KfW

Armenia: Loan Programme for the Promotion of Private SMEs I and II

Ex-post evaluation

OECD sector	24030 - Financial intermediaries of the formal sector	
BMZ project numbers	1998 65 387 (investment) 1998 194 (complementary measure)	
Project-executing agency	Central Bank of Armenia (CBA)	
Year of evaluation	**2003**	
	Project appraisal (planned)	**Ex-post evaluation (actual)**
Start of implementation	1998	1999
Financing, of which Financial Cooperation (FC) funds	EUR 3.06 million (FC EUR 3.06 million)	EUR 7.16 million (FC EUR 7.16 million) after the increase
Other institutions/donors involved	none	none
Performance rating	**1**	
• Significance / relevance	1	
• Effectiveness	1	
• Efficiency	1	

Brief Description, Overall Objective and Project Purposes with Indicators

The project involved the provision of funds, offered via a local APEX unit at the CBA, the German-Armenian Fund (GAF), to selected Armenian commercial banks. The funds were granted for a specific purpose: to grant loans to the target group - small (1-50 employees) and medium-sized (51-200 employees) enterprises (SMEs). Additionally a complementary measure was funded with EUR 1.12 million to support the participating banks. The project purpose was to give private SMEs in Armenia permanent access to formal financial services. In this way the programme was to contribute to creating or ensuring jobs and additional income for SMEs able to survive in the long term (overall objective).

The following indicators were defined to measure achievement of the project purpose and overall objective:

(1) The APEX unit accomplishes its tasks (proper assessment and selection of the commercial banks and on-lending of the FC funds),

(2) The FC funds of EUR 7.16 million are utilized during a period of no more than three years (change at the increase of funds; at project appraisal two years),

(3) The personnel of the partner banks reviews the sub-loans according to general banking standards and in accordant to the needs of the target group,

(4) The banks taking part in the programme increase the number and total volume of the outstanding loans (portfolio perspective) to SMEs at an above-average rate, and

(5) the default rates for this sub-portfolio average no more than 5% (“portfolio-at-risk”).

Project Conception / Major Deviations from the original Project Planning and their main Causes

Owing to the good project progress and the high demand for borrowed funds within the target group, the GAF funds were increased in 2000 from EUR 3.06 million to EUR 7.16 million. This was followed by another increase in August 2001 by EUR 5.11 million for the GAF and EUR 0.62 million for the complementary measure (GAF III, BMZ no. 2001 65 258). During the intergovernmental negotiations in April 2003 new funds amounting to EUR 4.5 million were committed for the GAF and EUR 0.5 million were promised for a complementary measure (GAF IV).

Key Results of the Impact Analysis and Performance Rating

By March 2003 the partner banks had extended 5,215 loans averaging EUR 7,325 (total volume EUR 38.2 million). The outstanding credit portfolio comprised 2,211 loans (EUR 12.2 million), some of which were financed by the banks' own funds. With 53% of the GAF portfolio volume (70% according to the number of customers), ACBA is the most important partner bank. Anelik Bank accounts for 28%, Armeconom Bank for 13% and Converse Bank for 6% of the portfolio. Especially ACBA has in fact already become a microfinance bank owing to its product and customer policies. Since it was founded as a cooperative agricultural bank, it can be used as a vehicle to successfully reach the segment of micro agro businesses in rural regions with financial products. This has been achieved to only an extremely limited degree in other downscaling projects.

In contrast to the previous concentration on financing short-term commercial transactions, the GAF portfolio reflects the compilation of all of Armenia's private economic sector: trade 47%, industry 29%, services 15% and agriculture 9%. The GAF is offered by twelve branch offices of the partner banks in ten regions. Based on the number of outstanding loans, 38% were granted in Eriwan, 34% in Artashat, 18% in Echmiadzin, 5% in Vanadzor, 2% in both Ashtarak and Yeghnadzor, and 1% in Gumri. Due to the accumulation of larger SMEs with higher average credit needs in Eriwan, however, 73% of the fund volume flows into this capital city.

All indicators of achievement of the project purpose were either achieved or greatly exceeded:

<u>To (1):</u> The APEX unit (5 employees) situated within the central bank was trained for its task by the consultant until year-end 2002. It takes care of the support, supervision and reporting for the GAF independently. The introduction of a Supervisory Council is to ensure the quality of the work of the APEX unit and its continued conceptual development on a long-term basis. The APEX unit finances itself via an administration margin of 1%.

<u>To (2):</u> The GAF funds for the first two phases were already fully disbursed in October 2001, two years after the project started.

<u>To (3):</u> All partner banks have accepted the credit technology introduced by the consultant and are using it effectively and efficiently. Thanks to the good results of the credit technology that was implemented – for example, at all partner banks the quality of the GAF portfolio is better than the remainder of the credit portfolio – some of the methods (e.g. performance-based salaries and analytical methods) were applied at all partner banks in other banking areas as well.

