or USD (guaranteed up to the first roll over of the project-executing agency's loans to the banks). The maximum loan amount is EUR 200,000. Because many SMEs suffer from a lack of foreign currency for purchasing goods abroad, the demand for loans was high and the loans were quickly made available after the end of 2012, following the delayed start of the project. The lending processes were further improved as part of the accompanying FC measure. Despite economic crises in the economies of some of Uzbekistan's most important trade partners, the share of non-performing loans is low, aided by the fact that many SMEs produce for the domestic market. Only a small part of the funds was used by the banks to award microloans, very few of which were paid out in cash (those paid out in cash are more expensive).

The euro funding for the state-owned bank in the housing finance component is converted by the bank into UZS at the official exchange rate and issued to customers (mortgage loans in this segment may not be issued in foreign currency). The maximum loan amount is equivalent to EUR 20,000. This maximum amount has never been adjusted and no future adjustment is planned either. At the same time, property prices in Uzbekistan have been rising rapidly since 2008. As provided for at the project appraisal, in urban areas in particular, the maximum loan amount does no target the Uzbek middle class, or is only sufficient to finance a smaller part of a total investment.[1] The loans are mainly taken out by customers who do not qualify for loans from more affordable government programmes (which target young families or rural property, for example). Due to the low volume of the loans, they are not an attractive business area for the bank. No serious financial difficulties were encountered for any of the loans, even after the grace period.

The achievement of the programme objectives defined during the programme appraisal can be summarised as follows:

Indicator	Ex post evaluation
(1) The annual growth of the loan portfolio to SMEs is higher than the average growth of the partner banks' total loan portfolio.	Partially achieved. Share of SMEs in the total portfolio 16 % in 2008 and 81 % in 2014 for Bank A (total loan portfolio growth approximately 440 %). Share of SMEs in the total portfolio 48 % in 2009 and 48 % in 2014 for Bank B (total loan portfolio growth approximately 260 %).
(2) SME and mortgage loan portfolio at risk (in default > 90 days) < 5 % over two successive quarters (separately).	Achieved.
(4) Partner banks continue to offer SME and microloans or housing finance after the funding ends.	Achieved.

Overall, we rate the effectiveness of the SME and microloan component as good and the housing finance component as satisfactory. Given the distribution of funds, we assess the effectiveness as good overall.

Effectiveness rating: 2

[1] This effect is intensified by the fact that house prices are often denominated in USD on an unofficial basis. This means that a credit disbursed in UZS effectively has less purchasing power if it first has to be exchanged by the customer into USD on the black market.

Efficiency

The efficiency of the private banks in the SME and microloan component is high by national comparison. The lending processes were simplified in the course of the accompanying measure and are in line with international standards. The simpler processes are a good reason for customers to choose to borrow from private banks, even if the loans can be marginally more expensive than in the state-owned banking sector.

The actual start of the project was preceded by a long period of negotiations between Germany and Uzbekistan. After the funds were finally paid out after the end of 2012, they were disbursed by the banks very quickly and much faster than had been anticipated. The thorough preparation thus resulted in the efficient processing of the funds. In addition, very good partner banks were selected for the SME and microloan component in the course of the screening process. On the other hand, the main reasons for the delay in contract negotiations were problem areas that have ultimately been of little relevance for the implementation – such as for example the cash disbursement of microloans (of which only a small portion was disbursed in cash) – and which therefore delayed the programme somewhat unnecessarily. It was therefore not possible to use existing structures from the previous SME projects in an optimum way.

The efficiency of the state-owned bank in the housing finance component has increased in the course of the project, although implementing the accompanying measure in a state-owned bank has been difficult. The requirements for taking out a mortgage loan have been simplified somewhat in the context of the accompanying measure, but remain too high, even when compared to the low loan volume of EUR 20,000. The efficiency of the housing component is also reduced by the fact that the banks need to first convert the funds that they receive in EUR into UZS. The financing in foreign currency, which is urgently needed in other parts of the economy, is therefore not used in the best possible way.

All banks report that both the transfer via the Ministry and the mechanism adopted by KfW for reimbursement to the banks work well.

Overall, we assess the efficiency of the two components as satisfactory.

