Mozambique: SOCREMO - strengthening equity capital

Ex post evaluation report

OECD sector	24030 - Financial intermediaries in the formal sector	
BMZ project ID	2001 66 496 (2009 random sample)	
Project executing agency	SOCREMO	
Consultant	LFS	
Year of ex post evaluation	2010	
	Project appraisal (planned)	**Ex post evaluation (actual)**
Start of implementation	Q4 2003	Q4 2003
Period of implementation	14 months	61 months
Investment, counterpart contribution	n.a.	n.a.
Finanzierung	EUR 0.51 million, EUR 0.32 million (training)	EUR 0.51 million, EUR 0.32 million (training)
Other institutions/donors involved		
Performance rating	2	
• Relevance	2	
• Effectiveness	2	
• Efficiency	2	
• Overarching developmental impact	2	
• Sustainability	2	

Brief description, overall objective and project objective with indicators

This project comprised the issue of a financing contribution (in grant form) in the amount of EUR 0.51 million, which was provided as capital investment finance to 'Sociedade de Credito de Moçambique' (SOCREMO), a microfinance institution (MFI). In addition, the project included the co-financing of the management service contract for the international management at SOCREMO (a supplementary programme), to a total of EUR 0.32 million. The aim was to strengthen SOCREMO as a financial intermediary, in order to make a sustainable improvement in access to loans for Mozambican micro and small enterprises (MSEs), this being the project objective. This would help to lift income levels amongst the poorer layers of Mozambique's population (the overall objective). At the same time the project would help to stabilise and reinforce the formal finance sector, in that the funds would be used to develop the business of issuing microloans to MSEs and to expand the range of saving deposit products. The project's target group were MSEs (predominantly in the informal sector) in Mozambique's urban centres and semi-urban districts.

The funds were deployed as financing for the Mozambican Government's equity capital in SOCREMO. KfW provided independent fiduciary management for this equity capital. As envisaged at project appraisal, these holdings were transferred in 2008 (in accordance with a Finance Ministry decision) to 'Gabinete de Consultoria e Apoio a Pequena Industria S.I.' (GAPI), an institution which had been involved with SOCREMO since 2002. At this point, KfW's fiduciary management services ended.

The project objective was to achieve a sustainable improvement in access to loans for micro and small enterprises by strengthening SOCREMO as a financial intermediary for this group of customers. This would help to create additional income for poor layers of the Mozambican population (the overall objective). At the same time, the project would help to stabilise and reinforce the formal finance sector. Project objective indicators were: (a) growth in the outstanding credit portfolio to a minimum of USD 3 million within three years of funds disbursement; (b) savings deposits of at least 10 % of debt capital in the third year after the commencement of savings deposit business; (c) PAR (portfolio at risk) < 5 % of average credit portfolio value.

The supplementary programme of project agency support was functionally and financially subordinate to the project's major activities. It aimed to assist SOCREMO to progress from a microfinance institution to a sustainable, working full-service bank. In general, an MFI without a banking licence is extremely limited in terms of the range and variety of products it can offer, and in its ability to build up the human capital, processes and control mechanisms which make a self-sustaining mode of operation possible. The aim was to change this using an experienced consultant who would take over leadership of the company for a defined period, and lay the organisational foundations for a sustainable, successful, full-service bank.

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

The beneficiary of the grant funding was the Republic of Mozambique, represented by the 'Ministério do Plano e Finanças' (MPF). The FC grant was used to acquire holdings (shares) in SOCREMO. Under a separate 'Channelling Agreement', it was agreed that KfW would acquire the holdings in trust, and would act as an independent trustee with regard to the voting rights which accompanied the shares. As envisaged in the project appraisal report, and as agreed with the Finance Ministry, the shares linked to the capital invested were transferred to GAPI. However, this was not in 2005 as initially foreseen, but in November 2008. In accordance with the 'Channelling Agreement', dividends that accrued whilst KfW held the shares in trust were paid to the Finance Ministry.

With its capital base strengthened by FC funding, SOCREMO used this to obtain a full banking licence, pull in savings deposits and expand its business in loans for working capital and investments. SOCREMO set end-loan interest rates in accordance with market conditions.

Key results of the impact analysis and performance rating

Relevance: this project targeted deficiencies in Mozambique's finance and banking sectors in the area of MSE lending. The causal relationships which underlay the project - that supporting MSEs through a better range of financing and financial services would lead to increased employment and improved security of income, and help to expand and strengthen the Mozambican finance sector - were reasonable, and still remain valid. In addition to the difficult situation for MSEs with regard to opportunities for financing, the Mozambican finance sector is still at an early stage of development (as demonstrated, for example, by the low level of credit in relation to GDP). For this reason, the establishment of SOCREMO as a full-service bank, concentrating on MSE financing and also offering savings products, is highly relevant, even today. After ProCredit, SOCREMO is now the second largest microfinance bank in Mozambique. The fact that SOCREMO is directly targeted on the MSE customer group, and issues virtually no consumer loans, is seen as particularly positive. The project's objectives complied with the goals of German-Mozambican development cooperation in the priority area of 'Sustainable economic development'; they integrated sensibly into Mozambique's developmental strategy, and were embedded within a rational framework of donor relationships. Inter-donor cooperation has been good. We have assessed the project's relevance as good (rating: 2).

