KfW ENTWICKLUNGSBANK

Mosambique: Promotion of Small Enterprises (GAPI III)

Ex post evaluation report

OECD sector	24030 – Formal sector financial intermediaries	
BMZ Project number	1999 65 922 (financial contribution) 2000 70 011 (complementary measure)	
Programme executing agency	GAPI	
Consultant	Not applicable	
Year of ex-post evaluation	**2006**	
	Programme appraisal (planned)	**Ex-post evaluation (actual)**
Start of implementation	April 2000	December 2001
Period of implementation	30 months	34 months
Investment costs	No figures	No figures
Counterpart contribution	No figures	No figures
Finance, of which FC funds	EUR 2.8 million	EUR 2.8 million
Other institutions/donors involved	None	None
Performance rating (Overall)	3	
• Significance/Relevance (Subrating)	2	
• Effectiveness (Subrating)	3	
• Efficiency (Subrating)	4	

Brief Description, Overall Objective and Programme Objectives with Indicators

The programme objective is the sustainable efficient provision of appropriate financial services to small and medium-sized enterprises (SMEs). By (1) providing refinance for medium-term and long-term investment loans to enterprises with a workforce up to 50 for the procurement of equipment and where necessary for operating capital in foreign and domestic currency (real investment) and by (2) conducting studies, training, technical support and other measures (personnel support), the intention is to make an overall contribution to establishing and maintaining viable SMEs (including cooperatives) and strengthening private-sector capacity in Mozambique. The financial contribution of EUR 2,812,105.35 was conduited by the recipient, the Republic of Mozambique, represented by Banco de Moçambique, as a loan in the form of a refinancing line to the programme executing agency, Gabinete de Consultoria e Apoio a Pequena Industria (GAPI). The financial contribution for the personnel support measure amounted to EUR 460,162.69.

Programme Design/Major Deviations from Original Programme Planning and Main Causes

Gabinete de Consultoria e Apoio a Pequena Industria (GAPI) was founded in 1984 by the Friedrich Ebert Foundation (FES) as a programme to promote small industry. In 1990, GAPI was converted into a financial institution with the Friedrich Ebert Foundation (30%) and the state development bank BPD (70%) as owners. BPD was privatized in 1997 and its shares assigned to the Ministry of Finance. As of 1999, GAPI is run as a joint stock company under the oversight of the banking supervisory authority. Forty per cent of the stake held by government consists of non-voting shares so that voting rights are parity split between it and FES.

GAPI now runs 9 branch offices covering all 10 Mozambican provinces (one province is co-served by a branch office in a neighbouring province). In the course of regional expansion, the number of personnel has grown steadily in recent years. From 31 personnel as recently as 2002, they now number 68. Altogether, the standard of qualification and motivation of GAPI personnel is probably above the national average. The salary scale is in line with Mozambican banking standards and can generally rate as competitive.

A protracted problem that has still not been fully solved is the inadequate management information system (MIS) at GAPI. The system presently in use is based on a programme in the Access programming language, which was designed in 1996 by the chief executive officer Antonio Souto. The system handles loan payouts, repayments, reserves and sectoral information. The MIS is not networked to the electronic accounting system, which was changed with the purchase of a new programme (PHC Corporate Software) last year. The MIS suffers from many deficits, which had already been pointed out in the last ex-post evaluation on GAPI II. It is not networked with the branch offices, generates information after a long delay only and is unreliable. This also hampered the preparation of the present ex-post evaluation, as some of the available data was inconsistent. Studies by consultants showed that the MIS reports with a 30-day delay recorded an error rate of up to 15%. So the need to introduce a new system was recognized and a specifications profile drawn up as early as 1998. In the FC complementary component as well, several measures were financed to set up the new MIS. Based on a feasibility study, a product was selected in 2003, which is already used by financial institutions in Mozambique and whose manufacturer employs servicing firms in South Africa (Tenemos eMerge). The adjustment and implementation of the system has, however, been repeatedly delayed, partly due to technical problems and the bankruptcy of the installation firm in the meantime so that the system is still awaiting final installation. According to GAPI, the problems have, however, been remedied and the new MIS has been ready for installation for a year. Its introduction has had to be deferred due to the ongoing reorganization of GAPI. After completion of the reorganisation, the management of GAPI Bank will then decide on introducing the system.

