Vietnam: Economic Reintegration of Returnees II

Ex post evaluation report

OECD sector	24030 - Financial institutions of the formal financial sector	
BMZ project ID	2000 66 076	
Project executing agency	Industrial and Commercial Bank of Vietnam (ICBV)	
Consultant	Not applicable	
Year of ex post evaluation	**2006**	
	Project appraisal (planned)	**Ex post evaluation (actual)**
Start of implementation	11/2001	04/2002
Period of implementation	24 months	10 months
Investment costs	No information available	No information available
Counterpart contribution	No information available	No information available
Financing, of which Financial Cooperation (FC) funds	EUR 5.1 million	EUR 5.1 million
Other institutions/donors involved	None	None
Performance (overall rating)	3	
• Significance / relevance (sub-rating)	3	
• Effectiveness (sub-rating)	3	
• Efficiency (sub-rating)	3	

Brief description, overall objective and project objectives with indicators

The project objective was to support the Industrial and Commercial Bank of Vietnam (ICBV) in the provision of sustainable loans to private micro, small and medium-sized enterprises (SMEs), including business start-ups. The overall objectives were to create and safeguard incomes and employment in the private sector in Vietnam and to support the economic reintegration of returnees from Germany to Vietnam.

The FC funds in the amount of EUR 5.1 million were to be spent as follows: Refinancing of (a) medium and long-term sub-loans to finance investment projects, the acquisition of active stakes in enterprises, the take-over of enterprises and business start-ups which primarily serve the economic reintegration of returnees from Germany, and (b) medium- and long-term sub-loans to non-state SMEs to finance investments in fixed and current assets.

Programme design / major deviations from the original programme planning and their main causes

The project-executing agency was the Industrial Bank of Vietnam (ICBV). With a share of 17% in the total assets of the banking sector, ICBV is one of the four large state-owned commercial banks in Vietnam. ICBV was established in 1988 through separation from the State Bank of Vietnam (the Central Bank) into an independent institution. Pursuant to the Credit Institutions

Law dated 1998, ICBV is subject to the supervision of the SBV but is formally independent in the pursuit of its business policy and day-to-day business. It enjoys vast independence in its lending to the private sector. However, as at the time of the project appraisal, there are still certain expectations and a certain informal pressure from politics with regard to lending to state enterprises. Nevertheless, in the last five years ICBV was able to gradually reach a certain autonomy in its lending decisions also with regard to state-owned enterprises. Still, it has to be admitted that political influence on the decision about lending to state enterprises can never be entirely excluded.

The Socialist Republic of Vietnam, represented by the Ministry of Finance, is the borrower of the FC funds totalling EUR 5.1 million. The FC loan has a term of 40 years (of which 10 grace years) and an interest rate of 0.75% p.a. As agreed, the Ministry of Finance on-lent the FC funds in domestic currency (VND 76.1 billion) with a loan term equal to that of the FC loan to ICBV. The exchange rate risk was borne by the Ministry of Finance, which we consider appropriate. The margin for ICBV was 4.5% and served to cover ICBV's operating costs and loan losses. Given the high costs and the high risks involved in SME financing this margin for ICBV is very low. The interest differential funds (difference between the interest paid by sub-borrower and the bank's cost of funds) were allocated to a counterpart resources fund. By 30 June 2006 a total of VND 9.3 billion had been paid into this fund. As contractually agreed, these funds were to be used to cover the exchange rate risk and to finance training measures for ICBV and for sub-borrowers. Due to the strong depreciation of the VND the interest differential funds have so far been used by the Ministry of Finance almost exclusively to cover the exchange rate risk.

At the time of the ex post evaluation, the real value of the fund vis-à-vis the euro had not been maintained, as the VND had depreciated considerably vis-à-vis the euro (at the time of the ex post evaluation, the real value of the fund was EUR 4.2 million). Measured in VND, however, the real value of the fund had been almost maintained.

