Uzbekistan: Credit Line to promote the Private Sector /SME I

Ex-post evaluation

OECD sector	24030 - Financial intermediaries of the formal sector	
BMZ project number	1995 67 124	
Project-executing agency	Ipak Yuli Bank, Uzprivatbank	
Consultant	Icee	
Year of evaluation	**2002**	
	Project appraisal	**Ex-post evaluation**
Start of implementation	Q 4 1996	Q 1 2002
Financing, of which FC funds	EUR 2,556,459	EUR 2,556,459
Other institutions/donors involved	None	None
Performance rating	3	
• Significance / relevance	3	
• Effectiveness	3	
• Efficiency	4	

Brief Description, Overall Objective and Project Purposes with Indicators

The FC loan was extended as a credit line to two Uzbek banks (Ipak Yuli Bank and Uzprivatbank) for the purpose of granting medium and long-term investment loans to small and medium-sized private enterprises and start-up companies. The partner banks extended the funds to the sub-borrowers in the form of foreign currency loans which have an interest rate of 9%, a term of 4 to 6 years and may be serviced in local currency.

In addition to the credit line, a complementary measure in the amount of EUR 410,000 was financed in order to advise the banks on handling the credit line. The German consulting firm iCee was assigned with the implementation of the complementary measure.

The overall objective was to contribute to increasing growth, incomes and employment in Uzbekistan. The project objectives were pursued on two levels: (1) at the SME level the use of the facilities financed was to be ensured and (2) at the financial sector level a contribution was to be made to the establishment of financial intermediaries offering financial services to SMEs.

The following target indicators were defined:

<u>At the SME level:</u>

- Two years after the start of operation the capacity utilization of the facilities financed is at least 70%.

- From the second year of operation onwards 80% of the companies earn a profit and meet their debt service obligations when due.

At the financial sector level:

- The banks in charge of the implementation of the programme are able to evaluate loan applications on their own and operate at least on a break-even basis. The rate of return on equity equals at least the annual inflation rate.

Major Deviations from the original Project Planning and their main Causes

None

Key Results of the Impact Analysis and Performance Rating

The credit line was fully disbursed between early 1999 and early 2001. Altogether, 10 loans in the average amount of EUR 260,000 were extended.

The indicators defined for the achievement of the project purpose at the SME level were largely met:

- Apart from one exception, the capacity utilization of the facilities which started operation according to schedule is satisfactory to very good.

- All companies meet their payment obligations when due or even ahead of schedule.

- Most companies report a profit.

However, the target group of small and medium-sized private enterprises was only reached to a limited degree. The criterion determined in the appraisal report and defining that 20% of the enterprises should receive loans not exceeding EUR 51,129 was not fulfilled. The disposition funds originally set up with the two banks of EUR 127,823 each intended for the extension of small loans were closed – according to the banks for lack of suitable applicants. In addition, it turned out that at least four companies were part of holding companies, which meant that though they formally belonged to the target group they did in effect not qualify.

The financial-sector objectives at the level of the financial intermediaries were not fully achieved. Generally, with the support of the consultant the partner banks were able to appraise loan applications professionally. Due to the consultant's strong commitment and the request of KfW that all loans be approved on a case-by-case basis in order to avoid politically influenced lending decisions it is however difficult to assess whether the banks are generally in the position to conduct loan appraisals on their own. Moreover, the banks do have functioning lending departments but owing to their limited possibilities they currently handle only few loans. In the financial years 2000 and 2001 only one of the two commercial banks participating in the project succeeded in maintaining the equity provided in real terms. In addition, there are sustainability risks regarding the revolving use of the funds.

Thus, the overall objective was met to a limited extent. Apart from one exception, the capacity utilization of the industrial plants financed from FC funds is satisfactory to very good, thus, a contribution was made to increasing employment and incomes. However, as a result of the specific repayment conditions with a regulated exchange rate the distortions in the financial market caused by the existing exchange rate system will tend to be aggravated.

