Jordan: Industrial Development Bank IX (IDB IX)

Ex post evaluation report

OECD sector	24030 / Financial institution of the formal sector	
BMZ project IDs	1995 66 167 / 1995 70 342	
Project executing agency	Industrial Development Bank	
Consultant	./.	
Year of ex post evaluation report	**2007**	
	Project appraisal (planned)	**Ex post evaluation report (actual)**
Start of implementation	Q3 1998	Q3 1998
Period of implementation	6.25 years	3.25 years
Investment cost	EUR 1.5 million	EUR 1.5 million
Counterpart contribution	./.	./.
Financing, of which FC funds	<>	<>
Other institutions / donors involved	<>	<>
Performance rating	5	
• Relevance	4	
• Effectiveness	4	
• Efficiency	5	
• Overarching developmental impact	5	
• Sustainability	4	

<u>Brief description, overall objective and project objectives with indicators</u>

The aim of the project was to assist Jordanian industrial enterprises with attaining and adhering to national environmental and safety standards which were still being elaborated at the time of the project appraisal and only some of which had a legal basis (project objective). In this way, the project was to contribute to reducing harmful emissions by commercial enterprises and the associated risk to human health and the environment. To achieve this, these enterprises received loans at favourable conditions to finance investments in environmental protection. The funds for these loans stemmed from a newly established revolving credit fund at the Industrial Development Bank (IDB).The revolving fund was initially endowed with EUR 2.17 million provided in the form of a Financial Cooperation (FC) financing contribution. The plans also called for a complementary measure (FC financing contribution of EUR 0.38 million) to offer advice to sub-borrowers on preparing the investments in environmental protection being financed out of the credit fund. The following indicators were defined in the project appraisal report to measure achievement of the objectives:

(1) Following completion of the investment, the environmental protection limits set for the enterprises receiving the funds are being adhered to during continuous operation (indicator for the overall objective).

(2) At least 85% of the refinanced loans are being properly repaid to IDB (no payment arrears, no debt rescheduling) (indicator for the project objective).

Project design / major deviations from the original project planning and their main causes

IDB was founded by law in 1965 as an institution under public law and is supervised by the Jordanian Central Bank. Its main task is to support the country's industrial, commercial and tourism sectors by providing medium and long-term loan and equity financing. In line with its mission as a promotional bank, IDB operates according to private-sector standards and has legal, financial and personnel autonomy. Until 1994 the Jordanian Ministry of Finance held 19% of its equity, yet this holding has since been reduced to 9% in the course of the government's privatisation efforts. Additional key shareholders include the Social Security Corporation (Jordan's public pension fund; 12%), the European Investment Bank (EIB; 8%) and the Arab Bank (7%). The remaining shares are held by a broad range of institutional and retail investors.

IDB employs 103 people in total (some 60% fewer than at the time of the project appraisal in 1995); the share of female employees is 36%. All of its employees are well educated or trained and the share of academics is high at 60%.Extensive basic and advanced training measures (in computers, accounting, management, loan management and collection, and marketing) keep employee qualification on a high level. In the past few years, however, the level of fluctuation at IDB has been very high, particularly among younger academics. In the future IDB needs to make an effort to ensure adequate remuneration, especially for key positions in the loan departments, in order to recruit and retain qualified employees.

Its promotional business focuses mainly on medium to long-term financing (loans and leasing) for industry and the craft trades and also, for some years now, tourism. The industrial sector continues to account for the largest share of the loan portfolio (approx. 75%). The bank also offers financing to micro enterprises, brokerage services on the Amman stock exchange and management training for entrepreneurs. As regards its business policy and working methods, overall IDB has been able to maintain professional standards despite the personnel problems mentioned above.

In general, credit analysis and approvals are taken care of by the *Project Finance Department* - in most cases at the bank's headquarters in Amman - which employs both loan officers and engineers. In addition to evaluating loan applications, this department always appraises projects on-site. IDB's credit analysis procedure includes a sector and market study, a detailed financial analysis of the company applying for financing as well as a technical analysis of the investment project. Evaluations of loan applications for the environmental credit line are based on environmental audits, studies by consultants and on the requirements of local approval processes. Approved environmental loans are processed by the *Loan Management Department*. Loan collateralisation (in the form of land charges or bank guarantees) is standard procedure. An IT-supported management information system is in place. The bank does not yet have a standardised procedure for handling loans in default, yet further measures to strengthen the risk management are planned.

