Ex Post-Evaluation Brief
Mongolia: Microfinance Project XacBank

Programme/Client	Microfinance Project XacBank BMZ ID 2005 66 414 (investment)	
Programme executing agency	XacBank	
Year of sample/ex post evaluation report: 2011*/2011		
	Appraisal (planned)	Ex post-evaluation (actual)
Investment costs (total)	EUR 2.7 million	EUR 2.7 million
Counterpart contribution (company)	-	-
Funding, of which budget funds (BMZ)	EUR 3.0 million	EUR 3.0 million

* random sample

Project description: The project executing agency, XacBank, is a private Mongolian commercial bank with a pronounced focus on financing micro and small enterprises in rural regions. The microfinance project comprised a KfW equity holding in XacBank on behalf of the German Government amounting to EUR 1.8 million in the form of a subordinate loan with a conversion option, a supplementary refinancing line of EUR 0.9 million and a staff support measure for improving risk management amounting to almost EUR 0.3 million (accompanying measure).

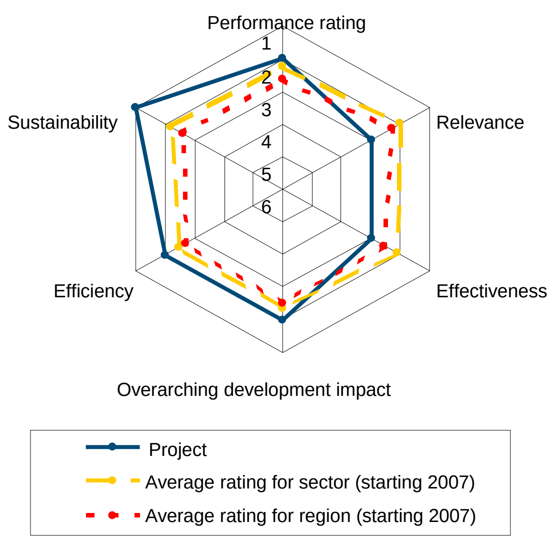
Objective: The project aimed at strengthening the equity base and the refinancing position of XacBank to enable it to provide sustainable, efficient and customer-oriented microfinancial services (project objective). Overall, it was to contribute to poverty reduction by promoting employment and income in the target group and to alleviating the housing shortage. Besides this, the overall objective was defined as deepening and widening the financial system in keeping with market-economy principles to meet needs.

Target group: The target group of the project was defined as private micro (up to 10 employees) and small enterprises (up to 50 employees) of all sectors, including farming. The project also aimed at supporting low-income private final borrowers currently living in yurt settlements and the XacBank itself.

Overall rating: 2

Of note: Due to the loans granted by the project, the financing basis of XacBank was strengthened to such an extent that it was one of the few banks that could continue to grant loans to micro and small enterprises in the economic crisis of 2009 (Only two out of 14 banks had a growing loan portfolio in 2009.). It was therefore able to contribute to securing employment and income (Overall objective 1) in a particularly difficult economic climate.

Rating by DAC criteria



EVALUATION SUMMARY

Overall rating: The XacBank microfinance project can be assessed as successful and sustainable. The target group of micro and small enterprises was reached and mortgage loans granted for housing finance. Due to the international financial and economic crisis in 2008-2009, which also had a severe impact on Mongolia, the project had a greater direct effect by securing jobs and income (Overall objective 1). At the same time, the acute housing shortage could not be alleviated (Overall objective 2) through lending. For these reasons, the developmental impact of the project is assessed as good. **Rating 2**

Relevance: According to the project executing agency, XacBank, the three components of the microfinance project at the time of appraisal and issuance of loans and/or implementation of the accompanying measure were appropriate to the needs of the bank. With the project, German Financial Cooperation (FC) was the first development institution in 2007 and KfW Entwicklungsbank also the first bank to provide a subordinate loan to XacBank. The project was intended to strengthen the equity base of XacBank without changing the equity structure so as to support loan portfolio growth in a 'simple way'. At the same time, the long-term refinancing sources made available were to enable the bank to make long-term loans to final borrowers. A 'pure' equity stake in the XacBank was not possible at project appraisal, as the ownership arrangement had already been established. The results chain at appraisal was plausible: These measures were intended to contribute to expanding credit supply to raise employment and income of poorer sections of the population and to alleviating the housing shortage.