Refinancing was provided for loans to Vietnamese non-state SMEs and to Vietnamese people returning from Germany, who re-entered Vietnam after the date of the conclusion of the repatriation agreement dated 6 July 1995. The loans are to be extended to returnees who start up a business or to take over or acquire an enterprise. The terms and conditions applied by ICBV vis-à-vis the sub-borrowers should be market conforming. The sub-loans may not exceed 80% of the respective investment costs; the maximum loan amount is EUR 51,000. Refinancing was to be provided for medium and long-term sub-loans with a term of at least one year to finance capital investments and working capital. The maximum term of the sub-loans was 10 years with not more than 2 redemption-free grace years. Projects that hold substantial environmental risks or that require complex technical installations or an intensive control and monitoring effort to prevent negative environmental impacts were excluded from promotion in order to avoid any potential project risks (among others, dying mills, galvanisation plants, tanneries). The loans funds repaid by sub-borrowers were to be used by ICBV to extend new loans in the area of general SME financing. ICBV complied with these criteria as had been contractually agreed.

The FC funds of EUR 5.1 million were fully disbursed in the period from April 2002 to January 2003 (10 months). In the first round of lending the equivalent in VND (VND 76.1 billion) was spent by ICBV to finance 255 SME sub-loans. The average loan is for approx. VND 300 million or EUR 20,000. The portfolio at risk of the portfolio outstanding is approx. 2.2%. By sector, the focus of the lending activities was on the transport sector accounting for 40% of the disbursement volume, followed by the construction industry (17%), trade (13%), industry (12%) and others (18%). Of the total of 255 loans granted 252 loans were to finance investments in fixed assets and three to finance working capital. 250 of the 255 loans went to business start-ups and five loans were used for the acquisition of active shares in companies. According to information provided by the project-executing agency, the loans helped to create a total of 3,672 new jobs. Up to now returnees are not among the borrowers. According to ICBV information, 53 jobs (out of 3,672) were created for returnees. A positive aspect to be mentioned with a view to the development of the financial system is the fact that the loans extended have relatively long terms. Thus, 85% of the loans had maturities of more than 48 months. The fact that the credit line was disbursed very swiftly is an indication that there is strong demand for long-term capital. The audit of the records performed under the ex post evaluation revealed no misappropriation of funds.

Key results of the impact analysis and performance rating

The project objective was to support the Industrial and Commercial Bank of Vietnam (ICBV) in the provision of sustainable lending to private micro, small and medium-sized enterprises (SMEs), including business start-ups. The overall objectives were to create and safeguard incomes and employment in the private sector in Vietnam and to support the economic re-integration of returnees from Germany to Vietnam. During the project appraisal the ”portfolio at risk” was defined as the indicator for measuring the project success: The project objective was considered as achieved if the share of loans with interest and/or principal arrears of over 90 days does not exceed 10% of the loan portfolio refinanced with FC funds (indicator). At project appraisal no individual indicator was defined for the overall objective because of the close relationship between the project objective and the overall objective. The overall objective was considered achieved if the project objective had been achieved. From today’s perspective it would have been appropriate also to define indicators for measuring the achievement of the overall objective. The overall objective of creating and safeguarding income and employment in the private sector in Vietnam could have been assessed with the help of the customary indicator of “the number of newly created jobs”. A separate indicator could also have been defined for the overall objective of the reintegration of returnees (“number of successfully reintegrated returnees”). However, from today’s perspective we would cancel this overall objective as well as the related indicator because the overall objective of the reintegration of returnees was unrealistic due to the framework conditions already existing at the time of the project appraisal (parallel implementation of another DC project with more attractive loan conditions for sub-borrowers). With hindsight it can be said that the project consists of a credit line to support the private SME sector.