At present, large institutional changes are pending at GAPI. The lending activities are to be transferred to a new bank (GAPI Bank) and the consultancy and training tasks bundled in the GAPI development agency (GAPI DA). This is in response to deficits in banking lending business and the measures taken to separate lending business and advisory services and found a universal bank were recommended in the ex-post evaluation on GAPI II. The intention of reorganising GAPI and professionalizing the shareholder bodies through experienced shareholders is to enable the bank to remedy its present problems, earn a positive return on capital and operate sustainably. This will benefit the future GAPI DA as it can then concentrate on its core business, business development services (BDS) (see KfW appraisal report of 25 August 2006). Rabobank (30.7%), GAPI DA (29.3%), KfW (20%) and Norfund (20%) will hold shares in GAPI Bank, with the FES stake assigned to KfW. Reportedly in response to the findings of the last ex-post evaluation report in 2002, FES decided to withdraw as an investor in a financial institution, which is not really part of its mandate. GAPI Bank is supposed to successively take over a large part of the loan portfolio, the branch offices and up to 45 personnel from the present GAPI (see KfW appraisal report of 25 August 2006). The bank will start off with an equity capital of US$ 7.0 million and increase this to US$ 10.0 million after one or two years. In the startup phase, Rabobank International Advisory Services will support the management board of the new bank under a management contract. The shares of KfW and Norfund will be sold to Mozambican investors after a few years. The shareholders agreement was signed in August 2006. At present, approval procedures are underway for issuing the banking licence. As the central bank is amenable to the project, a speedy implementation is likely and business activity can be expected to begin in 2007.

Between 2002 and 2004, 97 loans were allocated under the FC credit line and 32 advisory and training measures were financed through the complementary measure. Ninety-one SMEs and 2 MFIs were financed with the 97 loans (some SMEs receiving more than one loan).

The sectoral allocation largely tallied with the overall portfolio at GAPI. Loans issued in the underdeveloped North (37%) were above average. GAPI has made increasing use of the FC credit to finance the activities of the branch offices outside Maputo, that is, for regional expansion. At US$ 33,000, the average loan amount was slightly higher in comparison with GAPI's overall portfolio. Portfolio quality developed in line with the overall portfolio (portfolio at risk > 90 days in 2003: 9.9%; 2004: 6%; 2005: 32.5%). Final borrower interest conformed with general interest rate policy at GAPI.

Under the complementary measure, altogether 32 activities were financed, comprising institutional support for SMEs and for GAPI itself. The largest part (21 measures) was devoted to institutional development at GAPI, in which 10 measures were carried out to develop and install the MIS. The remaining 11 measures were concerned with advising and training SMEs and credit unions. The large fraction of measures devoted to GAPI is due to the critical findings of the ex-post evaluation report on GAPI II in 2002, which shifted the focus of the complementary measure from the SMEs to GAPI as an institution.

The FC funds were provided as a financial contribution to the Republic of Mozambique, represented by the central bank, for conduiting to GAPI. The financing agreement and the special agreements were signed on 13 December 2000. The funds were conduited as a loan (15-year term with 5 years of grace) originally with interest charges but then interest-free. Agreement was reached on using split-interest counterpart funds to strengthen the equity base. Recirculating funds from the loan are channelled into a fund managed by GAPI. The first repayment installment is due at the end of 2006. At present, however, GAPI is conducting negotiations with the government on capitalising the funds, as with the first credit lines. So far, GAPI has assumed that it can retain the funds or that they will recirculate to it at a later date.

A positive aspect of the conduiting arrangements is that instead of a subsidy as in the two previous credit lines the funds in GAPI III have been provided as a loan, the lack of interest, however, still making up a large subsidy element. A closer market alignment of terms and conditions could have given GAPI more incentive to improve portfolio quality and put the funds to more efficient use. As most of the credit available to GAPI was interest-free or provided as a subsidy, it has little incentive to raise management efficiency and improve portfolio quality. In most cases, the funds at GAPI remain capitalized so that in the case of final loan losses only subsequent capitalization diminishes but this does not entail any great economic risks.