In the course of project implementation, the project executing agency extended its business scope - micro enterprises are still served by XacBank but its average loan amount has continuously increased. In addition, it has shifted its focus more towards small and medium-sized enterprises (SMEs). According to the project executing agency, micro enterprises play a diminishing role due to strong economic growth in Mongolia. They are developing into SMEs or individual entrepreneurs are abandoning self-employment to take up paid employment. XacBank further argues that due to the quite small total population (2.7 million people, almost 67% of whom are of working age) the 'renewed growth' of MSEs is limited. However, this is not confirmed by the statistics. In Mongolia, companies are defined by the size of the workforce – i.e. enterprises with fewer than 10 employees are classified as MSEs. According to the Mongolian statistical yearbook of 2010, approx. 73,822 enterprises were registered (2009: 64,574) of which almost 90% had a workforce of <10 (micro enterprises). Contrary to the project executing agency's assertion, therefore, MSEs can also be expected to continue to play a major role for employment and income and the new business policy shift towards SMEs is not completely warranted from a development-policy standpoint.

The coordination of international donor activities in the sustainable economic development priority is limited. The Federal Government's adoption of the EU lead donor function has so far only resulted in greater information exchange on development issues among the embassies of European donors in Ulan Bator. At project appraisal, however, Asian Development Bank (ADB) supported Mongolia with a Housing Finance Project, which can be seen as subsidiary to the project reviewed here. In July 2011, the governments of Federal Republic of Germany and Mongolia agreed to reduce and/or concentrate the many priorities and fields of activity and the related number of individual projects. It was decided that sustainable economic development would no longer make up a priority of Mongolian-German cooperation in future. ADB and the World Bank are currently preparing to introduce a deposit insurance system in Mongolia. European Bank for Reconstruction and Development (EBRD), however, largely supports the sector through its cooperation with XacBank.

A shortcoming in relevance is that the KfW loans have been granted in US$ so that mortgage loans to final borrowers are also denominated in US$. According to the central bank, approx. 20% of mortgage loans are granted in US$, a large part of which through XacBank, which ascribes this to lack of refinancing in local currency.

At the time of project appraisal, the design of the development measure was more or less adjusted to the needs of the partner country, the target group and project executing agency and aligned with the activities of other donors. However, given the strategy of XacBank towards SMEs, that the international development cooperation and the assistance needs of Mongolia have meanwhile changed so that development measures to support the banking sector are no longer accorded priority and as in particular no strategic donor harmonisation took place during the whole project term, we allot the Sub-Rating 3 for project relevance.

Effectiveness: The project design was not altered in the course of implementation.

The project objectives have been basically achieved. Although the business policy of XacBank concentrates more on small and medium-sized enterprises, demand-led financial services have been and still are provided to micro enterprises. XacBank, however, redefined micro enterprises in the course of the project: At project appraisal loans <US$ 10,000 were counted as microloans, but this already quite large amount for a microloan was raised to US$ 15,000 in 2009. No related adjustment was made in project reporting.

The purchase/construction of yurts has been financed by XacBank since 2007 and the ratio to the total housing finance portfolio has continually increased over the last four years (end of 2010: 21.5%).

The indicators for loan portfolio growth (on average 30% a year) and quality (PAR >30 days, max. 5%) were met over the last four business years. The indicator to assess target group outreach (at least 60% of MSE loans granted to micro enterprises) was revised in ex-post evaluation and was accordingly met throughout the project term. The target group was therefore reached. Return on total assets of XacBank fell below the target of 2% a year, which is not very important, however, as the significance of this indicator is disputed in any case.

In 2010, XacBank commissioned a social performance rating from the Planet Rating agency. On a scale of 0 to 5, with 5 the best possible result, it was given the grade 4- altogether and 3+ for client protection & ethical finance. The bank is attested good processes that contribute to avoiding client overindebtedness. At the same time, there is room for improvement in transparency and data protection. The ratio of consumer loans in the loan portfolio (amounts) came to almost 15% at the end of 2010, which confirms the positive rating for responsible finance.

One notable shortcoming is that the positive business development of the bank is only partly attributable to the project. German FC was, however, able to make a contribution to meeting the refinancing requirements of XacBank. In the course of project implementation, however, there was a high demand for equity capital. XacBank did not avail itself of the option of converting the FC/KfW subordinate loan, as the then shareholders were always prepared to increase their stake in keeping with needs. A new ownership arrangement was set up, also including EBRD and the International Finance Corporation (IFC) as shareholders, that could directly steer and exert large influence on the development of XacBank. As lender, KfW was unable to influence the management of XacBank.

Although the project objectives were basically achieved, this would very probably have been the case without the project. We allot Sub-Rating 3 for effectiveness.

