Ex Post-Evaluation Brief
Indonesia: Credit Line for Industrial Efficiency and Pollution Control Project Phase II

Programme/Client	2003 66 781, FC loan (IDA terms and conditions) for credit line to SMEs - environmental investments EUR 9 million	
Programme executing agency	Indonesian Ministry of Environment (KLH)	
Year of sample/ex post evaluation report: 2010*/2011		
	Appraisal (planned)	Ex post-evaluation (actual)
Investment costs (total)	EUR 11.25 million	no change
Counterpart contribution (company)	EUR 2.25 million	no change
Funding, of which budget funds (BMZ)	EUR 9.0 million	no change

* random sample

Project description: The project, IEPC II, is the second phase of the evaluated credit line for Industrial Efficiency and Pollution Control 2005. The intervention in Phase II was aimed at the following:

1) Setting up a refinancing line at Bank Negara Indonesia (BNI) and Bank Ekspor Indonesia (BEI - today Indonesian Eximbank) to be fully disbursed by Indonesian commercial banks within three years for refinancing environmental investments by SMEs. Environmental investments refers to those investments with a beneficial environmental impact, that is, both so-called end-of-pipe solutions (e.g. treatment plants) and integrated measures (including the installation of more modern machinery with lower consumption of water, raw materials, etc.) were eligible for finance.

Objective: As overall objective, the project was to make a contribution 1) to reducing environmental pollution and the efficient use of natural resources by SMEs and 2) deepening the financial system by establishing long-term financial instruments for corporate environmental investments. The main project objective was efficient and demand-side lending for corporate environmental investments.

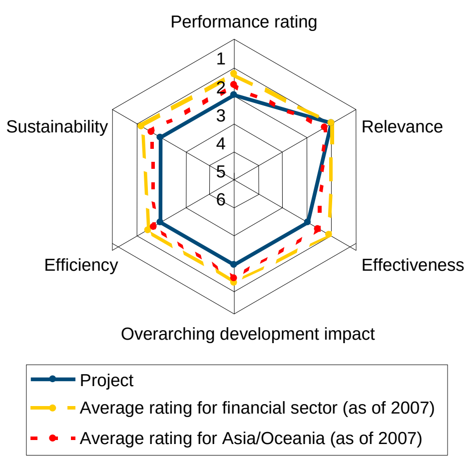
Target group: Indonesian (M)SMEs in the industrial sector with assets of up to IDR 10 billion (approx. EUR 1 million) initially in the particularly polluted regions, Java and Bali, and later Indonesia-wide. Consideration was also given to SME clusters looking to make joint environmental protection investments eligible for assistance.

Overall rating: **3**

In response to the highly relevant need for environmental protection and the establishment of long-term financing facilities, finance was provided for effective environmental investments by SMEs with a simultaneous high measure of ownership on the part of the executing agency, although implementing capacities were in part inefficient.

Of note: In view of the dual objectives (environmental and financial sector results), a broad set of complementary consulting inputs and the establishment of adequate refinancing facilities are of central importance for successful, effective and efficient programme objective achievement.

Rating by DAC criteria



EVALUATION SUMMARY

Overall rating: Along with the complementary measure and with its dual objectives in response to the high developmental relevance of green banking on the one hand and the need for long-term refinancing capacity in the Indonesian financial sector and adequate supply of finance for MSMEs on the other, due to the impacts achieved and the enhanced awareness in the environmental sector, the high measure of ownership and successful sustainability results in the lead executing agency, and despite delays and ongoing deficits in the financial sector, the project performance overall is assessed as sufficient: **Rating 3**.

Relevance: Environmental protection and particularly the adequate provision of financing facilities for environmental investments remain relevant issues and/or have been upgraded in Indonesia with the current so-called Green Banking Initiative of the central bank (Bank Indonesia, BI), which also reflects the current priorities of the Indonesian Government. Building long-term refinancing capacities, improving maturity matching in the banking sector and establishing financial services to meet needs, particularly for Indonesian SMEs, remain central challenges for the Indonesian financial system. With the ambitious dual approach of contributing both to reducing environmental pollution and conserving resources, establishing long-term financial instruments and deepening the financial system through efficient, demand-side lending for corporate environmental investments, the project addresses a major development constraint. Besides German development cooperation, other donors, such as Japan, France or the multilateral ADB, also address the issue of environmental lending and/or support the development of technical expertise in the environment and certification sector, such as Australia, Denmark or Switzerland. The project conformed with the priorities of German development cooperation at appraisal and with its dual objective is still consistent with the BMZ sectoral strategy in sustainable economic development today. Environmental protection and sustainable economic development still play a role in the current priority sectors of cooperation with Indonesia - climate protection and private-sector development (Sub-Rating: 2).