Business development and financial situation

The business development of IDB reflects the economic and sector development that could be observed in the country over the past 10 years, beginning with a recession and stagnation in lending and moving towards gradual stabilisation and economic recovery. At the end of 2006 the balance sheet total of IDB was JOD 137 million, marking a 19% rise over the prior year and approximately matching the figure at the time of the project appraisal (1996: JOD 134 million). Owing to a high volume of non-performing loans (NPLs), at the end of the 1990s IDB attempted to prevent the situation from deteriorating further by imposing a more restrictive lending policy. This led to a steep drop in loan commitments in the year 2000 to JOD 5 million. Loans committed under the environmental credit line IDB IX in the years 1999 to 2002 were an exception: these loans were granted in precisely the same period as a result of additional marketing activities in connection with the favourable lending conditions.

IDB's equity base remains comfortable, shielding the bank from credit risks. Its capital adequacy ratio (equity to risk-based assets) has doubled since the project appraisal and is currently around 60% (2006), thus significantly exceeding the requirements of the Jordanian Central Bank (at least 12%).The bank has sufficient liquidity, the ratio of its liquid funds to the balance sheet total rose to 42.9% in 2006 (2005: 39.3%), and its short-term liabilities with maturities of up to 12 months are covered to nearly 190% by short-term receivables (excluding NPLs). In light of the high potential risk emanating from the net loan portfolio (e.g. restructured loans), the bank's liquidity management, which is rather conservative, seems adequate.

The FC contribution was provided to IDB in the form of a grant for the establishment of a revolving credit fund to, in turn, finance a total of 19 environmentally relevant projects by small and medium-sized enterprises (SMEs) for a total volume of JOD 1,097,535 (EUR 1,542,034.60; converted at the weighted exchange rates prevailing at the time of the individual disbursements). The average volume of the sub-loans was JOD 57,765 and the maximum loan amount was JOD 80,000. All of the sub-loans were denominated in local currency and granted at the same conditions: 7-year maturity including 2 redemption-free grace years, 5% fixed interest rate (below the market rate) and no additional charges. According to IDB, the interest income was used as follows: 2.5% to cover IDB's administrative expenses, 1% to a development fund of the Ministry of Planning, and 1.5% to finance studies and publicise the environmental credit fund IDB IX. These lending conditions do not make real capital retention possible on a long-term basis.

Fourteen of the 19 refinanced projects involved environmental investments in *end-of-pipe technology* (emission control): 5 wastewater treatment facilities, 8 air filter facilities and a combined wastewater / air pollution treatment system. In addition, 5 *cleaner production technology* projects (energy efficiency measures) were carried out that not only had direct environmental impact but also achieved cost savings in production. The sub-borrowers were SMEs from the food, pharmaceutical, chemical and producing industries.

The sub-loans were granted by IDB following (environmental) technical and banking reviews. The conditions for the sub-loans corresponded to the stipulations in the appraisal report and the separate agreement to the financing agreement. The sub-loans were extended to private SMEs whose fixed assets did not exceed EUR 5.1 million. As documented in the project appraisal papers, this criterion was met in all cases at the time of approval of each loan. However, some of the enterprises have since grown or merged with other companies, so that some of the financed businesses now have fixed assets that exceed this limit. Since the unofficial Jordanian definition of SMEs does not specifically mention a maximum value of fixed assets, we do not consider this point to be critical.

Overall, the implementation of the project remained far behind expectations. In spite of IDB's efforts to market the environmental loans adequately, the first sub-loan was not granted until 1999 - 3 years after the financing agreement was signed - and, between 2002 and 2006, no new projects were identified, leading to a total cutback in the funds of 30%.A combination of various factors led to this unsatisfactory result regarding the commitment of the funds:

- Insufficient experience and lack of special know-how on the part of IDB employees in connection with the review and monitoring of 'environmental loans.' This could have been avoided by introducing a corresponding complementary measure. Yet, during the project appraisal it was assumed that a previous training measure had trained enough employees in key aspects related to such loans. Therefore, no precautions were taken that could have stemmed the personnel fluctuation in the years to follow.
- Weak demand for the loan product by the target group since in the implementation phase - contrary to expectations at the time of the project appraisal - there was no coherent legislation in place to prescribe mandatory limits, polluters were neither subjected to reviews nor sanctioned by the authorities, and there were no further positive incentives such as tax benefits to encourage environmental investment.
- Occasional low prioritisation of project implementation by the (former) IDB management.

In spite of this, IDB is planning to keep running the environmental credit fund with its own funds, possibly together with other donors. Although the current sub-loan conditions would not assure cost coverage, IDB would strive to gradually modify them accordingly. The enterprises themselves are responsible for the operation and maintenance of the projects financed via the sub-loans. With the exception of a chemical producer, no obvious shortcomings were noted in this regard during the project visits.