Efficiency: The loans to XacBank were granted at market conditions in keeping with the project appraisal report. Of note here is that the interest rate for the FC loan is variable and available comparative figures are for a fixed rate of interest. The terms of the comparative loans are also shorter. Our impression is that the final loans were allocated for useful investments. The results achieved by the project seem to stand in reasonable relation to the resources allocated.

The production efficiency of the bank is good - average productivity per loan officer amounts to 263 loans (number of loans handled). At the same time, portfolio quality (portfolio at risk – PaR >30: 1.64% in 2010) is above average so that the repayment rate for final loans is very high (indication of good allocative efficiency). This is attributable to the good lending technology and/or loan appraisal at XacBank. The liquidity position of the bank is comfortable and profitability is also good. At the end of 2010, return on equity amounted to 22.2% and return on total assets to 2.0%.

The implementation of the accompanying measure was delayed and did not begin until the end of 2009. At the start of implementation, the consultant and XacBank agreed on adapting the planned measures to the needs of the bank, which was expedient in response to

the delay. However, in discussions with the departments of XacBank that benefited from the accompanying measure (Treasury Department, Credit Management Division and Integrated Risk Management Division), it emerged that the proposals and/or papers prepared by the consultant, AFC, could not be put to use at all or only to a small extent. Due to the delay, the accompanying measure (completion in October 2010) can only have had an influence on the business development of XacBank at the end of 2010 at the earliest. The sustainability and results of the accompanying measure are therefore assessed as low.
Based on the high production and allocative efficiency of XacBank and the adequate ratio of fund allocation to project results (except for the rather ineffectual accompanying measure), we assess the efficiency of the project as good (Sub-Rating 2).

Overarching developmental impact: The loans issued under the project strengthened the financing capacity of XacBank to such an extent that it was one of the few banks that could continue to grant loans to MSMEs in the economic crisis in 2009 (with loan portfolio growth in only two out of 14 banks in 2009). This contributed to securing employment and income in a particularly difficult economic climate (Overall objective 1). There are indications of employment and income growth in Mongolia since the economic upturn in 2010.

In 2006, XacBank was the first private bank in Mongolia to provide housing finance (Overall objective 2) through mortgage securitisation. Long-term refinancing is particularly needed in this business segment, which was facilitated by the project. Due to the impacts of the global economic crisis on Mongolia, particularly on the building sector, the provision of long-term refinancing alone proved insufficient to alleviate the housing shortage. Above all, during the total building freeze in the country in 2009, no housing was constructed. At the same time, mortgage loans were solely issued in US$, so that when it appreciated they were no longer in demand by then. For these reasons, the XacBank housing loan portfolio stagnated, even declining slightly at times. An alleviation of the housing shortage cannot have begun until the economic upturn in 2010 and the improved framework for mortgage loans (enactment of a law enabling banks to sell real estate as collateral for mortgage loans without a court ruling and securitise mortgage loan portfolios).

The project can be expected to have widened the financial sector (Overall objective 3), as support for XacBank will make longer-term finance available. However, measured by total assets XacBank has only a market share of 7.5%, while the three largest banks in Mongolia combined account for 75% of total assets in the banking sector. As XacBank was itself strengthened as an institution with the subordinate loan, the financial sector was also widened through the introduction of additional financial services unintended at project appraisal (e-banking and green finance). The extent of financial intermediation in Mongolia increased from 48.4% in 2007 to 56.7% in 2010, to which XacBank will also have contributed.

The overall objective of employment and income growth could only be achieved in part after a delay. Poverty has not, however, generally been reduced in Mongolia. It is not possible to definitively ascertain how far the project has supported (employment and income growth) or impeded (increased poverty) these developments. As it nevertheless had additional beneficial effects amidst an unexpected deterioration of the economic climate, we allot the Sub-Rating 2.

Sustainability: XacBank has earned continuous profits since 2005 and was able to increase these substantially in the period of six years (14-fold). Even during the world economic crisis in 2008-2009, which had a very adverse impact on the financial sector in Mongolia overall, XacBank was able to successfully continue its business activity. The holding company ownership arrangement set up since 2008 (including shareholders such as IFC and EBRD) has additionally strengthened the institution and after a capital increase in 2010 is also prepared to support portfolio growth at XacBank with additional equity capital in future. Since 2008, the institution has not just continuously enlarged its business scope (greater focus on SMEs) but also its product range (mobile banking, financing energy-efficient investments) and is also planning to continue to provide and step up financial services to meet client needs (e.g. microinsurance).

We expect XacBank to sustain its operations in the financial sector in Mongolia and see no impediments to this development at ex-post evaluation. At the same time, the bank will be able to continue to provide more loans for MSMEs and housing finance in future. We therefore allot it the Sub-Rating 1.

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).