Tajikistan: First Microfinance Bank Tajikistan

Ex post evaluation report

OECD sector	2403000 / Formal sector financial intermediaries	
BMZ project ID	2003 65 999 (equity investment with trust funds) 2003 65 981 (credit line) 2003 70 346 (complementary measure)	
Project executing agency	First Microfinance Bank Tajikistan	
Consultant	Maxwell Stamp PLC	
Year of ex post evaluation report	**2010 (2010 sample)**	
	Project appraisal (planned)	**Ex post evaluation report (actual)**
Start of implementation	1st quarter 2005 (I) 1st quarter 2005 (II) 1st quarter 2005 (CM)	1st quarter 2005 (I) 1st quarter 2006 (II) 1st quarter 2005 (CM)
Period of implementation	131 months (I) 38 months (II) 25 months (CM)	131 months (I) 38 months (II) 30 months (CM)
Investment cost	N.A.	N.A.
Counterpart contribution	N.A.	N.A.
Financing, of which Financial Cooperation (FC) funds	EUR 1.0 million (I) EUR 1.5 million (II) EUR 1.5 million (CM)	EUR 1.0 million (I) EUR 1.5 million (II) EUR 1.5 million (CM)
Other involved institutions / donors		
Performance rating	I: 2 II: 2	
• Relevance	I: 1 II: 1	
• Effectiveness	I: 3 II: 3	
• Efficiency	I: 4 II: 4	
• Overarching developmental impact	I: 3 II: 3	
• Sustainability	I: 3 II: 3	

Brief description, overall objective and project objectives with indicators

The project comprised the foundation and establishment of First Microfinance Bank of Tajikistan (FMFB), a bank specialising in the provision of financial services to micro and small private enterprises and households (target group) in Tajikistan. The establishment of the bank coupled the upscaling of socially oriented lending programmes of the Aga Khan Foundation (AKF-T) in the east of the country with the creation of new branch offices in the west of Tajikistan, including the capital of Dushanbe and the economic hub of Khujand. The project was implemented in cooperation with the Aga

Khan Fund for Economic Development (AKFED) and the International Finance Corporation (IFC). The FC measures covered the acquisition of a participation in the share capital of FMFB equivalent to EUR 1.0 million, which at the time of the foundation represented a share of around 21%, and the provision of an FC credit line of EUR 1.5 million to FMFB. In addition, support included an FC complementary measure to help establish FMFB in the amount of EUR 1.5 million, which was primarily used to co-finance the management services and training measures necessary for the establishment of business operations and staff capacity building.

The objective of the project was to make financial services available to micro and small private enterprises and households (project objective). This was expected to lead to higher incomes for poor groups of the population, promote the creation of new jobs and contribute to reducing income fluctuations in the target group (overall objective). The project was also intended to make a contribution to strengthening the formal financial sector in Tajikistan as hardly any professional microfinance institutions (MFIs) existed in Tajikistan at the time of project appraisal. Furthermore, the creation of an MFI that operated with international standards promised to have structure-forming effects for the entire financial sector.

The indicators for the achievement of the project objective were (i) a loan portfolio outstanding of at least EUR 7.5 million after 5 years, (ii) at least 37,000 customers, (iii) a portfolio at risk of not more than 5% to 7% of the loan volume outstanding (payments overdue > 90 days), (iv) achievement of the break-even point after 5 years and (v) a share of female borrowers of at least 40%. The indicator for the achievement of the overall objective was the establishment of a sustainably operating microfinance institution and the simultaneous achievement of a satisfactory return on equity by the enterprises.

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

The FC funds were provided in the form of an equity investment, an FC credit line and an FC complementary measure. The FC equity was contributed from trust funds of the Federal Government in the USD equivalent of EUR 1 million through the acquisition of shares from AKFED and AKF-T in the amount of USD 500,000 and an equity increase of a further USD 614,000. KfW's initial shareholding thus initially amounted to 21%. The participation was to be limited to the establishment phase of 7 to 10 years. The ownership structure as at November 2010 was as follows: Aga Khan Agency for Microfinance (AKAM) 55.6%, Aga Khan Foundation Tajikistan (AKF-T) 17.2%, IFC 14.6% and KfW 12.6%.

