Georgia: Georgian Micro-Credit Bank / ProCredit Bank

Ex-post evaluation

OECD sector	24030 – Financial intermediaries of the formal sector	
BMZ project ID	1997 65 686	
Project-executing agency	Georgian Micro-Credit Bank / ProCredit Bank	
Consultant	IPC GmbH	
Year of ex-post evaluation	**2004**	
	Project appraisal (planned)	**Ex-post evaluation (actual)**
Start of implementation	Q I 1998	Q 2 1998
Period of implementation	24 months	36 months
Investment costs	EUR 2.56 million	EUR 2.56 million
Counterpart contribution	no information available	no information available
Financing, of which Financial Cooperation (FC) funds	EUR 2.56 million	EUR 2.56 million
Other institutions/donors involved	FMO, IFC, IMI	EBRD, IFC, IMI, IPC, Commerzbank
Performance rating	**1**	
• Significance/relevance	1	
• Effectiveness	1	
• Efficiency	1	

Brief Description, Overall Objective and Project Purpose with Indicators

The project comprised the foundation and buildup of financial institutions specialized in micro and small lending: the Microfinance Bank of Georgia, which was renamed in 2003 to ProCredit Bank. The project purpose was to establish long-lasting business relations between a formal financial institution and micro and small enterprises. In this way, the project was to contribute to the growth of private Georgian micro and small enterprises across all sectors (overall objective). EUR 0.69 million of the Financial Cooperation (FC) loan amounting to EUR 2.56 million have been contributed to the equity of ProCredit Bank on the urging of the German-Georgian Foundation to promote the development of the private sector. The remainder of the FC loan, or EUR 1.87 million, was offered to ProCredit Bank to fund its lending business. The development of ProCredit Bank was supported by short-term and long-term experts who assisted the management and trained local bank employees. A total of EUR 1.69 million were provided under FC for staff support. Additionally, the European Bank for Reconstruction and Development (EBRD) and the Dutch Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden NV (FMO) also contributed to building up ProCredit Bank.

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

– Arrears ratio (portfolio-at-risk) is a maximum of 5%;
– Average increase in lending of approx. 68% p.a. over 6 years;
– Development of outstanding loans according to the business plan;

– Increase in the average original loan amount from EUR 9,200 in the first year to EUR 15,300 in the sixth fiscal year.

Achievement of the project purpose was taken to imply achievement of the overall objective.

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

The project was carried out without any major deviations from the original concept. In October 1998 ProCredit Bank, a closed joint stock institution under Georgian law, was founded with GEL 5 million (approx. EUR 3.4 million) in share capital. The German-Georgian Foundation (GGF), the FMO, the International Finance Corporation (IFC), Internationale Micro Investitionen (IMI) and also four Georgian banks took part in the foundation. After being issued its general banking license from the National Bank of Georgia, ProCredit Bank took up business in May 1999. Currently (March 2004) the equity shares in ProCredit Bank are held by the GGF, EBRD, IFC, IMI, IPC and Commerzbank.

ProCredit Bank was founded as a micro finance bank specialized in lending to micro and small enterprises. The business activities of ProCredit Bank are monitored by a supervisory board. Further organs of ProCredit Bank are the shareholders' meeting and the Audit Committee, which reports to the Supervisory Board. ProCredit Bank employs approx. 440 people (as of December 2003: 46% women and 54% men). ProCredit Bank is a reputable employer that pays attractive salaries. Thus far it has not been difficult to recruit qualified staff on the local labor market.

ProCredit Bank has set itself the goal of being Georgia's most customer-friendly bank. The degree of service in terms of processing times is already impressive: there is seldom more than one week between receipt of the loan application and disbursement, and some types of loans are disbursed within 24 hours. Credit assessments are performed very carefully. On average, approx. 19% of the loan applications are rejected, mostly because of poor creditworthiness and a poor credit history of the applicant. Based on the number of loans approved, around 32% are granted for a lower amount than that originally applied for. The main reason for the reduction in the loan amount is that the business and financial data provided justify only a small loan amount. A high risk assessment and insufficient security also lead to a reduction in the requested loan amount. Environmental aspects are taken into account in the loan decision. ProCredit Bank's hedging policy is highly conservative. With the exception of loans < USD 3,000 - for which all available assets are reported but not officially transferred – all other loan types require a pledge on a house, apartment or real estate property. Additionally, all other assets of the applicant and the 1-2 personally liable guarantors are noted. Most of the loans are collateralised to approx. 200%. This type of collateral is indispensable for establishing long-term, sustainable credit relations in the difficult situation in Georgia. ProCredit Bank carefully monitors the credit portfolio. Same-day information about arrears can be retrieved from the management information system. The provisions for loan losses that are created to hedge against risks comply with standard international requirements. Debt consolidation and loan restructuring are taken care of by the respective credit committee. Attempts to collect on non-performing loans (NPLs) are brought before a court. On average, however, these proceedings usually take between 2 and 3 years. To save time and court expenses, ProCredit Bank strives to reach extrajudicial agreements with borrowers in cases involving small NPLs.

