Ex Post-Evaluation Brief
Peru: SMEs – Subordinate Loans II (COFIDE II)

Programme/Client	Financing Subordinate Loan Capital II/BMZ No. 200166181	
Programme executing agency	Corporación Financiera de Desarollo S.A. (COFIDE)	
Year of sample/ex post evaluation report: 2010*/2011		
	Appraisal (planned)	Ex post-evaluation (actual)
Investment costs (total)	n.i.	n.i.
Counterpart contribution (company)	n.i.	n.i.
Funding, of which budget funds (BMZ)	EUR 5,113 million	EUR 5,113 million

* random sample

Project description: To sustainably improve the credit supply to Peruvian micro and small enterprises (MSEs), the programme aimed at providing particularly qualified microfinance institutions (MFIs) via the government development bank, COFIDE, long-term subordinate loans at market-conform conditions. This was to increase the liable equity base and hence the refinancing capacity of these institutions on the interbank market. As the subordinated loans were treated as effective equity capital, it was expected that they should enlarge the institutions' scope for lending. The project followed up directly on the almost identical first phase of the programme, which was assessed as very good in an ex-post evaluation in 2006.

Objectives: The objective of the programme was to improve the access to finance for MSEs from MFIs (particularly the municipal savings banks) and also contribute to securing jobs and raising income in poorer sections of the population.

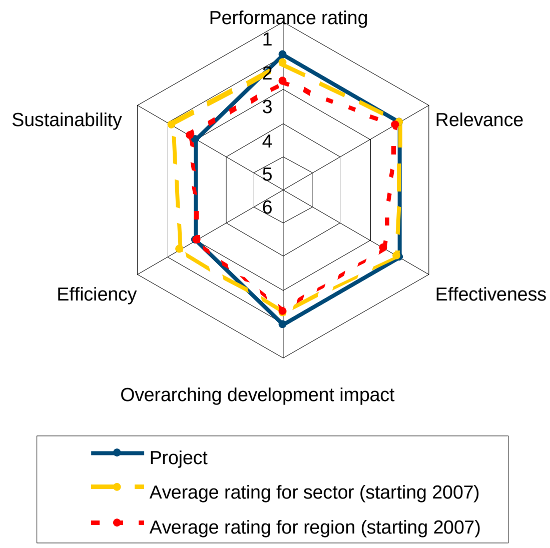
Target group: The target group comprised micro and small enterprises in Peru with a basically bankable demand for credit, i.e. with genuine financial requirements and both the necessary ability and willingness to repay the loans.

Overall rating: 2

The programme succeeded in mitigating the impacts of lack of access to equity capital in Peruvian municipal savings banks and contributed to improved credit supply for MSEs outside the Lima conurbation. However, consideration should be given in the longer term to structural reforms in the savings bank sector.

Of note: The savings bank sector, in whose development German development cooperation played an outstanding role and which performs an important function primarily outside the conurbation of Lima, faces growing competition from private microfinance institutions. The structural differences in the savings bank sector (political influence, no participation of private equity holders) in comparison with private providers mean a large competitive disadvantage. Only the best savings banks (e.g. CMAC Arequipa) can maintain their market share without problems.

Rating by DAC criteria



EVALUATION SUMMARY

Overall rating: The programme succeeded in mitigating the impacts of the shortage of equity capital in Peruvian savings banks and contributed to improving credit supply for MSEs particularly in underdeveloped regions outside the Lima conurbation. However, comprehensive structural reforms will be needed in the savings bank sector in future. **Rating: 2**

Relevance: Microfinance market in Peru: Peru is regarded as having one of the most advanced microfinancial markets in the world. Economist Intelligence Unit's Global microscope on the microfinance business environment has placed Peru in top position for the third successive year, with best ratings in particular for the regulation of the microfinancial market, the quality of its banking supervisory authority (SBS) and the level of development of its microfinance institutions. Four different types of regulated microfinance institutions exist in Peru: (i) Entidades de Desarrollo para la Pequeña y Microempresa (EDPYMEs), which cannot provide any savings services, (ii) Financieras, which are allowed to provide the complete range of banking services except for issuing cheques and foreign business, (iii) banks that are able to carry out all kinds of financial business and (iv) Cajas Municipales de Ahorro y Crédito (CMACs) which are also able to offer the whole range of banking services. Added to this are institutions that are not regulated officially by the banking supervisory authority (NGOs and rural, private savings banks - CRACs), which are unofficially regulated through the umbrella organisation, the Consorcio de Organizaciones Privadas de Promoción al Desarrollo de la micro y Pequeña Empresa (COPEME) in cooperation with the SBS. The high growth rates in the microfinance sector in recent years demonstrate that unserved demand for financial services by MSEs was high and it still is today, particularly in rural areas. Overheating trends are held in check by SBS.