The target group of the project comprised on the one hand private SMEs including business start-ups with a registered capital of not more than VND 5 billion (at project appraisal: approx. EUR 394,000) and up to 200 empoyees (this is in line with the definition of SMEs formulated at project appraisal). In 2006 the definition of SMEs changed and now covers enterprises with a registered capital of VND 10 billion (approx. EUR 495,000) and 300 employees. The SME definition for the purpose of the project was not changed during the period of implementation. We consider this as acceptable. Nevertheless, it has to be mentioned that Vietnamese nationals returning from Germany to Vietnam after the signing of the repatriation agreement dated 06 July 1995 also belonged to the target group. At the time of the project appraisal a substantial demand for funds to finance investments in fixed assets and working capital had generally been assumed for both segments of the target group.

However, already at the time of the ex post evaluation for Phase I of the returnee programme (ex post evaluation report dated 20 September 2000) it had been stated that the FC project (Phase I) had not been successful in reaching the target group of returnees from Germany. One reason for this was that many of the returnees had already entered Vietnam before Phase I of the project started and had already taken roots (economically speaking). On the other hand, in parallel with the FC programme DEG was implementing another programme for returnees together with ICBV, under which the returnees were offered a number of attractive complementary measures in addition to loans (at subsisized interest rates). For this reason it was proposed to the BMZ alread prior to the project appraisal for Phase II to limit the target group of Phase II to private SMEs and to formally redefine the project purpose as an “SME refinancing line“ in the framework of the government negotiations. From today’s perspective we generally consider this adjustment of the project purpose as reasonable, because already in Phase I the developmental focus of the FC project was rather on a credit line to “support private-sector SMEs“ and not so much on a “programme to support the economic reintegration of returnees“.

The DEG programme to support business start-ups and the reintegration of returness (“DEG Returnee Programme“), which was implemented in parallel with the FC programme and which offered the target group very attractive terms, fully absorbed the existing demand for loans of the returnees. Besides mere financing arrangements the DEG programme provided complementary training measures to borrowers. In addition, the DEG programme comprised a guarantee fund, under which guarantees were provided to borrowers to partially compensate for a lack of collateral. Moreover, interest rates charged to sub-borrowers under the DEG programme were subsidised. The interest subsidisation was ended only in April 2003. Between 1993 and 2004 altogether around 4,600 loans with an overall volume of about VND 888 billion were granted under the DEG programme. Of these loans almost 2,000 loans worth VND 305 billion were handed out to returnees. The sectoral focus was on transport (27%) and trade and services (25%). According to information provided by DEG, 42,000 jobs were created under the programme (18,274 of which in the context of the returnee programme). 93 % of the supported companies reported positive results. The repayment rate was 97%. At the end of June 2005 the portfolio-at-risk of the DEG portfolio outstanding was 2.0%.

The main reasons for the fact that the FC project did not reach any returnees was due to the attractive design and conditions of the DEG programme implemented in parallel with the FC project and the decline in the number of people returning to Vietnam. According to statements by ICBV there were no incentives for returnees to refer to their status as returnees when applying for a loan refinanced under the FC programme because the returnee status did not imply any financial or non-financial advantages. Instead, returnees preferred to apply for loans as “regular SMEs“.

The FC funds of EUR 5.1 million were fully disbursed in the period from April 2002 to January 2003 (10 months). In the first round of lending the equivalent in VND (VND 76.1 billion) was spent by ICBV to finance 255 SME sub-loans. The average loan is for approx. VND 300 million or EUR 20,000. At the end of June 2006 the portfolio-at-risk of the loan portfolio outstanding (arrears of more than 90 days) was 2.2 %. The project objective indicator was clearly met. However, due to the long average maturities of the sub-loans it might be that payment difficulties will occur rather at the end of the loan term (i.e. when redemption instalments are due for payment). Thus, problems regarding the portfolio quality will only become apparent in the future. Moreover, the figures provided by ICBV on the portfolio quality should generally be viewed with caution, especially taking into consideration the qualifications to be made for ICBV’s annual financial statements in terms of portfolio quality and the random checks made during the final evaluation mission. Thus, the precise volume of the portfolio at risk is difficult to quantify. However, on the basis of our analyses we assume that the portfolio at risk is higher than indicated by ICBV. Nevertheless, we think is reasonable to assume that the indicator for the project objective is sufficiently fulfilled.