The spot checks on application of funds carried out in ex-post evaluation gave no indication of any improper use.

Key Results of Impact Analysis and Performance Rating

The programme objective was the sustainable efficient provision of appropriate financial services to small and medium-sized enterprises (SMEs) on market terms. The following programme objective indicator was defined: At final borrower level, debt service is timely for at least 80% of the outstanding loan amount throughout the programme term and for at least 85% in the final year. As defined, the programme objective indicator was only able to verify part of the programme objective.

The overall objective was the establishment and maintenance of viable small and medium-sized enterprises (including cooperatives) and a contribution to the sustainability of private-sector capacity. Moreover, by improving financial service delivery for private SMEs a contribution was to be made to developing the Mozambican financial system. No indicators were defined for the overall objective.

The target group was defined as private small and medium-sized enterprises (SMEs) with a workforce of up to 50 per enterprise and their personnel. Cooperatives also numbered amongst the target group. In actual fact in some cases, enterprises with over 50 employees were financed (13 loans out of a total of 97). Based on perusal of the borrower's files or inspections at some enterprises, all these can, however, otherwise be designated as SMEs in terms of size and structure. In some cases, seasonal workers were also counted or the enterprise still employed fewer than 50 personnel at the time of application. In cases of significant deviation (2 labour-intensive cashew processors with up to 800 employees), approval was obtained from KfW. The borrowers included 2 credit unions, which received refinance for their microfinance business. Altogether, the programme's target-group outreach was good. GAPI itself applies no specific definition of SME and there is no general definition in Mozambique overall, either. It would have been useful to define distinctive criteria for the target group together with GAPI at programme appraisal.

As defined, the target indicator only permits a limited assessment of programme objective achievement. Confining attention to portfolio quality does not do justice to the capacity-building and real economic impacts aimed at by the programme. It would have been better to define a more discriminate set of programme objective indicators to include institutional and real economic targets. Furthermore, the indicator does not make clear whether to include only the loans paid out under the FC programme or GAPI's entire loan portfolio. Nor is the time period defined for the final year of the programme term. If we take the year of the last disbursal of FC funds, 2004 would be the reference year. We propose applying portfolio growth and the expansion of branch offices as ancillary indicators for assessing programme objective achievement.

According to GAPI's calculations, the repayment rate for the loans under the FC programme and for the overall portfolio amounted in every year of programme implementation to over 80%. At the end of 2004, it came to 85% for the overall portfolio and 88% for the FC programme and at present it amounts to slightly more than 85% in both cases (end of June 2006). According to GAPI estimates, the programme objective indicator has thus been met. The GAPI indicator, however, only compares actual repayments with the expected repayments per period. If we apply the more usual calculation based on portfolio at risk, portfolio quality is no longer sufficient. Although measured against portfolio at risk (90 days) portfolio quality had improved in recent years and declined from 50% in 2001 (according to the ex-post evaluation of GAPI II) to 14% in 2004, it deteriorated again to 47.7% in 2005. The main reasons GAPI adduced for the deterioration is the reorganization of accounting in 2005 (adjustment of payment dates to the new system, requiring an amendment of the payment schedule for some borrowers, which was then entered automatically in the system as rescheduling and included in the portfolio at risk), a more adverse economic climate in the agricultural sector in 2005 and the reorganization workload for management and personnel. The exact role of the individual factors cannot be determined exactly. The actual losses at GAPI are, however, quite low (2.2% loans written off in 2005). A less consistent loan monitoring due to the workload entailed in the reorganization measures at GAPI is therefore certain to have had a major influence on the deterioration in portfolio quality. Most of the final borrowers visited as part of the ex-post evaluation had a record of delinquency and rescheduling, were, however, altogether solvent customers with only temporary financial difficulties except for one case (an entrepreneur who had fallen ill with AIDS and unable to continue business). Although GAPI's adaptability in rescheduling and repayment adjustment to the economic circumstances has certainly been helpful in many cases, it is probably too lax altogether and this has had an adverse influence on clients' payment morale. Despite acute problems in their enterprises, many clients could presumably service their debt on time as they can resort to additional sources of income but prefer the more convenient option of rescheduling where possible. With the foundation of GAPI Bank and the improved professionalization of lending business, however, portfolio quality can be expected to improve considerably. Despite weaknesses in portfolio quality so far, we can therefore also expect institutional sustainability in lending business.

