KfW

Mozambique: Promotion of Small Industry (GAPI)

Ex-post evaluation

OECD sector	24030 / Financial intermediaries of the formal sector	
BMZ project number	1995 67 090	
Project-executing agency	Gabinete de Consultoria e Apoio a Pequena Industria (GAPI)	
Year of evaluation	**2002**	
	Project appraisal (planned)	**Ex-post evaluation (actual)**
Start of implementation	Q 2 1996	Q 3 1996
Financing, of which FC funds	EUR 2.3 million	EUR 2.3 million
Other institutions/donors involved	None	None
Performance rating	4	
• Significance / relevance	4	
• Effectiveness	4	
• Efficiency	5	

Brief Description, Overall Objective and Project Purposes with Indicators

The overall objectives of the project were on the one hand the establishment and maintenance of small and medium-sized enterprises (including cooperatives) and on the other hand to make a contribution to the sustainability of private-sector structures and to improving incomes and employment.

The project purpose was the establishment of a financial institution which is in the position to grant small and medium-sized enterprises permanent access to financial services, either for short-term working capital or for medium and long-term financing of capital goods. The goal at the sub-borrower level was to have at least 80% of the debt service for the outstanding loan amount paid when due (indicator for the achievement of the project purpose).

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

None

Key Results of the Impact Analysis and Performance Rating

At the end of April 2002 GAPI had a volume of loans outstanding of USD 10.2 million with 210 borrowers. In the last 5 years the volume of loans outstanding increased markedly (1997: USD 3.2 million), whereas the number of borrowers rose only to a minor extent (1997: 184). Accordingly, the average volume of loans outstanding increased continuously and is currently USD 48,571. The target group of small and medium-sized private enterprises (upon project appraisal defined as companies with up to 50 employees) was largely reached.

Despite the relatively low number of borrowers GAPI has considerable difficulties with the administration of its loan portfolio, due to the serious institutional deficiencies in particular in the areas of information systems, organizational and ownership structure and credit technology. The institutional problems result in operative inefficiencies and an insufficient quality of the loan portfolio. Since 1998 the repayment rate (repayments received in relation to repayments due in a given period) has been 81%. This means that formally the target indicator has been achieved. However, this rate does not take into account that over many years a significant share of non-performing loans (about 20% of annual disbursements) have been rescheduled. For this reason the actual repayment rate is estimated to be lower than the requested 80%. In addition, the repayment rate is of little significance. Much more reliable is the item “portfolio at risk”, which, however, GAPI usually does not calculate. According to information collected by GAPI and by KfW the portfolio at risk (measured by the risky loan portfolio outstanding and overdue for more than 90 days in relation to the total outstanding loans) is 50%. A quarter of these loans have been in default for more than one year. Even taking into account that with its focus on medium-term financing of medium-sized companies GAPI is active in a segment that by its nature involves high risk, the level of defaulting loans is no longer acceptable by international and national comparison.

Despite its institutional deficiencies GAPI has been able to cover its operative costs, mainly due to the fact that GAPI is financed for the most part from grants and, thus, financial costs are low and are negligible. Moreover, GAPI bears no or little default risk for a part of the credit lines it manages. GAPI has no savings deposits and due to its cost and risk structure it is not in the position to refinance itself at market conditions in the interbank market. Thus, GAPI is completely dependent on favourable funding from international development institutions. Despite the funding costs converging on zero GAPI has so far not been able to maintain its equity capital in national currency in real terms. Since 1999 the equity capital has dropped from USD 3.5 million to USD 2.3 million at the end of 2001.

According to GAPI the intended non-monetary results of the project were achieved and, thus, the overall objective was reached. GAPI reports that most of the loans extended contributed to expanding the companies’ production and to increasing returns. According to GAPI calculations, on average 14.9 jobs were created per loan. However, in view of the deficient credit analysis and the inadequate monitoring by GAPI the intended positive effects have generally to be viewed with reservations. For instance, the data provided on jobs created is based solely on projections made when the loan application was submitted.

Under the complementary measure carried out in the period from 1997 to 2000 GAPI implemented approx. 35 individual measures. Most of these measures were seminars on setting up and managing companies. In addition, feasibility studies, legal advice, loan-accompanying technical assistance as well as environmental impact analyses were implemented in individual cases. Short-term expert missions to improve GAPI’s business procedures, especially those of the MIS, were also financed. Advisory measures were professionally prepared by GAPI and for the most part implemented by local experts with high quality.

In view of the project purpose entitled “establishment of a financial institution”, the scope of the complementary measures, which were intended to give GAPI institutional support through institution building, was clearly too limited. This area should have been covered mainly by personnel support provided by the Friedrich-Ebert-Stiftung (FES). However, the FES has only limited know-how in the field of setting up financial institutions. Overall, the results of the measures were too short-lived. Since the end of 1999 GAPI has no longer received any support from full-time FES experts. With the few FC-financed measures in the field of institutional support it was not possible to remedy GAPI’s institutional deficiencies detected during the project appraisal. In particular, it was not possible to improve the management information system.