For the past two years ProCredit Bank has been undergoing a change from a micro finance bank specialized in granting loans into a universal bank. Above all, this change of strategy is tied to the importance of deposit business for refinancing its own credit portfolio without requiring assistance from donors. ProCredit Bank is continually expanding its range of products. Nevertheless, its core business is still lending to micro and small enterprises. The conditions offered by ProCredit Bank are market-driven and profit-oriented. Another key aspect of the business policy of ProCredit Bank is regional expansion. The bank currently has 18 branches and local offices across Georgia. It plans to open additional offices in 2004. Preferably, new branches are opened in commercial centers or other areas with a high level of customer traffic since both the location and the equipment of the branch offices are key criteria for the continuous generation of high volumes of deposits.

The balance-sheet total of ProCredit Bank increased continually between 1999 and 2003 from USD 5.5 million to USD 61.6 million. After initial growth rates averaging > 150%, average growth during the past two years was 30% p.a. Therefore, the growth rate projected at the time of the project appraisal was exceeded. ProCredit Bank operates profitably. Just one year after taking up operation it already crossed the threshold of profitability. In the year 2003 its profit after taxes was USD 1.5 million (2002: USD 0.3 million). In the past it reinvested its profits and used them to strengthen its equity base. Since it began operating the bank's outstanding credit portfolio increased to USD 46.5 million. This corresponds to approx. 75% of its total assets. Overall, its outstanding credit portfolio grew by 38% in the year 2003. Since taking up business, ProCredit Bank has granted 34,879 loans for a total volume of USD 171.2 million as well as 154,758 gold-backed loans valued at USD 25.4 million in total. In terms of sectors, trade dominates the bank's outstanding commercial credit portfolio (2003: 58% of loans and 49% of the loan volume). The sectors of production, agricultural and foodstuff production as well as transport followed, with loan volumes ranging between 7 and 9%. Loans are granted in GEL, USD and EUR, with USD loans accounting for most of the volume (85% USD, 12% GEL and 3% EUR). In terms of the number of loans granted, the situation is quite different: 66% GEL loans, 33% USD loans and 1% EUR loans. This clearly shows that especially small loans are requested and granted in GEL. 98% of borrowers are enterprises with up to 10 employees. In many cases family members also work at the same enterprise. The predominantly short loan terms (approx. 68% of the loans have a term of < 1 year; in exceptional cases the maximum term is 2 years) reflect the low state of development of Georgia's credit sector. With its current credit offers ProCredit Bank is just as unable to meet demand for medium and long-term investment loans as other banks active in the Georgian market. In view of its mere 5 years of operations and its dynamic growth, the equity base of ProCredit Bank can be considered very good. In 2003 the bank's rate of return on equity was 16% (2002: 6%) and its capital adequacy ratio was 13% (2002: 16%).

Key Results of the Impact Analysis and Performance Rating

By building up ProCredit Bank as a new financial intermediary (Greenfield approach), in the past 5 years highly positive structural effects were generated for Georgia's financial sector and for SME lending. Not only were new products introduced onto the market and established (broadening of the financial sector), but new customer groups could be reached as well (deepening of the financial sector). The entry of ProCredit Bank onto the market made a substantial contribution to improving SMEs' access to credit in the formal financial sector. The greater majority of SMEs were able to take out their first bank loan. In addition, ProCredit Bank had a positive demonstrative effect on local banks: it is profitable to grant loans of less than USD 10,000. As a result, three more Georgian banks (Bank of Georgia, United Bank of Georgia and TbilUniversalbank) have begun to serve this credit segment. This is improving the credit supply for SMEs. Altogether ProCredit Bank grants approx. 90% of its commercial loans (excluding gold-backed loans) in the segment < USD 10,000. Additionally, for about 2 years ProCredit Bank has been systematically granting loans of more than USD 10,000 and, in this way, has been serving larger SMEs as well. Here it is competing directly against the established Georgian banks. ProCredit Bank has made a substantial contribution to heightening competition among Georgian banks, in particular for loans > USD 10,000. This is reflected in a significant decrease in interest rates, among other things. In the area of gold-backed lending ProCredit Bank has again succeeded in significantly reducing the interest rate from over 60% p.a. to recently 42% p.a. as a result of its activities in the market. Customers benefit from this greater competition in the form of better conditions, offers of new products (e.g. loans with lower collateral requirements) and improved service.

