

## Ex Post-Evaluation Brief

### Honduras: MSE Financial Sector Development



<b>Sector</b>	24030 – Formal-sector financial intermediaries	
<b>Programme/Client</b>	MSE Financial Sector Development, BMZ no.: 2004 65 625* Complementary measure, BMZ no.: 2005 70 317	
<b>Programme executing agency</b>	Banco Hondureño Para La Produccion y La Vivienda (BANHPROVI)	
<b>Year of sample/ex post evaluation report: 2012*/2012</b>		
	Appraisal (planned)	Ex post-evaluation (actual)
<b>Investment costs (total)</b>	at least EUR 7.4 million	at least EUR 19.2 million
<b>Counterpart contribution (company)</b>	at least EUR 0.6 million	at least EUR 12.4 million
<b>Funding, of which budget funds (BMZ)</b>	EUR 6.8 million EUR 6.8 million	EUR 6.8 million EUR 6.8 million

\* random sample

**Project description:** The programme comprised of a loan to the apex institution, Banco Hondureño Para La Produccion y La Vivienda (BANHPROVI) for refinancing loans granted by financial intermediaries (FIs) to micro and small enterprises (MSEs). A complementary measure was also financed to support the executing agency in professionalising its executive capacities for a MSE programme to meet needs (amounting to EUR 800,000). The FC funds of EUR 6 million were issued at IDA conditions to the project executing agency. The contract was concluded in 2006 and the last payment made in December 2010. BANHPROVI far exceeded the required counterpart contribution for MSE finance (10% of FC funds).

**Objective:** The overall objective of the programme was to make a contribution to improving the competitiveness of micro, small and individual medium-sized enterprises. The programme objective was to afford MSEs access to medium-term loans to meet their needs and improve the executive capacities of BANHPROVI.

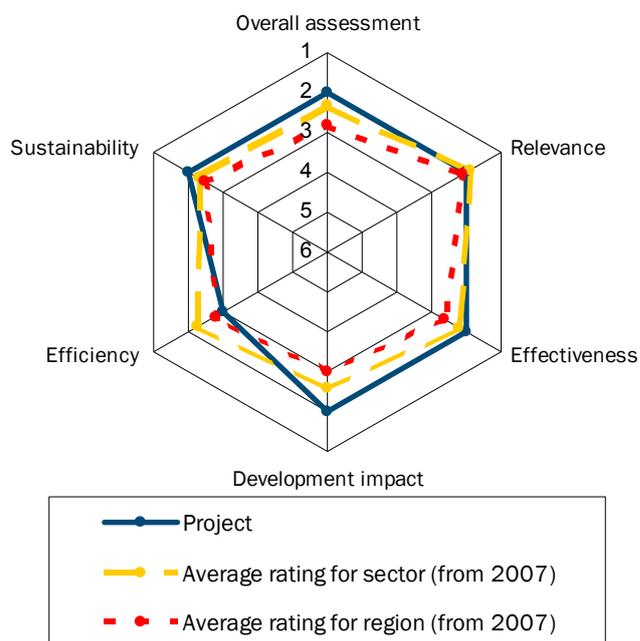
**Target group:** The target group of the programme comprised micro, small and individual medium-sized enterprises (MSEs). Medium-sized enterprises with up to 150 employees and a monthly turnover of up to US\$ 25,000 were also included here.

#### Overall rating: 2

The MSME department set up at BANHPROVI with the help of the FC programme operates efficiently and also supported the FIs in particular in bridging liquidity gaps during the political crisis. The interest for the FIs, however, fell well short of the market rate.

**Of note:** The flexible repayment modes of the programme, with complete maturity risk of the refinanced loans borne by BANHPROVI, enable the FIs to offer specific products with flexible conditions adapted to the specific situation of the final borrower. This helps access new clientele. As, however, it does not provide an incentive for FIs to improve risk management, these funds should be channelled as far as possible into heavily underserved market segments (very long terms, innovative products, rural areas).

#### Rating by DAC criteria



## EVALUATION SUMMARY

**Overall rating:** Establishment of an efficiently operating MSME unit in BANHPROVI and lending to sustainable FIs, with reservations as to efficiency. **Rating: 2.**