According to the information provided around 3,700 new jobs were created in the first of round of lending. It can be assumed that further jobs were created in the later rounds of lending when funds were used on a revolving basis. ICBV did not precisely quantify the results achieved during the revolving use of funds. A problematic aspect of the indicator is that it only shows the “gross effect“ of the project and does not provide any information on the number of jobs that were “crowded out” by the project (for example in the informal sector). Overall, however, it is reasonable to assume that the project had a positive net effect. Thus, the overall objective of creating and securing income and employment in the private enterprise sector in Vietnam was sufficiently achieved. Overall, at the level of the overall objective the FC project has made a substantial contribution to improving the provision of financial services (in particular long-term financing opportunities) for MSEs in the programme region in Vietnam. Access by the target group to the formal financial sector has been improved.

The project is fundamentally in line with the current development policy objectives and priorities of the federal government in the financial sector (sector concept financial system development from 2003) and in relation to the poverty reduction objectives (MDG). It is also in keeping with the economic and social policy objectives and priorities of the government in Vietnam. Against the background of the long-known challenges of carrying out a fundamental restructuring of the state banks with the aim of improving efficiency, increasing transparency and achieving as much depolitisation as possible, however, future projects with ICBV should be more firmly imbedded and coordinated in the sectoral reform process.

The restricted access of SMEs to financial services and especially to long-term financing constitutes a major obstacle. By making available long-term refinancing funds to ICBV the project subject to ex post evaluation here made a substantial contribution to improving and expanding the provision of medium and long-term financing opportunities to SMEs. By creating approx. 3,700 jobs in the initial round of lending the FC project had substancial real economic impacts. 21% of the loans granted to individuals were extended to women.

The risk of a deterioration of the economic situation identified during project appraisal has not occurred. The risk that the restructuring of ICBV might not be sufficiently successful occurred in that the necessary reforms of SOCB and also of ICBV were implemented more slowly and less consistently than anticipated. This was also the reason for the the main weaknesses of the project. However, no foreseeable resultant sustainability risks can be ascertained at present. The risk that the project does not reach returnees actually occurred – as had been correctly anticipated at the time of project appraisal. Our proposal to adjust the target system accordingly, which was made already during project appraisal, was not implemented.

In a summarised evaluation of the above aspects we rate the overall developmental efficacy of the programme as follows:

Effectiveness

The project objective was to support the Industrial and Commercial Bank of Vietnam (ICBV) in the provision of sustainable loans to private micro, small and medium-sized enterprises (SMEs), including business start-ups. During the project appraisal the ”portfolio at risk” was defined as the indicator for measuring the project success: The project objective was considered as achieved if the share of loans with interest and/or principal arrears of over 90 days did not exceed 10% of the loan portfolio refinanced with FC funds. At the end of June 2006 the portfolio-at-risk of the loan portfolio outstanding (arrears of more than 90 days) was 2.2 %. The project objective indicator was clearly met. However, due to the long average maturities of the sub-loans it might be that payment difficulties will occur rather at the end of the loan term (i.e. when redemption instalments are due for payment). Thus, problems regarding the portfolio quality will only become apparent in the future. Moreover, the figures provided by ICBV on the portfolio quality should generally be viewed with caution, especially taking into consideration the qualifications to be made for ICBV's annual financial statements in terms of portfolio quality and the random checks made during the final evaluation mission. Thus, the precise volume of the portfolio at risk is difficult to quantify. However, on the basis of our analyses we assume that the portfolio at risk is higher than indicated by ICBV. Nevertheless, we think it reasonable to assume that the indicator for the project objective is sufficiently fulfilled. As contractually agreed, ICBV uses interest and redemption amounts repaid on FC loans handed out in the initial round of lending on a revolving basis to refinance its SME loan portfolio. Due to the consistent restructuring efforts of ICBV, which are reflected in the improved key figures of the bank, we think that the sustainable use of the FC funds for the financing of SMEs is ensured. Overall, we judge the project's efficiency as satisfactory (sub-rating 3).