Effectiveness: all project goal indicators were achieved. Objectives for developing lending and saving business were clearly surpassed, and both areas have demonstrated significant growth. Whilst growth in the savings domain has come to a sudden stop, the number of borrowers since 2007 has also stagnated, pointing to increasing market saturation in the Greater Maputo area. The quality of the loans portfolio, measured against PAR >30 days, has climbed in 2009 from a very low initial level. However, by August 2010 it had dropped back to 3.9 %. This development can be attributed in the main to the unfavourable economic climate that prevails in the wake of the financial crisis, since every MFI has had to struggle with deteriorating portfolio quality. Moreover, improvements in the second half of 2010 indicate that the introduction of portfolio consolidation has been implemented successfully. The bank has been operating at a small profit since 2008, with a good level of productivity. Furthermore, by bringing in savings deposits, expanding into targeted peri-urban areas and steadily expanding its range of credit products, SOCREMO has established itself in the market as a stable business bank, and has contributed to the diversification of the finance sector. Hence it is reasonable to assume that the project objective - to improve access to the finance sector - has been attained. We have assessed the project's effectiveness as good (rating: 2).

Efficiency: the project concept was implemented according to plan, albeit with some delays; these were caused primarily by the protracted approval procedures required for bank formation. When compared to a refinancing line of credit, capital investment financing offered scope to broaden the range of financial services on offer and, by strengthening equity capital, provided an opportunity to exert greater influence over the establishment of working structures of governance. This also served to reduce gearing. Leverage potential from capital financing was put to efficient use, being deployed to improve the credit offer. SOCREMO's operating methods are seen as efficient. The borrower to staff ratio stands at 50:1, which falls slightly below the average for the microfinance sector overall. Allocative efficiency for lending at SOCREMO is satisfactory: in August 2010, the PAR was within acceptable limits at 3.9 %. In view of the worldwide economic crisis and increased market saturation, greater PAR volatility is likely in future. However, the allocative efficiency of the FC funding commitment can be described as good, especially considering the low volume of FC funding and the remarkable economic progress made. We have assessed the project's efficiency as good (rating: 2).

Overarching developmental impact: since the ratio of SOCREMO's credit portfolio and savings deposits to GDP has grown steadily over the last ten years, SOCREMO's contribution to the growth of private sector lending, which was adopted as the indicator for the overall objective, is considered as having been achieved. However, it is not possible to make a comparison with the project appraisal objectives, as no firm target values were defined. SOCREMO concentrates on a target group of micro and small enterprises, furnishing them with loans with an average value of a little over USD 1,000 for microenterprises and USD 17,000 for small enterprises. Furthermore, SOCREMO's expansion into peri-urban territory means that customers in the micro and small enterprise segments who could not previously be reached now have access to banking services. The structural impact on Mozambique's finance sector is seen as positive. Through the provision of appropriate capital resources and the commercial development of the bank that followed, a competitive new player has emerged in the finance market. We have assessed overarching developmental impact as good (rating: 2).

Sustainability: SOCREMO's financial situation indicates a good level of sustainability, and would seem to guarantee that in the future SOCREMO will still be in a position to service the demand for banking services, especially for the poorer sections of the population. With refinancing from savings deposits and Mozambican bank lines, and a high level of identification with its MSE customers, it seems likely that the bank will continue its business without any further donor finance. It is well worth noting that investors have been secured whose business policies are results-oriented, but also more commercially focused (Nordic MicroCap, Africap, Norfund). Norfund's entry at the end of 2009 underlines the bank's potential. Management of the institution is being increasingly transferred to competent local specialists. We have assessed the project's sustainability as good (rating: 2).

Having given due weight to the individual evaluation criteria stated, we rate the project overall as good (rating: 2)

General conclusions and recommendations

Analysis carried out in the MSE sector has established that loans are being used to balance income over time; this needs to be considered according to circumstances. Provided that it serves to reduce exposure to external factors and puts borrowers in a position to improve their basic provisions, it is considered acceptable. However, there is an increased risk that the financing funds will be used to raise consumption beyond a financially sustainable level. This risk can be limited, primarily by appropriate monitoring of total end borrower debt. Against this background, it would be wise to give greater consideration to suitable credit information systems in the relevant sector approach.

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

Projects are evaluated on a six-point scale, the criteria being relevance, effectiveness (outcome), "overarching developmental impact" and efficiency. 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 rating that clearly exceeds expectations
2	Good rating fully in line with expectations and without any significant shortcomings
3	Satisfactory rating – project falls short of expectations but the positive results dominate
4	Unsatisfactory rating – significantly below expectations, with negative results dominating despite discernible positive results
5	Clearly inadequate rating – despite some positive partial results the negative results clearly dominate
6	The project has no positive results or the situation has actually deteriorated

A rating of 1 to 3 is a positive assessment and indicates a successful project while a rating of 4 to 6 is a negative assessment and indicates a project which has no sufficiently positive results.

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 an improvement is very unlikely. 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. A rating of 1 to 3 indicates a "successful" project while a rating of 4 to 6 indicates an "unsuccessful" project. In using (with a project-specific weighting) the five key factors to form an overall rating, it should be noted that a project can generally only be considered developmentally "successful" if the achievement of the project objective ("effectiveness"), the impact on the overall objective ("overarching developmental impact") and the sustainability are considered at least "satisfactory" (rating 3).