**Relevance:** Honduras is the poorest Spanish-speaking country in Latin America. Besides the financial and economic crisis in 2008-2009, it underwent a serious political crisis in 2009, when the acting president was removed from office. The political climate has now stabilised, but crime is continuously on the increase. Regulation in the financial sector has made progress in recent years. After a transition period, the law on transparency and customer protection aimed at raising transparency in the sector to international standards will be binding beginning in 2013. In the Economist Intelligence Unit's Global Microscope on Microfinance 2011, Honduras takes 18th place. In Central America, only the El Salvador market is more advanced (5th position), but the sector still lags far behind by Latin American standards. Besides the supply of financial services by unregulated organisations, institutions for the development of financial services (organizacion privada de desarrollo financiera, OPDF)<sup>1</sup> and financial institutions, the national banks have now also discovered the MSME market as a business segment. There is still a particular lack of longer-term refinancing and some rural regions continue to be completely underserved. Political influence on the financial sector is still comparatively high due to the adverse political climate. The agricultural bank, Bandesa, distorts the market through clientism and failure to collect repayments of outstanding loans. The institutional development of BANHPROVI was thus a good way to lend greater weight to the goal of financial sector development in policy discussions as well. Cooperation took place with GIZ, which advised some of the FIs that were later financed via the FC programme (FUNED, BANHCAFE, FINSOL, BANCOVELO, ODEF and CACIL). Apart from BANHPROVI, Banco Centroamericano de Integración Económica (BCIE) is also engaged in Honduras via a microloan programme partly refinanced by FC. Both programmes issue refinancing to selected institutions. As the amount of funds available per institution is limited and there are also slight differences in modes of repayment so that some funds are put to different use, we assess the relevance as good considering the comparatively low development of the sector and the difficult situation facing the country in recent years. Apart from German FC, the Inter-American Development Bank (IDB) in particular is engaged in the microfinance sector, which is, however, no longer a priority sector of German development cooperation. Sub-rating: 2.

**Effectiveness:** The programme objective was to afford MSEs access to medium-term loans to meet their needs and improve the executive capacities of BANHPROVI. The indicators were defined at project appraisal as: a) At least 60% of the loan portfolio financed by the FC programme is allocated with terms of more than 2.5 years. b) Portfolios at risk (<90 days) in the participant FIs is less than 5%. c) At least 5 FIs take part in the programme. d) The refinance

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<sup>1</sup> To develop into OPDFs, these organisations require a minimum of equity capital and must meet certain criteria specified by the financial sector supervisory authority. OPDFs are allowed to take savings deposits from their clients, affording them a favourable source of refinance.

applications for MSE finance are dealt with by BANHPROVI within 10 working days. In the ex-post evaluation, a real positive return on equity in the participant FIs was added as an indicator. Indicator a) was just about met: 60% of the loans financed from FC funds had a term of more than 2.5 years. In the overall portfolio of the MSME unit (FC funds and counterpart contribution of BANHPROVI), loans with a term of more than 2.5 years in 2011 recorded a total volume of approx. EUR 6 million, which amounts to about 30% of all funds. BANHPROVI therefore also deployed a significant ratio of its own medium-term to long-term funds for the programme. For the most part, the performance of the financed FIs was very good up to ex-post evaluation (also including revolving funds). Return on equity was positive in real terms on average and PaR also kept below the threshold of 6% at an average of 3.4%. Handling time slightly exceeded 10 days, but ought to be reduced to below 10 days after the current introduction of a new IT system and an internal audit of the procedures in the second half of 2012. Also of positive note is that BANHPROVI adapts the term for financing FIs exactly to that of the loans for the respective final borrowers. BANHPROVI thus relieves the FIs of maturity risk and enables them to introduce new types of product. On the one hand, this also lessens the incentive for FIs to upgrade liquidity management, but, on the other, limiting the amount of funds per FI ensures that it still plays some role.

During the consultant assignment, procedures and criteria were introduced for the selection of FIs (particularly for unregulated ones) and support provided in setting up the MSME department at BANHPROVI. The procedures are still applied and the department has become a firm and professional part of the organisational setup. Besides the FC and BANHPROVI's own funds, which are jointly issued under the same terms and conditions to the FIs, BANHPROVI also administers trust funds of the Honduran Government and of the EU, which are both also aimed at the MSME sector. Unfortunately, despite some efforts by BANHPROVI, the trust fund of the Honduran Government has not been harmonised. It is dispensed by BANHPROVI at a fixed rate of interest of 1% to the FIs, which must then on-lend the funds at an interest rate of 7% to final borrowers. Due to the restricted margin, the FIs are hardly interested in the money from the trust fund and this is disbursed mainly via banks that (presumably) allocate them to retain particularly good clients. There is therefore no reason to fear any adverse repercussions for the FC programme. Sub-rating: 2.

**Efficiency:** BANHPROVI was founded as a bank by the Honduran Government in 2005 and sees itself as a development bank. Meanwhile, the organisation has gained a great deal of experience on the microfinancial market and it maintains good contacts with the FIs. It appears to be an efficient organisation; the personnel are well trained and it operates with firm procedures and structures. The FIs also operate efficiently and for the most part recorded a real positive return on equity in December 2011. Despite the political, economic and financial crises the country has had to undergo in recent years, and which in part have caused a considerable contraction of FI portfolios, most institutions were able to expand their activities again in 2011 and are in a stable upward trend.