The urban savings banks: Between 1982 and 1992, altogether 13 CMACs were founded in Peru with support from the then GTZ. The most successful and largest savings bank is CMAC Arequipa. Besides this, there exist approx. 3 other large, 5 medium and 4 smaller savings banks. The savings bank system was changed in various reforms in 1997 (transformation into public limited companies) and in 2008 (the abolition of the regional principle) to enable the savings banks to align their business model closer with the private institutions. Certain provisions still exist, however, in the legislation on the savings bank sector (membership of the directorate in keeping with regional proportional representation, organisational regulations) that limit their scope for free enterprise. The various savings banks compete openly today in all regions of the country, but the respective municipalities still own 100% of the shares. The individual local authorities have not been prepared so far to surrender any of their own decision-making rights to an external investor and also partially exert heavy influence on business policy in some savings banks. External investors, whether commercial banks, Peruvian or foreign actors (such as COMPARTAMOS), therefore focus on the other purely private-sector actors (NGOs, CRACs, EDPYMEs, Financieras) to enter the market. Consequently, the savings banks forfeit access to venture capital and sectoral know-how.

Results chain: Although the programme evaluated here was generally available to all regulated microfinance institutions, it was ultimately directly aimed at CMACs lacking access to new (private) equity capital. It was therefore suitable to mitigate this problem. By granting subordinate loans to efficient CMACs (selection on the basis of specific financial indicators), it improved their equity position, which in turn enabled them to expand lending to MSEs. The mode of operation of the programme is confirmed by local interviews and the available data. It does not, however, solve the remaining structural problem of equity capital shortage in the savings bank sector.

Consistency with partner country and donor goals: The programme continued with the successful work of the former GTZ in the savings bank sector and conformed with the goals of the Peruvian Government for promoting micro enterprises and the financial sector policy of BMZ. However, the financial sector is not a priority sector in Peru.
Altogether, we consider that the programme for the savings bank sector, which unlike other microfinance institutions performs a major role in supplying MSEs with financial services outside the capital Lima, is of high relevance even if it only mitigates and does not solve the structural problems of municipal savings banks (Sub-rating: 2).

Effectiveness: Programme objectives: The programme objectives were as follows: (i) sustainable increase in credit supply to MSEs through the microfinance intermediaries (MFIs) at market conditions, (ii) larger equity base of participant MFIs by means of obligatory accumulation of profits, (iii) promotion of efficient and profitable institutions, (iv) consistent focus on micro and small (MSEs) and (v) improved refinancing for purely commercial providers.
Course of programme: The first two loans were issued in 2005. In the following years, only a few institutions met the selection criteria. In 2008, these were slightly relaxed so that municipal savings banks that had not met some selection criteria were also able to take part in the programme. A notable difference to the first phase is that the size of the participant institutions has increased. The reason for this is that the structural disadvantages of CMACs mentioned above had already made themselves strongly felt in smaller institutes, which were consequently unable to achieve good financial indicators and did not meet the admission requirements to the programme.

Objective achievement: The first programme objective was easily achieved. Lending measured by the volume or number of loans rose by more than 10% in the participant institutions after taking part. The second objective was also met: The participant institutions accumulated more than 75% (CMACs) and/or 50% (private institutions) of their annual earnings, and subordinated loan capital was itemised as equity capital in the balance sheets. The achievement of the third programme objective is assessed as medium to good: 3 CMACs and one private institution have recorded good to very good financial indicators.

Due to malinvestments, 3 participant CMACs incurred large losses. Two of these have now improved results again and one is in the process of restructuring. The focus on MSEs has been retained and refinancing from commercial sources has risen. Due to the largely positive objective achievement, we assess effectiveness as good (Sub-rating: 2).