Overall, the project was implemented under very difficult conditions at the beginning of the transformation process in Uzbekistan, though there was no alternative at the time of the project appraisal with regard to the project design. The existing risks to the sustained developmental effectiveness of the project result mainly from the political (and economic) situation of the country. The sluggish reform process, the ongoing state domination in the financial sector, regulated exchange rates and the persistent inflation hamper the development of companies and in particular also that of private-sector banks. The exchange rate system has unintentionally acted as an incentive to contract the foreign exchange loans, which are serviced in local currency at the regular exchange rate, which differed and still differs strongly from the black market rate, and thus include subsidies. This entails a bandwagon effect.

However, with the specific project design and the complementary measure the project succeeded in taking account of the special circumstances of the exchange rate system and the important political influence on the banks when assessing the investments financed. For instance, at the company level mainly those projects were financed which are expected to be competitive also once the distorting conditions have been eliminated.

By creating jobs the project contributes to reducing poverty, however the employment effect of the individual loans varies greatly: it ranges from 3 to 100 new jobs created in the respective companies.

It cannot be attested that the project specifically supports gender equality.

When making the loan appraisal the environmental compatibility of the plants financed is also assessed. In cases in which environmental problems occurred appropriate measures were taken. Overall, the environmental impacts of the loans granted are negligible and there is no need for action.

The project's developmental effectiveness is based on the following partial evaluations:

Effectiveness

The project objectives at the SME level and the financial sector level were not fully achieved. Most of the companies reported positive results. There are, however, sustainability risks regarding the use of the revolving funds. Moreover, the low return on equity and the weak equity base of Ipak Yuli Bank could threaten its future existence. Overall, we assign the project a still satisfactory degree of **effectiveness** (partial evaluation: **rating 3**).

Efficiency

The banks' operational efficiency in the lending business is not satisfactory. The credit analysis of the two banks shows a satisfactory picture and both report very low default rates, however, administrative expenses are disproportionately high. For instance, at Uzprivatbank one employee handles on average 7 loans and in the case of Ipak Yuli Bank the figure even is only 3 loans per employee. Given the low number of borrowers expenses under the complementary measure equally appear far too high at EUR 40,000 per loan. In addition, high labour turnover reduced the efficiency of the complementary measure.

In consideration of all these aspects the **efficiency** of the project is rated **inadequate** (partial evaluation: **rating 4**).

Significance / relevance

Uzbekistan is characterized by an insufficient access to foreign exchange loans to finance imports of production plants. The project has alleviated this problem. Owing to the FC funds incomes at the sub-borrower level increased and new jobs were created. However, due to the subsidy element contained in the lending the loans granted have contributed to maintaining and enhancing existing distortions in the financial market. Overall, however, the project will contribute to achieving the overall objective, i.e. it will increase growth, incomes and employment and thus is rated as **still adequate** (partial evaluation: **rating 3**).

Under consideration of its effectiveness, efficiency and significance/relevance we assess the project as overall having **adequate developmental effectiveness (rating 3)**.

General Conclusions applicable to all Projects

When analysing the creditworthiness of potential borrowers in the future it should also be examined to what extent the respective company is associated with other groups of companies.

As regards Ipak Yuli Bank, a coordination between lending under the FC credit lines and lending in the framework of the EBRD Microfinance Programme is recommended in order to avoid inefficiencies and overlapping activities, for instance in the organisation of the lending.

Legend

Developmentally successful: Ratings 1 to 3

Rating 1	Very high or high degree of developmental effectiveness
Rating 2	Satisfactory degree of developmental effectiveness
Rating 3	Overall adequate degree of developmental effectiveness

Developmental failures: Ratings 4 to 6

Rating 4	Overall inadequate 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 a project's "developmental effectiveness" and its assignment during the final evaluation to one of the various success levels described below in more detail focus 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? How can the project's microeconomic and macroeconomic impact be measured (aspect of **efficiency** of the project concept)?

- 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 (as is the case at the World Bank) 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 created over an economically reasonable period of time or to successfully continue the project activities on their own once the financial, organizational and/or technical support has come to an end.