Effectiveness: As measured against the indicators set at appraisal, the project objective of efficient, demand-side lending for corporate environmental investments has only been achieved in part. The project indicator for portfolio quality (loan default rate <5%) has been fully met with a reported 100% repayment rate. In contrast, the target indicator of full disbursement of the credit line three years after programme start has not been achieved due to substantial delays in the establishment of the APEX structure, also under the influence of external factors. As the disbursement indicator is primarily located at the output level, but only measures the outcome of the FC measure to a limited extent, it was agreed locally to consider adding another indicator to determine whether the agreed environmental investments were carried out at company level and the facilities were operational. The findings of the local inspection indicate that this indicator has been successfully met (Sub-Rating: 3).

Efficiency: Apart from slow disbursement, the efficiency of the FC measure is gauged to be adequate overall in terms of results achieved compared with allocated resources. As to allocation efficiency, an efficient selection was made of good borrowers, as evidenced by the full repayment rates. A sample of 10 borrowers confirmed the environmental relevance of the financed measures. The loans were granted by the banks as planned on subsidised terms and conditions slightly below market rates (1-1.5%). Basic incentives were therefore correctly set for corporate environmental investments, but these complement the pressure on the respective enterprises stemming above all from environmental legislation and supervision, from the export markets and from civil society. As far as the production efficiency of the project is concerned, the onlending banks operate cost-effectively and with adequate risk management. Loan handling time has improved enormously compared with 180 days in the predecessor project IEPC I (average handling time in IEPC II: 2 months). Delays/Inefficiencies in the lending process are largely due to the establishment of the APEX structure, the agreement on refinancing terms and conditions and the ill-defined role allocation between the APEX and the onlending banks, partly resulting in duplicate borrower appraisals. To a far lesser extent, the longer handling times were due to the detailed documentation needed as part of the technical advice from the consultant and/or for auditing by KLH. The procurement costs of the investments appear adequate and the quality of the works executed good so far (Sub-Rating: 3).

Overarching developmental impact: Without the continuous work of KLH in the environment sector, the diverse information and training events as part of the complementary measure and the provision and marketing of a suitable environmental loan product over the last decade (IECP I and II), environmental awareness and the familiarity with environmental issues in certain subsegments of the Indonesian banking and business sector would certainly not be as high as they are today. At the same time, the supervision and implementation of environmental legislation by the local offices of the environment agency as well as the dialogue and knowledge exchange between KLH at national level and the local representatives of the agency in the individual regions have played a central role here. Ongoing dialogue between KLH and the Indonesian central bank shows that green banking has also gained increasing strategic relevance as an issue, both at supervisory level and also among the banks. The establishment of long-term sources of finance and financial services and adequate foreign currency finance facilities remains a focus of Indonesian financial system development, but weaknesses remain which above all indicate the need for an adjustment of the APEX function and structure in both APEX banks based on the experience gained. The beneficial effects of the investments made on profitability and employment in the Indonesian private sector complement the positive results in the environment sector and the steps taken for further financial-sector development (Sub-Rating: 3).

Sustainability: Of positive note is the large measure of ownership on the part of the project executing agency, KLH. As a consequence, besides capacity building in KLH, it has mobilised its own funds beyond the project term and German FC funding to continue to improve environmental investment monitoring and/or ensure the continuation of technical consulting support for the enterprises. In contrast to this are the persistent sustainability shortcomings in the APEX structure and/or in the banking sector overall. Although many instruction, training and awareness measures were carried out at bank and company level as part of the complementary measure, on the one hand more intensive support was needed for the two APEX banks to establish their sustainable operation but also for a more critical appraisal. On the other, as a result of the national approach of programme marketing, the participant onlending banks generally provide the environmental credit line in all their branch offices, but actual know-how development in environmental finance in the individual branch offices, e.g. in a pilot approach, remains limited. A basic question is also whether building institutional know-how in technical environmental impact assessment in the banking sector makes sense considering the relatively low number of loans. A better alternative would be for the banks to draw on external technical experts, as some have already done (Sub-Rating: 3).

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:

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).