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Evaluation of Bank Assistance to Small and Medium Enterprises (2006–2013)

Executive Summary



AFRICAN DEVELOPMENT BANK GROUP

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Executive Summary

Introduction

This evaluation reviews the assistance provided by the African Development Bank (the Bank) to small and medium enterprises (SMEs) from 2006 to 2013. The evaluation assessed the relevance, additionality, effectiveness, sustainability, and efficiency of SME assistance operations, as well as the Bank's approach to SME development. The exercise involved a combination of desk work, including review of all relevant documents from various sources, and field work, including missions to six countries (Ghana, Kenya, Morocco, Tanzania, Togo, and Zambia). The evaluation also benchmarked the Bank's operations, organizational setting, and procedures against two other multilateral development banks (MDBs), namely, the World Bank Group and the European Bank for Reconstruction and Development. Although the evaluation focused on SME assistance operations approved between 2006 and 2013, as only a small number of these operations were completed at the time of the study, the analysis was extended to operations approved from 2000 for which self-evaluation reports exist. Overall, the exercise covered 105 operations, of which 50 had been completed by the end of 2013, and 55 were at various stages of implementation, including some projects that had been approved but not yet signed.

Overview of Bank Small and Medium Enterprise Assistance

The Bank approved **70 operations** specifically supporting SME development (targeted SME assistance) between 2006 and 2013. These include (i) **46 investment operations** involving the provision of debt and/or equity financing through lines of credit, investments in equity funds, credit guarantees, etc.; (ii) **16 technical assistance grants**, mostly complementing lines of credit to

financial intermediaries; and (iii) **eight institutional support projects** providing capacity-building and policy reform assistance in areas relevant to SME development. The total value of approved targeted SME assistance is **approximately US\$1.9 billion**, i.e. about **3.7 percent of all Bank approvals**. Discounting cancellations and projects approved but not yet signed, the total committed value is just below **US\$1 billion**. Investment operations account for about 98 percent of total approvals, with the bulk of funding channeled via credit lines (80 percent) or invested in equity funds (12 percent). An additional contribution to SME development was provided by **15 policy-based operations**. Aimed at supporting governments' broad policy reform and economic restructuring efforts, these operations also covered some themes relevant to SME development, such as the improvement of the legal and regulatory framework and the strengthening of some support structures.

Key Findings

Relevance of Strategic Orientation: Overall, the relevance of the Bank's strategic orientation is rated as satisfactory.

The importance of SME development in Africa has long been recognized by the Bank, and SME development has been a recurrent theme in strategic and policy documents. However, no dedicated SME strategy exists and SME assistance lacks a unified conceptual framework. This is partly reflected by the absence of a harmonized definition of SME, often preventing proper identification of target groups. The themes addressed by the Bank are highly relevant for SME development. However, when compared with other MDBs, the Bank is more focused on improving conditions for SME finance, while less attention is paid to other areas

of interventions (investment climate reform, financial market infrastructure, market access, etc.). About 80 percent of SME assistance was provided through credit lines, including apex lending operations with regional development finance institutions (DFIs). However, this preference for traditional instruments coexists with a certain propensity to innovate, as witnessed by the significant involvement in equity funds (in relative terms, on a scale comparable to that of the International Finance Corporation and European Bank for Reconstruction and Development) and the pioneering role in credit guarantees (with the launch of the African Guarantee Fund).

One persistent gap in the Bank's product mix is the limited use of local currency lending, which limits its ability to effectively reach SME beneficiaries. About one-quarter of SME assistance during the period under review was allocated to regional or pan-African initiatives, but at the regional and country level, assistance was highly concentrated, with West Africa accounting for nearly two-thirds of the total and Nigeria about half. Such a high geographical concentration to the detriment of low-income countries is clearly at odds with the Bank's emphasis on reduction of regional disparities across the continent. In this respect, the emphasis placed by the recent Africa SME Program (ASMEP) on seeking a "wide continental coverage including in LICs [low-income countries] and fragile states" constitutes an important innovation.

Relevance of SME Assistance Operations:
Overall, the relevance of the SME assistance operations is rated as moderately satisfactory.

