Philippines: Promotion of Small Enterprises II

Ex-post evaluation

OECD sector	24030 – Financial intermediaries of the formal sector	
BMZ project ID	1997 65 926	
Project-executing agency	Philippine Business for Social Progress (PBSP)	
Consultant	-	
Year of ex-post evaluation	**2004**	
	Project appraisal (planned)	**Ex-post evaluation (actual)**
Start of implementation	March 1998	December 1999
Period of implementation	36 months	39 months
Investment costs	EUR 9.6 million	EUR 4.4 million
Counterpart contribution	no information available	no information available
Financing, of which Financial Cooperation (FC) funds	EUR 7.67 million	EUR 3.5 million
Other institutions/donors involved	None	none
Performance rating	4	
Significance / relevance	4	
Effectiveness	4	
Efficiency	5	

Brief Description, Overall Objective and Project Objectives with Indicators

The aim of the project is to establish lending to small enterprises (project objective). The overall objective is to create and secure income and employment. For this purpose, the project-executing agency, the foundation "Philippine Business for Social Progress" (PBSP), received a loan which was transferred through the Land Bank of the Philippines (LBP). The refinancing unit of PBSP (apex unit) on-lends the FC funds to selected financial institutions for the refinancing of loans to micro and small enterprises. Originally, EUR 7.6 million was provided for the project. In 2003 the funds were reduced by EUR 4.1 million to EUR 3.5 million because there was not sufficient demand.

The indicator for the project success is the arrears ratio of the refinanced loan portfolio, measured as the ratio of overdue redemption payments to total redemption payments due, which should be less than 10%. No specific indicator was defined for the achievement of the overall objective of the project. The overall objective is considered as reached once the project objective has been achieved.

Project Design / Major Deviations from the original Project Planning and their main Causes

Apart from the reduction of funds by EUR 4.1 million the project was carried out without any major deviations from the original concept. The target group comprised micro and small enterprises in the manufacturing industry, in trade and commerce and the service sector. Micro and small enterprises are defined as firms whose assets (no including real estate) do not exceed PHP 1.5 million and PHP 15 million, respectively (official definition dating from 1997). At least 50 % of the funds are to be extended to micro enterprises. The maximum loan amount per sub-borrower was limited to PHP 5 million. Any interest differential funds accrued were used to support the achievement of the project objective through training measures for employees of banks and the project-executing agency.

The FC funds were on-lent via the state-owned LBP (borrower) to PBSP (project-executing agency). The Small and Medium Enterprise Credit Unit (SMEC), which acted as apex unit in the framework of the project, was responsible for the selection of suitable financial intermediaries to implement the project. The initial disbursement of the funds was made to the financial intermediaries in PHP (approximately PHP 140 million). Thereafter the funds were combined with the funds provided under phase I and used as revolving funds. Since 1999 a total of 726 sub-loans for about PHP 450 million were provided in the context of phase II. Of the total amount, roughly PHP 360 were made available from FC funds and 20% were provided by the partner banks as a counterpart contribution. The FC-funds disbursed were transacted and on-lent 2.5 times. The project helped to safeguard 4,119 existing jobs and to create 975 new jobs and to secure the incomes of the persons concerned. 9 out of 10 loans and around two thirds of the lending volume were extended to micro enterprises. However, contrary to what had been specified in the loan agreements, PBSP did not stick to the definition made in 1997 but applied the definition currently in place (PHP 3 million).

The sub-loans extended by the participating banks are refinanced with equal maturity by SMEC (maximum loan term: 5 years). The funds are disbursed in analogy with the FC project according to the disposition fund procedure. The interest rate for on-lent FC funds was originally 9.35%. At the end of 2002, at the request of PBSP and LBP, the rate was reduced to 7.9%. At the same time interest rates in the domestic capital market declined strongly. The interest rate on 3-months treasury bills fell from almost 10% in the fourth quarter of 2001 to below 5.5% in 2002/2003. Against this background, the financial intermediaries involved (FI) still considered the FC funds as too expensive. However, it has to be taken into consideration that the FC funds were offered not only as short-term funds but in particular for longer-term refinancing purposes (terms of up to 5 years). In comparison with 1-year treasury bills (7.5%) and term deposits with a maturity of more than one year (8.0%) these FC conditions are adequate.

The high turnover of funds under the credit line is due to the (on average) relatively short terms of the sub-loans extended and cannot be regarded as an indicator of success. Roughly half of all loans extended have a maturity of one year, around one third a maturity of 1 to 3 years. Only 12 % have a term between 3 and 5 years. 87% of the loans provided served to finance working capital, 13% served to finance investments. Most of the loans went to the trade sector (53%) and the service sector (33%). Due to the high liquidity in the financial sector and the lower interest level, there was a strong decline in the demand from banks for refinancing loans in the context of the project. Some financial institutions benefited from their favourable liquidity situation to prematurely repay their loans. At of the end of May 2004 the total amount of loans outstanding in the context of phase II was approximately PHP 78 million. This is approx. 55% of the funds disbursed and approx. 25% of the funds originally provided. The total amount of loans outstanding under phases I and II is only PHP 100 million and could have been refinanced without problems from the PHP 250 million provided under phase I. Only 25 % of the entire revolving fund has been disbursed as loans; thus the utilisation of the fund is by no means satisfactory.