<u>To (4):</u> By March 2003 the GAF portfolio of all partner banks saw more dynamic growth than the rest of their portfolio. A good example is ACBA: between March 2001 and December 2002 its GAF loans rose from 16% to 43% of the total credit volume.

<u>To (5):</u> The quality of the credit portfolio was very good – with a "portfolio at risk" of 0.7% for 30 days – in comparison with international standards, and it is far below the agreed indicator.

The <u>target group</u> of SMEs was reached. In terms of volume, 37% of all loans were mid-sized (over USD 50,000), 44% were small loans (USD 10,000 – 50,000) and 19% were microloans (under USD 10,000). The banks are increasingly willing to grant very small loans as well. Already at the end of March 2003 41% of the extended loans were smaller than USD 1,000. The average loan size dropped from over EUR 9,000 at the end of 1999 to EUR 6,918 in March 2003. 86% of the customers were given first-ever access to the formal financial sector.

Apart from loans, all partner banks also offer other financial products such as savings accounts, payment processing and credit cards for SMEs and sometimes also for the customers and employees of SMEs. The range of products is currently planned to be expanded (documentary credits, leasing).

In regard to the achievement of the overall objective, the development of income and assets of the final borrowers as well as the number of their employees indicate that greater income could be generated and jobs were created and supported for the SMEs participating in the project, even if a direct causal relationship is very difficult to establish in some cases. The average net income of a group of multiple borrowers that were the subject of an impact analysis increased from the first loan application by 82% for SMEs and 47% for microenterprises (except agro businesses), and the average number of employees increased by over 30% for both groups. The visits to final borrowers conducted during the ex-post evaluation also confirm these positive impacts. Altogether the borrowers employ more than 5,200 people, frequently also from especially poor population strata. Some of the partner banks have begun to discover these new workers as customers, too. In general, participation in the GAF increases the confidence of company owners in their company and therefore also makes SMEs more dynamic. The majority of customers and also former customers were very satisfied with the service and loan conditions. 82% of the current customers are planning to apply for a new loan once their current loan expires.

The complementary measure supported the APEX unit and the partner banks. The consulting for the APEX unit mainly comprised the definition of criteria for the selection and monitoring of partner banks, the preparation of framework credit agreements and support for the CBA with the institutional buildup of its Project Management Unit (PMU). The CBA and the PMU stress the good communication with the consultant and the high quality of the materials provided (handbooks, software). The chosen partner banks have high financial and operative efficiency, and the development of their GAF portfolio is positive.

On the level of the partner banks the consulting services involved the establishment of and support for SME credit departments, the introduction of credit technology that meets the needs of the target group, the decentralization of decision-making processes and the implementation of a Management Information System (MIS). The establishment of an adjusted credit analysis system is particularly important in Armenia. The training of the personnel by the consultant took place in the form of training courses in similarly conceived projects in other countries and on the job. Environmental impact assessments were part of the credit assessment process. At the moment, 27 loan officers are working exclusively for the GAF. In some cases training for new loan officers is already being carried out by the banks on their own. Decentralized credit decision-making processes are currently being implemented step by step. At the same time, the scope of the branch offices for making decisions was to be expanded even further. All partner banks accept the consultant’s right to veto credit decisions. The MIS installed by the consultant was introduced at and used by all banks. Only the integration with the banks' other systems was not yet fully achieved. Performance-based salaries for loan officers were introduced successfully by all partner banks and are to be progressively applied in other areas as well. In general, all partner banks judged the quality of the consulting services provided to be very good.

Apart from the positive effects on income and employment described above, the following impacts on the target group were noted:

a) Sustained access to credit increases the companies’ planning reliability and, thus, their willingness to invest.

b) Although the project did not involve a consulting component for final borrowers, as a result of the contact between the loan officers and the customers repeated borrowers usually plan their investments in more detail and are better informed about their financial situation than new customers.

c) One-third of all microcompanies and half of all SMEs also take advantage of bank services other than loans (payment processing, current accounts). For most of the micro companies, the loan from the GAF marked their first contact to a bank. Other banks benefit from this as well: 17% of micro enterprises and 23% of SMEs have since become customers of non-partner banks.