In a combined assessment of the project's effectiveness in development-policy terms, we have arrived at the following evaluation of the Georgian Micro-Credit Bank / ProCredit Bank project:

The goal of the project, namely to establish long-lasting business relations between ProCredit Bank and micro and small enterprises – has clearly been achieved. It grants 98% of its commercial loans to enterprises with up to 10 employees. After repaying their first loan, many customers take out a new loan. These follow-up loans are usually characterized by a higher loan amount compared to the first loan. What is more, the loan term tends to be longer. In the segment of loans < USD 10,000 ProCredit Bank is the most important source of financing in the formal financial sector. We rate the **effectiveness** of the project as being **very good** (**partial evaluation**: **rating 1**).

The project has exemplary, positive structural effects on the financial sector and on the development of SMEs in Georgia. The country's financial sector could be both deepened (by reaching new customer segments) and broadened (by offering new financial products). Most of the bank's customers obtained their first bank loan from ProCredit Bank, thus gaining access to formal financial services. Although at the moment ProCredit Bank is not offering any products for medium and long-term investment finance (neither are other Georgian banks), by extending loans to SMEs with a one to two-year term is making a significant contribution to creating and ensuring income and employment in the private sector and, thus, to encouraging economic development in Georgia. We rate the **significance/relevance** of the project as being **very good** (**partial evaluation**: **rating 1**).

We rate the allocation efficiency of the project as good. The loan interest rates are positive in real terms and are in line with market rates. ProCredit Bank monitors its credit portfolio efficiently. Its portfolio-at-risk ratio is at a constant low level, and any cases of default are brought before a court. We also rate the production efficiency as good. The productivity of the staff is good and continues to increase. In terms of outstanding credit portfolio, already today ProCredit Bank is Georgia's third-largest bank. The financial situation of ProCredit Bank is convincing, too. The bank's main source of income is interest earnings (net interest margin 15.9%). Interest on equity is growing, and in 2003 the bank's rate of return on equity was 16%. Since costs of building up the bank of approx. EUR 3.2 million were financed by donors under the training measure (item 3.26), ProCredit Bank has already been generating a profit since fiscal year 2000. We consider the **efficiency** of the project to be **good** (**partial evaluation**: **rating 1**).

Based on a combined assessment of all of the impacts and risks described above, our rating of the project is positive overall with no restrictions. **In summary we judge its developmental effectiveness to be very good. The project is suited to serve as an example of "*best practice*."**

General Conclusions applicable to other Projects

In the future, local banks should principally not be allowed to contribute to the equity of newly founded financial institutions owing to irresolvable conflicts of interest. If, at the time of the foundation of a new financial institution, there is no direct competition between the local banks and the new financial intermediary, it will probably arise in the medium term. If competitors are also shareholders, there is a great risk that decisions will be blocked and/or information about business policy may be exploited to the benefit of the shareholders (in this case, the competitor banks).

When building up a new financial intermediary, in the future the start-up financing for the build-up of the institution should be more ample and more comprehensive. Although factors such as the buildup of an IT infrastructure and the realization of marketing measures are expensive, they are crucial to the success of a new institution. A possible alternative worth considering is granting a long-term FC loan with a corresponding number of grace years to provide the additional funds required for the start-up financing.

In a newly founded financial institution, apart from lending the deposit business should be actively expanded at the same time. This is critical for a bank's long-term funding that does not depend on donor funds. Subsequent repositioning of a micro finance bank specialized in lending into a universal bank costs a great deal of time and money.

Access to medium and long-term investment finance is a decisive criterion for financing the assets of SMEs, particularly in the producing sector. Therefore, in economic terms it would be desirable to provide medium and long-term financing to build up the assets of SMEs. As a result, financial institutions should offer medium and long-term financing early on.

The definition of indicators to measure achievement of the goals should be ambitious, yet the indicators selected should be far from being unrealistic. If the indicators are tied to the projected development of a business plan, at least a risk deduction should be considered.

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 classification during the ex-post evaluation into one of the various levels of success described in more detail below concentrate on the following fundamental questions:

- Are the **project purposes** 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 design)?
- 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.