KfW ENTWICKLUNGSBANK

Egypt: Dakahliya Rural Finance Programme

Ex-post evaluation report

OECD sector	24030/Formal sector financial intermediaries	
BMZ project ID	1996 66 157, 1997 70 074	
Project executing agency	Social Fund for Development	
Consultant	GFA Consultants	
Year of ex-post evaluation report	**2009**	
	Project appraisal (planned)	**Ex post evaluation (actual)**
Start of implementation	Q 1 1998	Q 1 2000
Period of implementation	36 months	72 months
Investment costs	EUR 21.99 million EUR 2.54 million (CM)	EUR 13.99 million EUR 2.54 million (CM)
Counterpart contribution	-/-	-/-
Financing, of which Financial Cooperation (FC) funds	EUR 21.99 million EUR 2.54 million (CM)	EUR 4.60 million EUR 0.51 million (CM)
Other institutions/donors involved	-/-	-/-
Performance rating	5	
• Relevance	3	
• Effectiveness	5	
• Efficiency	5	
• Overarching developmental impacts	4	
• Sustainability	4	

Brief description, overall objective and programme objectives with indicators

The programme comprised a FC credit line for refinancing loans to private, rural small businesses and farming enterprises as well as grant funds for complementary personnel support to the financial institutions involved. The funds aimed to improve small-loan lending facilities for the target group of enterprises. The FC funds were onlent via the Social Fund for Development as the apex unit to the three state partner banks, Bank Misr (B-Misr), the National Bank of Egypt (NBE) and the Principal Bank for Development and Agricultural Credit (PBDAC).
The overall objective of the programme, to make a contribution to raising employment and income in Dakahliya Governorate, was not assigned an indicator. Programme objectives were the promotion of small rural businesses and farming enterprises and the development of small-loan lending facilities for this target group in Dakahliya Governorate.
The programme objective indicators defined at appraisal were:

1. The repayment rate by the final borrowers per bank amounts to at least 90% and the rate of arrears does not exceed 10%.
2. 10,000 jobs have been created or secured by the promoted projects.

3. The number and volume of investment loans granted by the participating branch offices of B-Misr and NBE per year and small-loan lending business of PBDAC have increased by a nominal 50%.

The target group consisted of private micro and small enterprises with movable assets of up to an equivalent of EUR 5,000 (enlarged in the contractual agreements to about EUR 15,000 or adjusted for inflation) and farming enterprises with holdings of up to 5 feddan (about 2 hectares) of agricultural land.

Programme design/major deviations from original planning and main causes

The programme was designed in 1996. The policy established in the sectoral strategy on financial system development in 2004 of aligning development goals in financial sector projects more towards capacity-building was not therefore taken into explicit account when defining the overall objective. Current practice requires greater emphasis on the aspect of improved access to sustainable financial services in the set of objectives. The capacity-building effect in the financial sector was taken into account in programme assessment.

The programme executing agency was the Social Fund for Development (SFD), which was to onlend the FC loans on ODA terms and conditions as an apex institution to the partner banks for refinancing their MSE loans. The complementary measure amounting to EUR 1.9 million (DM 3.8 million) addressed the participant banks to support them with advisory services for improving and implementing lending facilities for small customers and setting up an appropriate management information system. Finance for the complementary measure was initially replenished by EUR 0.6 million in the course of the programme.

The design centred on envisaged changes in business operations at the partner banks. Under the Law on the Development of Small Enterprises, SFD was assigned a central role in promoting MSEs in 2004. It was not only entrusted with tasks in strategy development and advice for MSEs, but was also authorised to operate as a financing institution in its own right.

SFD has therefore contributed a lot to steering lending and has increasingly established itself as a financial institution. For example, it identified prospective final borrowers, appraised the investments eligible for finance in a feasibility study and referred the applicant with a financial proposal to a participant bank of its own choice. The banks themselves were and are represented by personnel in the SFD regional office. After a banking appraisal of the documents, the partner bank paid out the loan on the terms and conditions agreed with SFD. The participant banks reported that they did not actively pursue MSE business themselves but simply vetted the loan proposals from SFD and carried these out in line with the contract.