The financial contribution of EUR 1.5 million was made available as a non-repayable grant to the Republic of Tajikistan, represented by the Ministry of Economic Development and Trade. The Ministry channelled the funds to FMFB in the form of a local currency loan at market-driven interest rates to refinance its lending business for a term of 15 years including five grace years. In on-lending the funds, the Government of Tajikistan did not index-link the currency in order to strengthen FMFB and, in this way, to promote the microfinance sector in Tajikistan. The funds, which have to be repaid in 15 years, and the accrued interest (interest differential funds) have so far been invested in four small water supply projects in the Sughd region.
In the start-up phase and up to the outbreak of the 2009 financial crisis the bank recorded steady portfolio growth and low default rates. During the financial crisis, the devaluation of the local currency and the decline in migrant workers' remittances in particular exposed weaknesses in the internal organisation and control structure. The

PaR rose to an average 16.1% and the bank incurred high losses. The establishment of a new management team in early 2009 was able to slow down this trend and initiate a reversal.

Key results of the impact analysis and performance rating

The project created a microfinance bank in an environment where the financial system had very limited penetration at the time it was founded and, accordingly, a shallow level of financial intermediation. It helped to overcome this development obstacle and the associated problems for MSMEs. The project created an institution with sustainable corporate governance structures that were intended to serve as a model for the sector. The rural population in particular benefited from the bank.

Based on the facts and circumstances described above, we rate the programme's developmental efficacy as follows (details on performance assessment can be found in the technical information sheet "Criteria and rating system in ex post evaluation reports on German bilateral FC" (14 September 2006)).

Relevance: Inadequate access to financial services for MSMEs was and continues to be a major obstacle to development and growth in Tajikistan. Although a large number of microfinance institutions exist, their outreach is often restricted by their small size. Consequently, the assumed impact chain that support of the private sector and MSMEs in particular through the establishment of a target-group oriented bank offering improved financial services can contribute to increased investment and, thus, to higher incomes and more employment, remains valid. The impact hypothesis that the introduction of new products can increase the breadth and depth of the financial system remains equally valid as well. The strong focus of FMFB on supplying rural and hard-to-access regions with financial services targets a customer group that would not have had any access to financial services without the bank or the preceding Aga Khan programmes. Even the EBRD credit lines, some of which were aimed at promoting rural financial services, have failed to reach the Khorog region in particular. The project objective was aligned with the developmental objectives and guidelines of the BMZ (whose priority area of cooperation is sustainable economic development), the objectives of the other shareholders of FMFB and the strategies of the Government of Tajikistan. The cooperation between the various donors within FMFB is good, and a regular working group of representatives of all donors active in the sector is in place. The equity investment using trust funds helped to establish the bank and, through its shareholding character, had the potential to contribute to the formation of a functioning corporate governance structure that would serve as a model for the sector. The configuration of the on-lending conditions made the grant funds particularly suited for reducing the shortage of local funding. We therefore rate the overall relevance of both projects as very good (sub-rating for both: 1).

Effectiveness: Only three of the five indicators defined at project appraisal were achieved. Of those achieved, only the portfolio growth indicator was fulfilled consistently and clearly. The proof of portfolio quality expressed as a low PaR > 30 days of less than 5% (indicator was adjusted to current standard parameters) on the other hand was not achieved again until autumn 2010 (2.1%), after it had climbed as high as 16.1% in the course of the financial crisis, which brought internal problems to light. This trend is a mirror image of the second indicator: the achievement of the break-even point. After heavy losses in 2009 and 2010, this was achieved for the first time in the third quarter of 2010 without any subsidies being contributed. The other two indicators, at least 37,000 customers and a share of at least 40% female borrowers, were clearly missed. In our opinion, however, these indicators were inappropriately chosen because it had not been recognised that with the establishment of the bank the social lending programmes it adopted could not be continued unchanged. On the contrary - introducing these programmes did not create a firm base of customers but rather brought with it the challenge of integrating and upscaling these programmes. The failure to recognise these problems already at the time of project appraisal ultimately constituted a major reason for the undesirable development of FMFB over a prolonged period of time. While the establishment of the new branch offices in Sughd and Rasht in particular was very successful, the rural branch offices that had emerged from the social lending programmes of the Aga Khan network were not integrated consistent with the standards of a sustainably operating bank. The problems (change of corporate culture, dismissal of employees, appointment of skilled staff) which upscaling programmes normally involve were neither mentioned nor addressed until the crisis in 2009. Nevertheless, it is very positive that the management which was newly installed in 2009 has embarked on a course that has laid the groundwork for a sustainably operating bank. Considering this recent positive development, we rate the effectiveness of both projects as just satisfactory, although it must be emphasised that an earlier recognition of the challenges existing at the time the bank was founded would have been desirable (sub-rating for both: 3).