Efficiency rating: 3

Impact

The funds in the SME and microloan component have been used mainly to finance SMEs. The banks place no particular focus on the microloan segment, to some extent because subsidised funding for microloans is available through state-owned banks. The evaluation determined that this focus on SMEs benefits the project's impact for three reasons: Firstly, SMEs import goods from abroad and require financing in foreign currency for this purpose. On the other hand, many SMEs do not export enough to be able to pay for the imports with the foreign currency proceeds. Currency conversion on the official markets, access to which is restricted, often takes a long time for SMEs. Under the programme, access to these markets is made simpler for SMEs . Secondly, it can be assumed that relieving the problem of foreign currency procurement among SMEs will lead to more official employment than the funding of micro enterprises, which tend to be organised as family firms and are often more volatile as a result of their focus on agricultural income. Thirdly, in contrast to microloans in local currency, SME loans do not result in any currency risk for banks.

As noted in the evaluations of the earlier phases of the project, foreign currency loans, which are repaid in UZS (at the official exchange rate), include a subsidy component for the recipient SMEs in contrast to other SMEs that do not have official access to foreign currency at the official (and most favourable) exchange rate, or to exporting SMEs, which normally have to exchange their foreign currency proceeds at the official rate. This direct subsidisation gives rise to the possibility for investments - which would not have generated positive returns without subsidisation - to become profitable. The possibilities for direct currency arbitrage on the black market for foreign exchange are, however, limited due to the non-cash payment. The evaluation determines that the existing system of multiple exchange rates and the strong restriction of currency transactions has a distortive effect on the market. The funding of SMEs with foreign currency loans, however, still has a positive impact on the economy and does not strengthen the existing multiple-exchange-rate system in any particular way. The visited SMEs have realised significant growth in the context of the financing that they have received. The impact of the SME component of the project is therefore based on addressing the artificially created scarcity of foreign currency.

The banks in the SME component achieved remarkable growth over the course of the project. Even if the banks are universal banks, the market for SMEs is a key component of both of their corporate strategies. According to reports, the activity of banks in the market for SMEs also puts state-owned banks under pressure to make their offerings in this segment more attractive and more modern. Nevertheless, the share of private banks in the overall banking sector remains low. The demand for foreign currency lending remains high.

The loan portfolio of the bank that runs the housing finance component grew more than seven-fold between 2008 and 2014. The 2014 share of housing finance in the portfolio is slightly lower than the 2008 value. The bank therefore resembles the rest of the state-owned banking sector in this regard. While there is a positive effect on customers who have taken out a housing loan under the project, due to the low level of funding of the component in comparison to the overall market for housing finance it is unlikely, however, that the FC was able to initiate additional lending. The influence of a small-scale, isolated project in a market where the FC does not take any other complementary measures is not quantifiable. The minimal effect is ultimately an expression of the component's lack of strategic positioning and relevance in the market.

Overall, we assess the impact of the SME component as just below good, and that of the housing finance component as unsatisfactory.

Impact rating: 3

Sustainability

All banks supported as part of the project are still on a rapid growth trajectory. Thus far, the increase in the portfolio has not led to an increase in the loan default rate at any of the banks. There is currently no indication that the financial sustainability of the banks is threatened, even though rapid growth does involve certain risks. All banks are diversified to some extent across various product categories and appear broadly equipped to be able to cope with potential failures that may occur in the economies of Uzbekistan’s main trading partners in the context of the economic crises.

The sustainability of the project with respect to the private banks in the SME component is furthermore strengthened by the fact that, following the support from the FC, both banks are now either financed by the German Investment Corporation (DEG) or are in negotiations with DEG. The banks have also been able to attract additional capital from international financiers in the meantime.

Because after a certain period of time has passed the banks no longer report to the FC on the use of funds, there is no guarantee that funds will also be awarded for the original purpose in the future. The risk that the private banks in the SME component will choose other target groups is low. There is no guarantee that the state-owned bank in the housing finance component will continue to provide housing loans of smaller volumes, and this depends primarily on the future development of the market.

From today's perspective, we assess the sustainability of the SME component as very good, since both banks were able to attract professional international investors, without this being a project objective. We assess the sustainability of the housing finance component as satisfactory. Overall, we assess sustainability as good.

Sustainability rating: 2

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).