SFD, which traditionally demands subsidised lending, has been able to sharpen its own profile considerably in the financial sector. The donors have come to very different assessments of this development; many of them have also supported SFD with substantial funds advance this development. The consequent enlarged role of SFD prevented agreements reached under the FC project from being implemented. KfW was, for example, unable to have minimum interest for final loans increased to market level as agreed in the FC programme, despite repeated reminders, as other donors did not provide concerted support for this. The minimum interest rate set under the FC project for final loans of 9.25% already made for a clear increase on the final loan interest rate envisaged by SFD and the partner banks, although it still fell short of the going rate. As sufficient finance was available through funds from other donors with which SFD was able to expand subsidised lending, the demand for FC refinanced loans increasingly declined in the course of the programme, despite greater personnel support for the participant banks and more flexible loan terms and conditions. This way, SFD was able to pursue its original strategy of centrally directed lending. It has

switched its lending conditions to charging flat interest,[1] so that effective well exceeds nominal interest, but SFD still reserves the right to set interest independently of the market rate.
Due to the deviations from the agreements originally reached, the insufficient implementation of market-aligned lending and inadequate information on the cost-effectiveness of MSE lending business, KfW reallocated undisbursed funds amounting to EUR 8.0 million from the FC loan and EUR 0.5 million from the complementary measure to another programme in 2006.

Key results of impact analysis and performance rating

We assess the developmental efficacy of the project as follows:
Relevance: The programme design addressed the additional latent development prospects of small businesses and farming enterprises and was confined to the agrarian Dakahliya Governorate. The approach was based on the results chain, which is still valid today: Affording access to medium-term and long-term loans can have a beneficial effect on the economic performance of small businesses and farming enterprises and thus make a positive contribution to job creation and higher income in the underdeveloped rural Dakahliya Governorate. At the same time, expanding small-scale lending by the participant banks was intended to make a contribution to financial system development and with that to improving target group access to financial services in general. This causal chain is plausible.
The objective conforms with Egyptian development guidelines. MSE promotion is an explicit strategic aim of the Egyptian Government. The design also largely corresponded with German development cooperation strategy at programme start. An unusual feature was the planned onlending to state-owned commercial banks, which was, however, due to the marked influence of the Egyptian Government in the financial sector at that time and which is still the case today. The approach was aligned with other donors, primarily the World Bank, EU and Canadian development aid and envisaged market-aligned capacity-building effects in the financial sector. These were, however, undermined in the course of the programme by new donors, which allowed subsidised lending. German development cooperation has also changed its approach in Egypt as a consequence; at present, sustainable economic development is no longer a development cooperation priority in Egypt (Subrating 3).
Effectiveness: In the programme, more than 2,000 loans were granted, averaging EUR 4,420, although the demand for loans was much less than initially planned. The loan funds promoted investments that contributed to the intended income and employment effects in the target group. Lending did not, however, take proper account of anticipated cashflow returns to compensate for collateral. For this reason, applicants who could not offer sufficient collateral may not have obtained a loan despite a commercially viable financial plan.
Despite the considerable number of financed final loans, the programme objective indicators were not met:

- Re project objective indicator 1: In keeping with the dirigistic approach of SFD, the programme partners lacked a coherent definition of overdue loans. Since loans in arrears can at least in part be transferred to special government institutions, they have no great influence on the cost effectiveness of lending business and are not accounted for by SFD and the partner banks as a specific benchmark for cost effectiveness. Possible costs incurred are not taken into account when calculating interest. SFD took quite intensive care of final borrowers and made arrangements to follow up on loan servicing. According to

[1] Also known as ‘simple interest’, this interest calculation method charges interest on the original loan amount over the whole term, i.e. the interest amounts due remain constant and do not decrease due to repayments made.

the consultant engaged in the programme, the ratio of loans in arrears of over 30 days, however, made up far more than 10% of the loan portfolio.

- Re programme objective indicator 3: As reported by the participant banks themselves, they did not actively pursue commercial MSE business themselves, but simply appraised the loan proposals conveyed by SFD and concluded the related contracts.

Programme objective indicator 2 pertained to overall objective achievement, but due to the complex interconnections among loan finance, commercial success and employment, it does not in our view permit any clear inferences on the economic performance generated by the programme.

At financial-system level, which is more important from a developmental standpoint, the objectives of the programme were therefore not accomplished. Instead of supporting existing commercial banks to develop lending business for MSEs via an apex arrangement, the programme executing agency foreseen as an apex unit, SFD, has increasingly established itself as a financial and advisory intermediary for MSEs. SFD does not direct lending business to cost-effectiveness and sustainability criteria as required by the sectoral strategy for financial system development in German development assistance (Subrating 5).

Efficiency: By virtue of its basic corporate policy, SFD is an institution that views subsidised lending as appropriate for promoting MSEs for social purposes. The agreement in the programme on a substantial final borrower interest rate of at least 9.25%, considerably higher than the usual SFD interest rates, was in our estimation an acceptable and notable compromise, but it still constituted subsidised lending, despite repeated reminders from KfW. The agreement reached at programme start to successively increase the interest rate as agreed between the World Bank and SFD for final borrowers was not given sufficient support by the other donors. Instead, they provided SFD with refinancing funds, with which it was able to step up subsidised lending. Although SFD then adjusted lending terms and conditions to charging 'flat' interest, thus raising effective interest far above nominal interest, SFD still reserves the right to set interest independently of the market rate. The allocative efficiency of the project must therefore be assessed as limited.