In summary the project's developmental effects are as follows:

GAPI is a project-executing agency, which depends on the support of international development cooperation and which, despite receiving substantial support, owing to its institutional deficiencies has not been able to maintain the funds managed in real terms and to achieve financial sustainability. The project purpose was not achieved and the developmental effects of the project on the target group are mixed. As a result of the institutional problems the number of borrowers serviced by GAPI was increased only marginally in the last few years. Every year about 20% of the funds are used to finance companies not able or not willing to pay. As regards GAPI's impact on the financial system one can state that in the first few years of existence GAPI was the only supplier of medium-term SME loans at market conditions and made a very important contribution to deepening the financial system. However, this importance has decreased in the last few years. As a result of the growing competition from commercial and micro-banks, but partly also due to the low credit-worthiness of its customers, GAPI started to on-lend loans sometimes at subsidized interest rates. Owing to the inadequate credit technology, in particular the rather low degree of loan monitoring, GAPI tends to make it more difficult for market-oriented commercial banks to enter the segment of SME financing.

In a summarized assessment of all impacts and risks we have arrived at the following rating of the project's developmental effectiveness:

Effectiveness:

The project purpose, i.e. the establishment of a sustainable financial institution, was not achieved. Therefore, we rate the project's **effectiveness overall as no longer sufficient** (partial evaluation: **rating 4**).

Relevance/significance:

The sector of small and in particular of medium-sized enterprises is of great importance for the economic development of Mozambique. The lack of access to medium and long-term loans continues to be a major obstacle to company growth. The overall developmental objectives with regard to the target group were achieved only to a limited extent and not on a sustained basis. Given the fact that lending is partly subsidized and credit monitoring is not sufficiently stringent the impact on the financial sector has to be judged critically. Thus, as regards the criterion of **relevance** / **significance** we rate the project overall as **no longer sufficient** (partial evaluation**: rating 4**).

Efficiency:

Despite the funding costs converging on zero GAPI is not able to achieve a positive return on equity. Given an average loan size of almost USD 50,000 the ratio of operative costs to the average outstanding loan portfolio is very high at 12.8%. The quality of the loan portfolio is unsatisfactory. Therefore, we judge the project's **efficiency** as **clearly insufficient** (partial evaluation: **rating 5**).

Overall, the **developmental effectiveness** of the project is **no longer sufficient** (**rating 4**).

General Conclusions applicable to all Projects

Given the institutional deficiencies and the negative structural effects on the financial sector as well as the changed market situation (the market for financial services for micro, small and medium-sized enterprises is very dynamic with several successful micro finance institutions) a reorientation of GAPI is desirable. GAPI's management is also aware of this situation and is currently trying to formulate a new strategic business orientation. Three alternatives are conceivable:

a) Acquisition of a full banking licence:

By obtaining a full banking licence GAPI would be able to expand its range of services offered (other sectors, micro and small loans with shorter terms) and to diversify its credit risk. To ensure GAPI's sustainability the introduction of savings products would be useful. The business area "advisory services" should be strictly separated from the lending business.

b) Closing down of GAPI's lending business and expansion of advisory services:

Under this scenario and after prior best possible financial restructuring GAPI should sell its loan portfolio to its aspiring competitors (commercial banks, micro finance institutions) and concentrate on the organization and implementation of advisory and training activities.

c) Abandoning the direct lending business and expansion of GAPI as an apex institution:

GAPI's activities as an apex institution have so far been comparatively limited. At the end of 2001 the outstanding portfolio was USD 330,000. In view of the growing market for financial services for small (and micro) enterprises, however, this field should offer a large potential. The market leaders Nuevo Banco and SOCREMO do not have sufficient funds to satisfy the strong demand. GAPI holds contacts with the most important donors and government circles and enjoys an excellent reputation with regard to the reliable management of credit lines extended under international development cooperation. In the last few months GAPI has acquired good market knowledge on the micro finance sector. Thus, major basic requirements for an apex institution are fulfilled. Moreover, the banking supervisory authority is currently completely overburdened with the supervision of the large number of micro finance institutions and could be relieved to some extent by an efficient apex institution. In order to preclude the danger of a possible exertion of political influence it is important that clear rules be defined for the selection of the participating financial institutions (e.g. maintaining the equity capital in real terms) and that such rules be laid down by law. Here, GAPI will be able to continue its advisory services as a separate field of business. The business area of direct lending is to be abandoned in the medium term.

From our point of view option c) is the most useful. Given the large number of institutional deficits the establishment of a bank offering full banking services would require many years of personnel support as well as an appropriate ownership structure. It is doubtful whether in view of the prevailing market situation such an investment makes sense at all. The commercial banks and especially the micro finance banks have clear comparative advantages in the area of SME financing and will enter the market more and more.

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 sufficient degree of developmental effectiveness

Developmental failures: Ratings 4 to 6

Rating 4 Overall no longer sufficient 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.