The relevance of SME assistance operations was often undermined by weaknesses in design. In some cases, there was a limited appreciation of client's financial needs, which resulted in project cancellations. Financing agreements often did not appropriately specify eligibility criteria for sub-loans. This provided ample room for the risk-averse banks, a substantial subset among the recipients of the Bank's SME assistance, to utilize loan proceeds for

safer corporate lending. As a result, a significant share of Bank assistance was nominally targeted at SMEs, but in practice can be better described as generic private-sector development assistance. However, since 2013 the SME focus has been considerably strengthened, and operations channeled through the ASMEP and the African Guarantee Fund are much more aligned with SMEs' financing needs. Another positive feature has been the frequent combination of investment and technical assistance operations, although the latter were not always squarely focused on SMEs.

Effectiveness of SME Assistance Operations:
Overall, the effectiveness of SME assistance operations is rated as moderately satisfactory.

Due to design weaknesses, the Bank's ability to reach SMEs was limited, with the majority of projects performing well below target. Out of the sample of 17 operations for which detailed data are available, 10 missed their targets by more than 25 percent, three performed on target, and four overperformed. These projects provided financing to 1,800 firms. While 90 percent of these beneficiaries can indeed be reasonably characterized as SMEs, they received less than 40 percent of the US\$622 million disbursed. The rest went to large enterprises, each receiving on average about US\$2 million, compared with an average of US\$150,000 for SMEs. Only a few financial intermediaries expanded their SME portfolio and even fewer introduced new financial products for SMEs. On the positive side, the majority of projects performed well in financial terms, experiencing little or no defaults. Somewhat predictably, the share of non-performing loans was higher in the case of operations more squarely targeting SMEs, a reminder of the difficulties of working with SMEs. The effects of the Bank's SME assistance are difficult to gauge, partly due to the lack of information. In the case of the 15 operations for which accurate data on employment were available, a crude before-and-after comparison suggested an increase in employment of some 25,000 people, of which about 15,000 were in SMEs and the remainder in large enterprises.

Additionality of the Bank's Intervention: Overall, the additionality of the Bank's intervention is rated as moderately satisfactory.

Provision of long-term resources enabled financial intermediaries to match the demand for term credit (medium- to long-term lending). The Bank was also an important investor in a dozen equity funds, contributing to their commercial viability. However, the Bank rarely played a catalytic role. Most intermediaries were recipients of or were concurrently receiving substantial support from other MDBs/DFIs. In the case of equity funds, the Bank was rarely a first-round investor, and again other MDBs/DFIs also provided substantial funding. Non-financial additionality is rather modest. The majority of banks receiving credit lines from the Bank were also supported with technical assistance, but these interventions do not seem to have appreciably influenced project results. Finally, an element of political risk mitigation is present in a limited number of operations undertaken in North Africa following the Arab Spring.

Sustainability of SME Assistance Operations: No rating is possible for sustainability.

Little can be said about sustainability due to the limited number of completed projects and the paucity of development results sustained. Most partner financial institutions (PFIs) receiving support have been performing well, but this is scarcely surprising given the selection criteria adopted. There are, however, a few cases in which the innovations introduced with Bank assistance have been pursued after project completion.

Efficiency of Organizational Set-up and Procedures: Overall, the efficiency of the organizational set-up and procedures are rated as moderately satisfactory.

The Private Sector and Microfinance Department of the Bank, responsible for investment operations and related technical assistance, handled the bulk of SME

assistance operations. The policy-based operations and institutional support projects, on the other hand, were implemented by the Bank's Governance, Finance and Economic Management Department. While this organizational setting is fairly compact (and certainly less dispersed than in other, larger MDBs, such as the International Finance Corporation), there is limited sharing of experience between the various units involved in SME-related work. Over the study period (2006–2013), the average time required to process an investment operation was about 10–12 months, i.e. about twice the average approval time at the International Finance Corporation and the European Bank for Reconstruction and Development. Similarly, the Bank had about twice as many approval gates, with a particularly laborious project clearance process. However, some improvements were recently introduced for operations undertaken in the framework of the ASMEP, which provides a streamlined approval procedure. No particular issues emerged regarding disbursements of investment operations, whereas problems were found with technical assistance operations, with the complexity of procurement procedures being the subject of criticism from clients.

Monitoring and Evaluation: In summary, the appropriateness of monitoring and evaluation arrangements are rated as moderately unsatisfactory.