<u>Efficiency:</u> The operational efficiency of the bank was not very pronounced in the past years. The newly established branch offices have achieved good results since the bank was founded. The other branch offices have had to absorb heavy losses since the financial crisis, and an improvement of the situation was only achieved through the efforts of the newly installed management. It must also be emphasised, however, that at the time of project appraisal a more cost-efficient alternative under which it would have been possible in such a short time to establish a branch network extensive enough to reach customers even in hard-to-access regions most probably would not have been available (allocation efficiency). If the mentioned errors in the conception of the project had not been committed, the assessment of project efficiency would be significantly more positive. Despite the improvement in the indicators under the new management we thus arrive at an unsatisfactory rating of the efficiency of both projects (sub-rating for both: 4).

<u>Overarching developmental impact:</u> The overall objectives were all achieved in November 2010. However, the same qualification must be made for the indicator "establishment as a sustainable microfinance institution" as was made for the indicators of the achievement of the project objective. In 2009, the sustainability of FMFB was severely endangered but one year later the trend was reversed by its reorganisation. No specific data are available on the achievement of the indicator "satisfactory return on equity of the financed MSMEs" because the information that would have been necessary for the calculation is not available. Samples taken during the evaluation mission and the renewed drop in the PaR of FMFB in November 2010 suggest that this indicator has been achieved. The share of agricultural loans (51% of the number of loans granted, 32% of the loan portfolio outstanding) is surprisingly high in comparison with other young microfinance banks which usually focus their initial business primarily on urban trade and commerce. The developmental impact of FMFB, therefore, is comparatively high. A further characteristic is the specific construction of the grant-financed credit line to FMFB which enabled FMFB to already extend local currency loans at an early stage, thus protecting the customers from the foreign exchange risk. The interest rates charged by FMFB lie in the lower end of the range in the microfinance sector in Tajikistan, the bank follows the principles of "Responsible Finance", and the broad range of products it offers include not only lending but also the acceptance of savings deposits, money transfers via SWIFT, the disbursement of migrant worker remittances, and mortgage loans with a maturity of up to 10 years.

Against this background, although the default rates were high at certain stages we rate both projects as satisfactory (sub-rating for both: 3).

Sustainability: In the third quarter of 2010, FMFB achieved the break-even point and is no longer dependent on subsidies. We therefore consider the preconditions for the sustainable development of the bank as fulfilled. We rate the measures adopted by the new management as very positive and crucial to the sustainability of the FC measures. It should be noted, however, that the sustainable development of the bank and its survival in the market are possible only if the shareholders continue supporting the current management's policy which is aimed at achieving a profit and consolidating its sustainable developmental impact. The preconditions that also prevent the expected stronger competition (including from Access Bank) from jeopardising the sustainability of FMFB are fulfilled, provided it stays the course it has charted. As the bank has embarked on this path only recently, and uncertainty over the further conduct of the shareholders remains, however, we rate the sustainability of both projects as satisfactory (sub-rating for both: 3).

Despite the problems outlined above, owing to the successful reorganisation we rate the overall developmental efficacy of the project as satisfactory (overall performance rating: 3).

General conclusions and recommendations

The reorganisation of socially orientated loan programmes (upscaling) is a particular challenge and usually takes longer to become sustainable than the mere establishment of a new bank. In projects of this kind, an adequate period of support, a change in corporate culture and the use of qualified personnel are crucial to their success.

The provision of individual loans to women with a high level of education outside the big cities is a particular challenge in conservative countries. In such a case, the quota of women as an indicator for a project objective should not be set too high unless measures through which a high quota of women can be achieved are expressly identified.

In formulating a microfinance law, care should be taken that banks and microfinance organisations be held to the same standards of responsible lending in order to prevent unfair competitive pressure from microfinance organisations.

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).