The portfolio indicator does not measure capacity-building effects through strengthening GAPI institutionally as a financial intermediary for the SMEs involved in the programme. GAPI has been able to increase lending considerably in recent years. In 2002, it had 301 credit customers with a total credit volume of US$ 9.5 million and in June 2006 it was already serving 1,001 customers with a volume of US$ 16 million. This makes for an increase of 233% (number of loans) or 68% (volume) in 4 years. Under the FC programme, GAPI has also been strengthened through the complementary measure in regional expansion and the establishment of branch offices in rural regions, which have contributed to regional diversification and greater outreach. In 2002, GAPI maintained 5 branch offices and it now runs 9, practically serving the whole country. Applying the ancillary indicators on loan portfolio growth and regional expansion, we can say that GAPI has been clearly strengthened as an institution through the programme but poor portfolio quality detracts from impact sustainability.

The real economic impacts pursued in the overall objective have been beneficial altogether. The important role GAPI plays in promoting SMEs, above all in rural regions as well, was confirmed by all interviewees and could be corroborated in inspections at several final borrowers. GAPI is rated as the only national financial institution in Mozambique that provides SMEs and specifically also rural enterprises with credit and with its approach of combining advice and training for promoting the creditworthiness of SMEs and lending it has made considerable developmental impacts. In Nampula Province, where visits were made, for example, promoting and financing value chains in cashew production made a decisive contribution to private-sector development in the region. GAPI plays a purposive part here in economic development with a sectoral focus. According to GAPI estimates, the FC programme directly created 6,900 new jobs. With a credit-financed investment, the FC programme has created jobs for EUR 408 a head, a relatively good figure. The actual employment effects are likely to have been much more pronounced since GAPI only includes jobs created directly.

So programme objectives achievement can be rated as sufficient altogether. The programme conforms with the development-policy objectives of the Mozambican government, which attaches special importance to SME promotion via the financial sector in its poverty reduction strategy PARPA II. At the time of appraisal, it was in line with the goals of German development cooperation and still belongs to a priority area in development assistance to Mozambique.

The programme has contributed to establishing GAPI as an institution for financing SMEs. Through the programme, GAPI has been able to expand its activities further especially in rural regions, where it has often been the only source of credit for SMEs. With the development of GAPI Bank, GAPI's role as a SME financier with a rural focus will be strengthened further. The placement of a universal bank geared to serving a target group has therefore had a beneficial capacity-building impact. Despite weaknesses in portfolio quality, a private strategic investor has been acquired. This can be expected to ensure a sustainable service for the SME segment.

By concentrating on rural areas, the programme has contributed in particular to developing underdeveloped and poorer regions. In part, the financed investments have generated considerable employment impacts, thus contributing to poverty reduction. For many SMEs, GAPI has been the only source of borrowing and in many cases business startups have also benefited. In cashew processing in northern Mozambique, GAPI has been able in combination with advisory measures to contribute to reviving an entire economic sector in a region and to private-sector development.

Since a large part of the SMEs and their workforces especially in rural areas can be classified as belonging to poor sections of the population (poverty rate > 50%) and considerable income and employment effects have been generated by the programme, we designate it as ODP.

The programme has afforded a certain scope for influencing gender equality. By affording women entrepreneurs access to credit, it has had attributable beneficial effects on gender equality. Altogether, men and women have benefited from the loans, the ratio of female borrowers amounting to 15%, an adequate ratio for a programme to finance asset investments largely with longer-term loans.

An environmental impact assessment figures as a standard component in credit rating at GAPI. So far, no adverse environmental impacts have been recorded due to SME finance. The programme did not aim at improving governance or increased participation and has not had any impacts in this area, either.

Risks for the sustainable developmental efficacy of the programme are largely located at institutional level, especially possible difficulties in the reorganisation of GAPI and the foundation of GAPI Bank. As the investor contracts have already been signed and there is keen political interest in the institutional realignment of GAPI, we assess the risk of the failure of the GAPI Bank foundation as low, however.