Key results of the impact analysis and performance rating

As environmental limits were not set in all cases and as state controls were lacking, during the course of project implementation neither IDB, the sub-borrowers nor external auditors systematically documented relevant emission limits for the entire IDB IX portfolio. Therefore, at the time of the ex post evaluation the degree to which the overall objective was achieved could only be determined on the basis of a random selection of 6 of the 19 projects refinanced under the credit line. The necessary data was available for only 2 of these 6 samples (both wastewater treatment projects). In one case all prevailing environmental limits were met; in another case, nearly all relevant measured data exceeded the limits to an alarming degree. Furthermore, there were no indications that the project had immeasurable environmental effects on the respective sector. Therefore, indicator no. 1 was not fulfilled.

The indicator for project objective no. 2 was basically considered to be fulfilled at the time of the ex post evaluation; during the course of project implementation its fulfilment was not always assured, however. Of the 19 refinanced projects, 13 loans have since been repaid in full and the remaining 6 are still in the repayment phase; 2 of these 6 are in default. The outstanding payments for the 2 loans that are in default total JOD 152,800, or 13.9% of the IDB IX loan portfolio (repayment rate > 85%).The quality of the IDB IX loan portfolio at the time of the ex post evaluation was still satisfactory overall, contradicting not only previous IDB reports (e.g. in 2005 the portfolio still contained 8 loans past due) but also the total portfolio quality of IDB, which is otherwise highly problematic (40.5% NPLs). The reasons why the IDB IX portfolio fared better are unclear, giving rise to slight doubts as to the actual value of the figure determined in the ex post evaluation.

Project impacts, risks and success rating

The project enabled IDB to offer loans at favourable conditions for investments by small and medium-sized industrial enterprises in environmental protection. Demand for environmental loans by the target group remained far behind expectations, though, causing the project to be discontinued and the committed funds to be cut back by about 30%. As a result, the project could not make a sustainable contribution to introducing a new financing product (environmental loan) and, thus, did not have any structural impact in terms of deepening and broadening the financial system in Jordan. In terms of the project's environmental impact, no improvements for FC projects could be observed. The financed projects were found to have positive environmental effects in individual cases only. Yet, environmental protection and resource conservation were primary project goals.

No specific impacts were noted with regard to gender equality. In view of the stated objectives, it would not have been purposeful to grant loans based on gender. The project did not focus on participatory development / good governance. The project was designed to have a general developmental orientation.

From a current perspective, we evaluate the project risks identified during the project appraisal as follows:

(1) The risk of insufficient demand by the target group - this risk was deemed to be rather low during the project appraisal - materialised. During the project appraisal the risk of a delay in the establishment of the Ministry of the Environment and in the reinforcement of the control mechanisms was underestimated, which was directly related to the demand for environmental loans. The consequences were very slow fund commitment of the funds and discontinuation of the project prior to full disbursement.

(2) The funds were used properly; thus, the risk of improper use of funds or of windfall effects caused by free riders did not arise.

(3) The local ex post evaluation revealed improper operation of the financed facility in only one case; for the 5 remaining facilities that were visited there were no indications of improper operation or maintenance. Therefore, it can be assumed that, for the most part, this risk did not arise.

(4) Apart from a few exceptions, the risk that prevailing emission limits are not being met despite investments in environmentally friendly technologies arose.

In summary, we have arrived at the following assessment of the developmental effectiveness of the IDB IX project:

<u>Relevance:</u>

The project design did not take into sufficient account that a reduction in harmful emissions cannot be achieved solely through the financial sector (by offering environmental loans at favourable conditions) but that above all, environmental laws and their enforcement have to be strengthened. The overall conditions necessary for the measures to succeed were not fulfilled until many years later than originally expected. The delayed adoption and implementation of relevant environmental laws and also poor monitoring and sanctioning of breaches of environmental law by industrial enterprises (primarily SMEs) were the main reasons for the sluggish and finally incomplete commitment of the FC funds. Therefore, we rate the project's relevance as unsatisfactory **(sub-rating 4).**

Effectiveness:

The environmental goal was attained in only a few cases and no structure-building effects were generated. Of the 19 environmental loans that were granted, at the time of the ex post evaluation more than 85% of the portfolio was being repaid properly; however, during the course of project implementation some substantial arrears accrued in a few instances. Despite several positive results, the achievement of the objective stayed far behind expectations. Real capital retention of the revolving credit fund is not possible with the loan conditions that were selected. For this reason we also rate the project's effectiveness as unsatisfactory (**sub-rating 4).**