The impacts were positive on the level of the financial sector as well, and in some cases even better than expected in the project appraisal. These were:

a) With more than 5,000 loans extended, the project made a decisive contribution to expanding Armenia's financial sector. Already 9% of all loans extended and 43% of the loans extended in local currency stem from GAF funds.
b) Via the project, credit technology for serving SMEs (analysis, assessment, performance-based payment) was successfully introduced into Armenia's financial sector. Owing to the good results, the technology was also introduced by the partner banks in other areas and was in part applied by non-partner banks as well.
c) The SME product is profitable for all partner banks and helped strengthen their financial situation and/or increase their market share.
d) The excellent training of the personnel brought in specific financial know-how that was not available prior to the project. Several non-partner banks expressed interest in recruiting the personnel of the GAF. The EBRD uses the personnel trained by the GAF to on-lend its funds.
e) The complementary measure initiated the changeover of the partner banks to monthly interest and redemption payments, which was then applied by most other banks afterwards and which led to a sector-wide risk reduction.
f) The good and close relations to the CBA made it easy for institutional experience (among others, microfinance business, portfolio assessments) to be passed on, which ultimately benefited the entire sector.
g) The good image of the GAF and the good results of SME business contributed to an above-average increase in savings for the partner banks and improved access for the partner banks to credit lines from other donors. For example, the EBRD is interested in participating in ACBA.
h) As a result of the increasing competition within the formal financial sector, some NGOs have begun to grant individual loans as well and to cut their interest rates. Two loan officers working for NGOs were trained by the GAF.
i) A demonstrative effect has come about in that the introduction of the credit technology at Converse Bank, which joined in March 2002, was done much faster and much more smoothly than at the other partner banks, and the bank, in order to demonstrate its focus on SMEs, voluntarily financed its portfolio initially only with own funds.

In a summarized assessment of all future impacts and risks we have arrived at the following rating of the project's <u>developmental effectiveness</u>:

- In view of the good and sustainable achievement of the project purpose, we judge the programme's **effectiveness** to be **very good** (partial evaluation: **rating 1**).

- With more than 5,000 loans granted in various regions in Armenia, the project is quite effective on a broad scale. The non-monetary overall objective was achieved. By providing a large number of SMEs with access to formal loans and other services, the project made a significant contribution to economic development and to support for the transformation process. From a financial perspective, the project's relevance/significance is very high. The project successfully introduced new credit technology and helped identify SMEs as a profitable target group for the banks. The good image of the GAF enabled the partner banks to improve their business position. Thus, as regards the criterion of **relevance / significance** we rate the project overall as **very good** (partial evaluation: **rating 1**).

- The APEX unit works efficiently and covers its costs. SME business is profitable for all partner banks. The quality of the GAF credit portfolio is very high and its operative efficiency – particularly in comparison with that of other projects – is high. The leverage effect of the funds utilized for the complementary measure compared with the revolving fund volume is excellent and will continue to improve owing to the permanent availability of the funds for SME finance. As a result, the **efficiency** of the project is rated **very good** (partial evaluation: **rating 1**).

Taking effectiveness, efficiency and significance/relevance into consideration, we judge the project's **developmental effectiveness to be very good (rating 1)**.

General Conclusions applicable to all Projects

It should be pointed out that the success of a downscaling project strongly depends on the country situation. It is important that

a) the central bank supports the project,
b) the competitive pressure within the banking sector is correspondingly high so that there is an incentive to pursue new, cost-intensive business areas such as SME finance,
c) the participating banks are not so large that their SME business can become a cornerstone of their business operations within a short time,
d) the relations to the target group are relatively close owing to transactions in other business areas,
e) under the complementary measure the consultant arranges appropriate credit technology and gains the confidence of the local stakeholders.

In addition, it has proven helpful to have the CBA assume the currency risk; in this way it burdens neither partner banks nor SMEs.

Legend

Developmentally successful: Ratings 1 to 3	
Rating 1	Very high or high degree of developmental effectiveness
Rating 2	Satisfactory degree of developmental effectiveness
Rating 3	Overall sufficient degree of developmental effectiveness
Developmental failures: Ratings 4 to 6	
Rating 4	Overall slightly insufficient degree of developmental effectiveness
Rating 5	Clearly insufficient degree of developmental effectiveness
Rating 6	The project is a total failure

Criteria for the Evaluation of Project Success

The evaluation of a project's "developmental effectiveness" and its assignment during the final evaluation to one of the various levels of success described below in more detail concentrate on the following fundamental questions:

- Are the **project objectives** reached to a sufficient degree (aspect of project **effectiveness**)?
- Does the project generate sufficient **significant developmental effects** (project **relevance** and **significance** measured by the achievement of the overall development-policy objective defined beforehand and its effects in political, institutional, socio-economic and socio-cultural as well as ecological terms)?
- Are the **funds/expenses** that were and are being employed/incurred to reach the objectives **appropriate** and how can the project's microeconomic and macroeconomic impact be measured (aspect of **efficiency** of the project conception)?
- To the extent that undesired **(side) effects** occur, are these tolerable?

We do not treat **sustainability**, a key aspect to consider for project evaluation, as a separate category of evaluation but instead as a cross-cutting element of all four fundamental questions on project success. A project is sustainable if the project-executing agency and/or the target group are able to continue to use the project facilities that have been built for a period of time that is, overall, adequate in economic terms or to carry on with the project activities on their own and generate positive results after the financial, organizational and/or technical support has come to an end.