Relevance/significance

The overall objectives were to create and safeguard incomes and employment in the private sector in Vietnam and to support the economic reintegration of returnees from Germany to Vietnam. At project appraisal no individual indicator was defined for the overall objective because of the close relationship between the project objective and the overall objective. The overall objective was considered achieved if the project objective had been achieved. From today's perspective it would have been appropriate to define indicators for measuring the achievement of the overall objective. The overall objective of creating and safeguarding income and employment in the private sector in Vietnam could have been assessed with the help of the indicator of "the number of newly created jobs". A separate indicator could also have been defined for the overall objective of the reintegration of returnees ("number of successfully reintegrated returnees"). However, from today's perspective we would cancel this overall objective as well as the related indicator because the overall objective of the reintegration of returnees was unrealistic due to the framework conditions already existing at the time of the project appraisal (parallel implementation of another DC project with the same project executing agency, which offered more attractive loan conditions to sub-borrowers). With hindsight it can be said that the project consists of a credit line to support the private SME sector. We assess the real economic impact of the project as sufficient. According to the information provided around 3,700 new jobs were created in the first of round of lending. Overall, by providing long-term financing opportunities the FC project has made a substantial contribution at the level of the overall objective to improving financing services for MSEs in Vietnam. Access by the target groups to the formal financial sector has been improved. Overall, we classify the project's **significance and relevance as sufficient (sub-rating 3).**

Efficiency

Overall, we consider the earnings situation and the capital endowment of ICBV as only sufficient. Despite the progress made in the restructuring, there is still need for action with regard to increasing profitability, equity capital endowment and capital adequacy. We consider the market-based design of the sub-borrower rates positively. Overall we judge the production efficiency to be sufficient. With regard to allocation efficiency, it can be assumed that the SMEs make clearly appropriate use of the loans. Overall, we assess the **efficiency** of the project as **sufficient.** (sub-rating 3).

In a summarised assessment of the above impacts and risks we rate the project as having sufficient developmental effectiveness **(overall evaluation: rating 3)**.

General conclusions and recommendations

A situation where several DC projects are being implemented in parallel with the same project executing agency and addressing the same target group should be avoided. In the event that two DC loan programmes focus on the same target group it has to be ensured that comparable sub-borrower conditions are applied under both programmes. For example, it should be ensured that sub-borrower interest rates are in conformity with the market so as to avoid a situation where one DC programme undercuts the other DC programme with more favourable (subsidised) interest rates and, thus, undermines the developmental efficacy of the other programme.

It makes little sense to link the real value retention of revolving loan funds in domestic currency to the euro or US dollar as exchange rate developments only rarely reflect inflation differences between the domestic and the foreign economy. By contrast, it is appropriate to take account of the rate of inflation in the partner country (plus any loan losses). The use of appropriate counterpart funds to retain the real value of the revolving fund should be formulated as a standard condition for financial sector projects (grant financing).

To ensure that revolving credit funds maintain their value in real terms sufficient inflows have to be provided to compensate for any loan losses or depreciations due to price increases. This may be achieved by using part of the interest payments made by the sub-borrowers and / or allocations from the counterpart resources fund. If in the event of FC loans the counterpart resources fund has to be used to hedge currency risks for the recipient or the project executing agency part of the sub-borrower interest payments and / or corresponding payments by the bank have to be earmarked accordingly.

In the case of known structural weaknesses at the project executing agency, such as in the case of ICBV, FC projects should be integrated more firmly into sector projects or at least closely coordinated with them. In so doing, verifiable progress in the restructuring of executing agencies should be taken into account as important conditions/requirements in FC projects.

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, organizational and/or technical support has come to an end.