Efficiency: Production efficiency of COFIDE: In February 2010, COFIDE was accorded the credit rating BBB-/A-3 and BBB-/F3 by Standards & Poor's (S&P) and Fitch Ratings with a stable outlook. This was the first international credit rating that the institution had received since its foundation in 1973 and the first rating for the Peruvian government at investment grade. In September, S&P even raised the rating to BBB. This reflects the good capitalisation of COFIDE but also the favourable policy expectations of the new government.

Production efficiency of participant MFIs: The only private institution (Financiera Crear Arequipa) to take part in the programme till now also records the highest RoE by far (September 2011) at 34.6%. CMAC Arequipa, which is currently in negotiations for a subordinate loan from COFIDE, is the leader among the CMACs with a RoE of 25.2%, followed by CMAC Huancayo (20.2%) and CMAC Cusco (19.2%). Of the larger CMACs, the already mentioned CMACs from Trujillo and Piura have had serious problems in recent years but have improved again this year with a RoE of 14.6%. The only small CMAC that took part in the second phase of the programme, Del Santa, in contrast, has a very poor financial record with a RoE of -1.1%.

Allocative efficiency: The criteria for participation were suitable to ensure access only to efficient institutions. The slight relaxation of the rules at the end of 2008 was a positive development for the timely application of funds without great efficiency loss. The rates of arrears in the participant institutions in September 2011 averaged 6.2% (5.3% without Del Santa), which is still largely acceptable in view of the previous economic crisis prompted by the financial crisis.

Programme efficiency can therefore be assessed as satisfactory altogether (Sub-rating: 3).

Overarching developmental impact: Market development: The microfinance sector in Peru has undergone rapid development since 2005. The number and amount of lending in the financial sector increased faster than the required 10% in the indicators for the overall objective. Interest rates were also reduced as required in the overall objectives. Interest for MSEs declined from on average 44.6% (September 2007) to 39.9% (September 2011) even at slightly higher inflation rates (4.25% in June 2011). This level is, however, still relatively high in comparison with other countries in Latin America. The reason for this could be the size of the country and the uneven distribution of urban centres, which in turn hampers competition among the institutions. Due to keener competition in future, interest can be expected to diminish further. The provision of credit to MSEs has thus steadily improved in the past and the programme has made a contribution to this. The poverty indicators in Peru have also consistently declined, particularly also in the regions outside the Lima conurbation. The participation of the poorer population in the banking market has improved above average in the last 5 years.

<u>Role of CMACs:</u> CMACs play a large role in supplying the population with financial services, particularly in areas outside the conurbation around the capital, Lima. As forerunners in the microfinance sector they have taken up this role not only in lending but also particularly in the deposit-taking segment. With its focus on CMACs, the programme has thus supported the provision of financial services particularly in remote, poorer regions of the country. Due to their structural restrictions, the role of CMACs in new, innovative products has declined in recent years, however, in comparison with other private banks (except for CMAC Arequipa). With the abolition of the regional principle, the focus of some CMACs has also shifted, as they have pursued partly unsustainable expansion plans in other regions and attempted to compete with other purely commercial banks by issuing consumer loans or larger loan amounts. A part of the profits of the CMACs is also used to finance infrastructure investments in the respective municipalities.

<u>Responsible finance:</u> A large part of the loans today are issued in local currency. The programme also made a contribution to this, as the subordinate loans were also granted in local currency. This afforded more leeway to protect final borrowers from exchange rate risks. CMACs generally attach priority to responsible lending, and responsible finance in general. We therefore assess the impacts of the programme as good (Sub-rating: 2).

Sustainability: <u>Future of CMACs:</u> The savings bank sector is moving in different directions. The current legal framework with its mixture of private and public elements does not provide a stable foundation, as private providers with strong capital donors and access to good know-how continue to enter the market, while modernisation is only making slow progress in CMACs due to uncertain ownership relations. The savings bank association only plays a subordinate role and the individual CMACs increasingly act independently of each other. Successful savings banks (e.g. CMAC Arequipa) are already planning to realign their marketing individually, particularly with a redesigned CMAC logo, to minimise loss of reputation in the case of other CMAC insolvencies. The sector should be consolidated and the ownership rights of municipalities curbed to open the way for external financiers with access to know-how. Many market players are aware of this and some discussions have taken place on possible solutions in the CMAC and in COFIDE to date. Efforts should be stepped up in this area. Otherwise, there is a danger that the structural deficits will cause problems in individual CMACs (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).