In summary evaluation, we assess the developmental efficacy of the programme as follows:

<u>Effectiveness</u>

The programme objective was the sustainable efficient provision of appropriate financial services to small and medium-sized enterprises (SMEs) on market terms. The programme has contributed to expanding lending facilities for SMEs. The number of the SMEs reached has increased by 233% over the last 4 years. Furthermore, through the FC programme support GAPI has been able to expand its offices in rural regions in particular, where SMEs had previously been deprived of almost any access to borrowing facilities. There are quite large weakpoints in portfolio quality. Despite these shortcomings, strategic investors such as Rabobank have been acquired to found GAPI Bank so that we may generally assume a sustainable provision of credit to the target group. In our estimate, the process of reorganising GAPI supported by the FC programme and the foundation of a SME bank, for which the shareholder agreement has already been signed, is now irreversible. Without the institutional reform measures, the sustainability assessment would have been considerably worse. We assess the **effectiveness** of the programme as **sufficient** (**Subrating 3**).

<u>Relevance/Significance:</u>

The programme was supposed to contribute to establishing and maintaining viable small and medium-sized enterprises (including cooperatives) and to the sustainability of private-sector capacity (overall objective). Moreover, by improving the supply of financial services for private SMEs a contribution was to be made to developing the Mozambican financial system. As the only source of finance in rural regions in particular, GAPI has evidently contributed to setting up and maintaining SMEs with loans from the programme. Important regional impacts have also been achieved in private-sector development. The future development of GAPI Bank will secure the capacity-building contribution to developing a financial sector segment for SME finance. Altogether, we therefore assess the **relevance and significance** of the programme as **satisfactory** (**Subrating 2**).

<u>Efficiency</u>

Loan management at GAPI has improved since the last ex-post evaluation in 2002. Large shortcomings nevertheless remain, particularly in loan monitoring, which have resulted in poor portfolio quality. The administrative costs are also relatively high. Although return on equity is positive, it is still very low despite the ongoing subsidy elements. So production efficiency must rate as low altogether. The high risks that GAPI takes in its market segment are probably not all factored into the risk margin. Due to its low financing costs, GAPI can, however, bear these risks. Altogether, the interest rate for final loans is in keeping with the market average for interest receivable in the financial sector. Due to the high delinquency and poor loan monitoring we assess the allocative efficiency as limited. This is also especially the case as GAPI has very low refinancing costs due to donor assistance. Without substantial donor aid, GAPI would have had difficulties in maintaining its business activities at the present scale and with the current risk profile. Altogether, we assess **efficiency** as **slightly insufficient** (**Subrating: 4**).

Altogether, weighing up the above impacts and risks and considering the positive influence the programme has had on and the impetus it has given to the reorganisation of the programme executing agency, we assess the **developmental efficacy** of the programme **overall** as **sufficient** (**Rating 3**).

General Conclusions

In programmes with a similar setup in future, more attention should be paid to incentives for the financial institutions involved to raise efficiency. This is particularly important for institutions that have developed on the basis of subsidized donor programmes. One way to do this is to arrange market conditions for conduiting.

In the set of objectives, care must be taken to ensure that the indicators actually permit statements to be made on intended impacts and cover the whole scope of an objective. Choosing one overly narrow indicator does not enable reliable statements to be inferred, especially for a comprehensive set of objectives (financial sector and real economy) addressing two levels.

Assessment criteria

Developmentally successful: Ratings 1 to 3	
Rating 1	**Very high or high degree of developmental efficacy**
Rating 2	**Satisfactory developmental efficacy**
Rating 3	**Overall sufficient degree of developmental efficacy**
Developmental failures: Ratings 4 to 6	
Rating 4	**Overall slightly insufficient degree of developmental efficacy**
Rating 5	**Clearly insufficient degree of developmental efficacy**
Rating 6	**The project is a total failure**

Criteria for Evaluating Project Success

The evaluation of the developmental efficacy of a project 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 objectives** 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 conception)?
- 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, organisational and/or technical support has come to an end.