With respect to its own goals, our impression is that SFD operates efficiently, but this efficiency is not necessarily geared to the objectives agreed on for the FC programme. For lack of sufficient information about the costs incurred and uncertainties as to actual portfolio-at-risk, production efficiency in MSE lending business cannot be assessed. Since the programme did not succeed in promoting market-aligned lending by commercial banks, we gauge its efficiency as clearly insufficient (Subrating 5).

Overarching developmental impacts: The programme has not contributed to developing MSE lending business in the refinanced partner banks, which continue to onlend MSME loans refinanced by other donors. The prime mover in lending is, however, SFD, which has long departed from its apex function as envisaged in programme design and started to issue MSE loans itself with the help of other donor funds in 2007. It has also been able to take up a central position in the MSE sector by virtue of the role of a comprehensive development institution for MSEs assigned to it under the law for MSE promotion. SFD has therefore positioned itself as a comprehensive financial, advisory and registration institution for small and micro entrepreneurs.

An affirmative aspect is the manifest political will of the Egyptian Government to promote MSE resources and provide specific support measures for this. The comprehensive role of SFD in MSE promotion and finance needs to be viewed in a very critical light, as it entails the risk of considerable market distortion, which in our assessment is already taking place. Added to this is its independence of the banking supervisory authority so that the existing structural risks, which are exacerbated by its strong political position, are not subject to adequate control. Another critical issue is SFD's forceful approach to conduiting loans to prospective borrowers and its recent new measure of granting consumer loans to households. According to its own information, it vets financial viability for borrowers, but no general system has been established for consumer protection.

The eight final borrowers visited reported that their standard of living had improved over the last ten years and they could make regular repayments. This was not, however, achieved through improved access to market-aligned financial services, but rather through politically-motivated development and financing arrangements entailing considerable risks. In some inspected enterprises, no sufficient measures had been taken to meet environmental and social standards. SFD intends to take this into account in future (Subrating 4).
Sustainability: Since the programme design could not be implemented in the way planned, the business model of market-based, cash-flow funded lending has not been established in the commercial banks either. Today's business model at SFD as a MSE advisory and financing unit in its own right is now geared to the long term and has been institutionalised in its present form by law. This means cementing market-distorting structures, although it is presently not possible to assess the commercial sustainability of refinanced MSE business in any detail, as more precise information is unavailable on the actual lending terms and conditions imposed by SFD, loan losses and actual lending business costs. In the course of ex post evaluation, SFD repeatedly voiced criticism of the interest charged to final borrowers in the FC programme, which it considered excessive.
Furthermore, the Central Bank of Egypt is still keen to make MSE business more attractive for commercial banks as well and has relaxed capital requirements so that MSE loans with a risk weighting of zero need not be underwritten with additional equity capital. In response to competitive pressure and the financial crisis, the participant state banks in the programme report that they are now giving renewed consideration to setting up MSE business. In view of the strong market position of SFD, it is impossible to assess how market-aligned commercial banks can establish themselves in MSE business.
At MSE level as well, there is limited scope only for assessing sustainability. At the MSEs visited during final inspection, we gained the general impression that commercially viable business models with corresponding development potential were indeed promoted, and as part of close customer monitoring that SFD sets incentives for loan servicing. No meaningful delinquency rates are, however, available (Subrating 4).
Altogether, we therefore attest the programme clearly insufficient developmental performance (Rating 5).

Notes on the methods used to evaluate project success (project rating)

Projects are evaluated on a six-point scale, the criteria being relevance, effectiveness (outcome), "overarching developmental impact" and efficiency. 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 rating that clearly exceeds expectations
2	Good rating fully in line with expectations and without any significant shortcomings
3	Satisfactory rating – project falls short of expectations but the positive results dominate
4	Unsatisfactory rating – significantly below expectations, with negative results dominating despite discernible positive results
5	Clearly inadequate rating – despite some positive partial results the negative results clearly dominate
6	The project has no positive results or the situation has actually deteriorated

A rating of 1 to 3 is a positive assessment and indicates a successful project while a rating of 4 to 6 is a negative assessment and indicates a project which has no sufficiently positive results.

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 an improvement is very unlikely. 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. A rating of 1 to 3 indicates a "successful" project while a rating of 4 to 6 indicates an "unsuccessful" project. In using (with a project-specific weighting) the five key factors to form an overall rating, it should be noted that a project can generally only be considered developmentally "successful" if the achievement of the project objective ("effectiveness"), the impact on the overall objective ("overarching developmental impact") and the sustainability are considered at least "satisfactory" (rating 3).