Efficiency:

We rate the production efficiency of the project as clearly inadequate. During the course of almost 10 years, the 15 employees (on average) working in the Project Finance Department granted only 19 sub-loans under the credit line IDB IX. In terms of cost efficiency this is not enough, also in view of the special marketing measures that were carried out for the credit line. Overall, IDB's operative figures paint a mixed picture: While the small branch network and several state benefits make for a very good ratio of operative expenses to the loan portfolio of 1.9%, the portfolio quality, the number of loans granted per employee and the difficult approval process of IDB IX loans paint a more negative picture of the bank. In addition, the allocative efficiency is insufficient: IDB was not able to use the funds provided in their entirety for sub-loans granted at favourable conditions, nor did it build up a portfolio of environmental loans through the revolving use of the funds. Overall we rate the efficiency of the project as clearly inadequate **(sub-rating 5).**

Overarching developmental impact:

A few of the projects of the sub-borrowers that were financed were able to generate positive environmental effects, yet in most cases it was not possible to quantify the environmental improvement and, in one case, the operation of the facility even polluted the environment to a considerable degree. No structure-building, broad-scale or even model effects were produced. Yet the situation did not deteriorate, either. Against this background, we rate the project's overarching developmental impacts as clearly inadequate **(sub-rating 5).**

Sustainability:

The extent to which IDB is serious about ensuring the revolving use of the funds is very difficult to gauge and depends heavily on the continuity of the current management as well as on the gradual commercialisation of the loan conditions towards cost-covering, risk-adjusted conditions. Through today the developmental efficacy of the project is still inadequate and it is highly unlikely that the project will attain positive efficacy in the foreseeable future - despite the plans announced by IDB. Therefore, we rate the sustainability of the project as unsatisfactory **(sustainability rating 4).**

In a summarised assessment of the above impacts and risks we rate the project as having clearly inadequate developmental effectiveness **(overall evaluation: rating 5).**

General conclusions and recommendations

It makes sense to introduce environmental credit lines as a complementary measure for implementing a country's environmental policy goals. When such credit lines are being considered, though, it is important to ensure that most of the corresponding environmental laws including monitoring of their enforcement and related sanctions have already been implemented.

As regards the initial endowment of revolving funds, the FC funds ought to be provided in the form of a loan. This would serve as a stronger incentive for assuring careful use of the funds and for replenishing the fund with monies that flow back in.

Furthermore, for environmental credit lines to be set up successfully we recommend ensuring sufficient personnel and technical capacities at the project executing agency, e.g. via a corresponding complementary measure, especially in pilot projects, as in the case at hand. Apart from a fund for environmental audits / feasibility studies that is managed by the project executing agency, selective support for the executing agency with project implementation (e.g. environmental training, lending technology, monitoring of the environmental impacts on the sub-borrower level etc.) is also necessary. Such a design will help achieve sustainable development goals for the financial sector so that the economic sector earmarked for support can continue to benefit from the development measure even after the FC financing comes to an end.

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

Legend

Projects are evaluated on a six-point scale, the criteria being relevance, effectiveness, efficiency, overarching developmental impact and sustainability. The ratings are also used to arrive at a final assessment of a project's overall developmental efficacy. The scale is as follows:

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

Sustainability is evaluated according to the following four-point scale:

Rating 1	very good sustainability	The developmental efficacy of the project (positive to date) is very likely to continue undiminished or even increase.
Rating 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.)
Rating 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.
Rating 4	inadequate sustainability	The developmental efficacy of the project is inadequate up to the time

		of the ex post evaluation and an improvement that would be strong enough to allow the achievement of positive developmental efficacy is very unlikely to occur. 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.

Criteria for the evaluation of project success

The evaluation of the 'developmental efficacy' of a project and its classification during the ex post evaluation under one of the various levels of success described in more detail above concentrate on the following fundamental questions:

Relevance	Was the development measure applied as designed (developmental priority, impact mechanisms, coherence, coordination)?
Effectiveness	Is the extent to which the project objectives have been achieved thus far through the development measure - based also on present-day requirements and the state of knowledge - adequate?
Efficiency	To what extent were the efforts spent - measured in terms of the impacts achieved - still justified overall?
Overarching developmental impact	Which impacts could be observed at the time of the ex post evaluation in political, institutional, socio-economic, socio-cultural and ecological terms? Which side effects not directly related to the achievement of the project objectives could be observed?
Sustainability	To what extent can the positive and negative changes and impacts brought about by the development measure be considered sustainable?