The efficiency of the programme is impaired by the interest terms and conditions with which BANHPROVI provides funds to the FIs. Both FC and own funds are granted at a fixed interest rate of 7%. In the programme proposal, it was originally planned to align the interest rate with market terms and conditions and put the interest differential funds in comparison with FC conditions to use for technical assistance to the executing agency. The short-term interest rate of 7% falls well short of the market interest rate (We estimate that market interest currently amounts to 10-15%; BCIE grants the loans with a minimum term of 1 year at a present interest rate of 12%.) and only covers administrative costs, exchange rate risk, refinancing costs and the profit margin for BANHPROVI. Inflation, which currently amounts to about 7% in Honduras, is not taken into account. For the financial sector in general, this low interest rate means that the FIs receive subsidies that they do not necessarily need and at the same time there is no increased incentive to shift to market-conform financing. Owing to the 100 percent maturity-matched refinancing and the long terms, the funds would also have been of interest and would be in demand without the interest subsidies for the FIs. Sub-rating: 3.

**Overarching developmental impact:** The overall objective of the programme was to make a contribution to improving the competitiveness of micro, small and individual medium-sized enterprises. The overall objective indicator was defined as the following: that at least 80% of the promoted MSEs are still available on the market a year after lending. This indicator has been met but is only partly valid due to the lack of a control group. Studies in other countries, however, demonstrate that for MSMEs affording access to financial services has a beneficial effect on the competitiveness of businesses. A considerable part of the funds went to the financial institution, ODEF Financiera SA, which holds a large portfolio in rural areas and is extremely creative in introducing new services. Due to the structure of the programme, the deepening and development of the financial sector was also included subsequently as an overall objective. The average interest rate for MSMEs and the ratio of private sector loans to GDP can serve as indicators for this. According to the banking supervisory authority, the average interest rate has not yet decreased in recent years. Genuine competition cannot be expected until the consistent application of the transparency law in January 2013. According to World Bank data, the ratio of private credit to GDP rose from 50.7% at project appraisal to 54.9% before the political crisis in 2009. It then slumped, however, to 52.7% in 2010. The indicator has therefore been met. It also needs to be stressed that during the threefold crisis (financial, economic and political), when the FIs had to struggle with losses and the cessation of commercial finance, the programme made a major contribution to bridging the liquidity gap. BANHPROVI conducts a study every year on the social performance of the FIs, thus also including aspects of responsible finance. As, however, the banking supervisory authority still does not require the unregulated institutions to disclose the effective annual rate of interest (which will not be binding until January 2013), transparency in the sector is still in need of improvement. We assess the large counterpart contribution of BANHPROVI as very positive. 70% of all funds of the MSME unit are now financed by BANHPROVI, with FC funds only making up 30% of the whole portfolio. We therefore assess the overarching developmental impacts altogether as good. Sub-rating: 2.

**Sustainability:** The creation of the MSME department has institutionalised major findings on the

microfinancial system at BANHPROVI for the long term, which are of benefit to the whole sector. A good example of the capabilities acquired is that BANHPROVI now issues its own publications on the impact of its programmes and carries out independent studies on the social performance of the promoted FIs.

To ensure the sustainability of the programme, it will be important for BANHPROVI to continue to resist political influence. The promotion of BANHPROVI by KfW has also made a contribution to enabling it to prevent politicians from influencing programme planning.

As BANHPROVI managed to uphold its independence during the serious national political crisis, sustainability is likely to be assured in the future as well. However, the interest rate for the participant institutions should be raised in future to increase the amount of revolving credit. In the microfinancial sector itself, capacities will continue to improve through the entry of foreign competitors and the above-mentioned improvement of customer protection, if the political climate remains stable in future. Despite the adverse political climate and the problems of violence in the country, we arrive at a favourable assessment of the development of the microfinancial sector due to the increasing professionalisation of the actors. Sub-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, effectiveness, 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:

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| 1 | Very good result that clearly exceeds expectations  |
| 2 | Good result, fully in line with expectations and without any significant shortcomings   |
| 3 | Satisfactory result – project falls short of expectations but the positive results dominate                                     |
| 4 | Unsatisfactory result – significantly below expectations, with negative results dominating despite discernible positive results |
| 5 | Clearly inadequate result – despite some positive partial results, the negative results clearly dominate                        |
| 6 | The project has no impact or the situation has actually deteriorated  |

Ratings 1-3 denote a positive or successful assessment while ratings 4-6 denote a not positive or unsuccessful 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 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 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 appropriate to the project in question. Ratings 1-3 of the overall rating denote a "successful" project while ratings 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" (rating 3).