Key Results of the Impact Analysis and Performance Rating

Around 730 sub-loans were financed under the project. According to the information provided at the time of the loan approval, the sub-borrowers employed more than 4,100 persons and put on almost 1,000 new employees. The project had positive effects with regard to the creation and safeguarding of employment and, thus, of incomes. Women accounted for around one third of all jobs. Due to the high share of working capital loans and the low utilisation of the credit line the employment effects were clearly smaller than might have been possible otherwise.

Only financial institutions with a clear focus on small enterprises were accredited under the project. All 22 currently accredited financial institutions show an increase in the volume of loans outstanding. In the last two years the increase in loans outstanding of most FIs was noticeably higher than the sector average. Thus, the banks have expanded their lending activities with small enterprises. Still, this positive development can be attributed only to a very limited extent to the project. For some years, the utilisation of the credit line has been very low; as per May 2004 only two banks used the funds to any significant degree. It was not possible on a sustainable basis to implement a cash-flow orientation and a project orientation at the banks in their assessment of borrowers' creditworthiness.

The apex structure used under the project is today acknowledged and established in the Philippines. In terms of technical competence and professionalism, SMEC has a model character for other apex units. The apex structure can serve as a model for other projects. But this clearly positive development can be attributed only to a very limited extent to the project evaluated here. The apex unit was set up in the context of a project implemented by USAID and was already supported by German FC with revolving funds under the project "Promotion of Small Enterprises I" (BMZ Project ID 1995 65 102). We rate the additional structure-building effect of phase II as low.

After weighing all of the described effects we arrive at the following final assessment of the developmental effectiveness of the project "Promotion of Small Enterprises II":

The objective of the project was to establish lending to small enterprises. Due to the low utilisation of the credit line it was reduced by over 50%. The increased revolving fund has hardly been used for more than two years. The current utilisation is 25%; this amount could have been refinanced entirely from funds available under phase I of the project. The observed positive developments can be attributed only to a very limited extent to the project. For this reason we rate the project's **effectiveness** as slightly insufficient (**sub-rating: 4**).

Since the project helped to create and safeguard jobs it contributed to achieving the overall objective. However, due to the low utilisation of the funds the project performed worse than might have been possible otherwise. As regards the structure-building effects on the financial sector, we rate the significance as slightly insufficient. This is due to the fact that the successful establishment of apex structures can only be attributed to a limited extent to phase II of the project, which has been evaluated here. We rate the project's **relevance/ significance** as slightly insufficient (**sub-rating: 4**).

The project was relatively expensive and caused high administrative expenses due to the fact that a large number of Philippine partners were involved. Almost 50 % of the refinanced sub-loans were one-year working capital loans, which might as well have been refinanced by most financial institutions through deposits and/or by the central bank. In consequence, the FC funds did not have a subsidiary effect but were in competition with the local refinancing possibilities. We rate the **efficiency** as clearly inadequate (**sub-rating: 5**).

In a summarised assessment of the above impacts and risks we rate the project as having an **insufficient developmental effectiveness (rating 4)**. Still, the major reason for this insufficient performance of the project is the negative development of the sectoral and macro-economic conditions in the wake of the Asian financial crisis. Thus, the negative rating is not due to the conception of the project.

General Conclusions

The definition and agreement of upper limits for company size and loan volumes is in general a suitable instrument to ensure that the target group is actually reached. However, the limits should be defined in a way to ensure that inflationary developments and changes in exchanges rates, which are inherent in the system, can be taken into account. The definition of the company size should not only be based on total assets but also include the number of persons employed. Ceilings for the maximum loan amount and possibly also for total assets and turnover should either be determined in a stable foreign currency or should be inflation-indexed.

The determination of maximum arrears ratios is useful as an indicator for the project objective, but is not sufficient. The assessment of successful lending must comprise current indicators on the portfolio quality (for instance, the portfolio-at-risk, the provisioning for non-performing loans, the development of the loan portfolio), but must also show a trend for these indicators and must include the quality of the lending process (for instance, the consideration of cash-flow analyses, the time it takes until a loan decision is taken). KfW has already started to take these aspects into consideration when establishing new projects.

In the event of projects that involve the establishment of a revolving fund in countries with high inflation and/or weak local currencies, funds that are not required at a certain point in time should be invested, at least in part, in Euro or US-dollar in order ensure that the project can benefit from potential value increases vis-à-vis the local currency.

Legend

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

Criteria for the Evaluation of Project Success

The evaluation of the "developmental effectiveness" 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.