The monitoring and evaluation of SME assistance operations is challenging, requiring design of appropriate measuring tools and the collection of a significant mass of data. The matter is further complicated by the two-tiered structure of most SME operations, which in principle requires information from both immediate beneficiaries (banks, equity funds, etc.) and ultimate beneficiaries (the SMEs). Tools for measuring the performance of SME assistance operations were developed in the framework of the ASMEP. However, serious problems persist in data collection, with client financial institutions showing little inclination to provide data in a timely manner and Bank staff sometimes hesitating to put pressure on clients.

Recommendations

Strategic Approach. In the Bank's Ten-Year Strategy, SME assistance is expected to play a growing role. The Bank's strategic approach to SME development would benefit from a more comprehensive framework for SME assistance operations, as well as from improvements in the range of instruments employed. To this effect, the Bank should consider the following recommendations:

Recommendation 1 – Develop a comprehensive conceptual framework for SME assistance.

The Bank should consider the establishment of a comprehensive framework for SME assistance. Ideally, this could take the form of a dedicated strategy, covering all forms of SME assistance, as done by the European Bank for Reconstruction and Development. The development of such a framework should be accompanied by a revamping of analytical work, which could provide useful inputs both for policy formulation and for the design of specific operations.

Recommendation 2 – Adopt a definition of SME.

An official definition of SME should be adopted by the Bank so that the target groups are clearly defined. The definition of SME put forward by the ASMEP, based on size, is a good starting point, as it differentiates between small and medium firms and countries at different levels of development. In the case of operations with financial intermediaries, the Bank may consider complementing the size-based definition with one based on loan size, which is likely to be more easily handled by PFIs.

Recommendation 3 – Expand the utilization of local currency financing.

The prevalent use of foreign-exchange funding negatively affects the reach of Bank operations, as SMEs' financing needs are usually in local currency and PFIs are hesitant in bearing foreign-exchange risks. An expansion of local-currency operations is

already envisaged under the ASMEP, and the Bank should definitely make efforts to translate this into concrete action.

Relevance and Effectiveness of Operations.

The findings of this evaluation show that there is ample margin for improving the relevance and effectiveness of Bank SME assistance operations. To this effect, the Bank should consider the following recommendations:

Recommendation 4 – Improve the design of investment operations.

The design of future operations should involve a more accurate assessment of PFIs' financial needs, with the primary objective of drastically reducing cancellations. This should be accompanied by a more realistic assessment of PFIs' propensities and abilities to effectively serve SME clients, with the setting of more realistic targets. Accordingly, project preparation work should include (i) a detailed review of the pipelines developed by PFIs to ascertain the nature of prospective sub-borrowers (are they really SMEs?); (ii) an assessment of market conditions, leading to a clear appreciation of the nature and magnitude of the financing gap(s) to be filled (which market segments are underserved? how many SMEs are likely to fall into these market segments?); (iii) a thorough assessment of PFIs' experiences in working with SMEs (entailing a review of the portfolio composition and its evolution); (iv) the identification of the changes (in organization, procedures, product mix, etc.) possibly required to effectively enter or scale-up SME financing operations; and (v) a review of other donor/MDB SME support programs to avoid possible crowding out effects.

Recommendation 5 – Diversify the range of client PFIs and countries of operations.

The Bank should actively seek to work with a broader range of PFIs across Africa. Diversifying the portfolio is already envisaged by the ASMEP, and the Bank should definitely deploy efforts to translate this into concrete action.

Recommendation 6 – Strengthen eligibility conditions to ensure that SMEs are effectively reached.

In the case of PFIs, eligibility conditions must be clearly specified so that on-lending (a financial intermediary lending money borrowed from another organization) is aligned with the intended objectives. Loan agreements with PFIs should make explicit reference to the official SME criteria retained by the Bank based on loan size. Sub-loans exceeding a certain size and/or extended to firms not qualifying as SMEs should be subject to explicit Bank approval.

Recommendation 7 – Improve the relevance of technical assistance and facilitate its implementation.

While the problems afflicting financial intermediaries have common roots, the deployment of standardized technical assistance packages is of limited benefit. Accordingly, technical assistance initiatives should be tailored to the specific needs of each intermediary and be more consistently aligned with the objectives of the associated lending or investment operations. In addition, to avoid delays in the deployment of technical assistance, the Bank should consider a simplification of procurement procedures to better match the capabilities of beneficiaries. For the former, the recent finalization by the Bank's Financial Sector Development Department of a framework contract for the provision of needs-assessment services for technical assistance for ASMEP-funded operations is a step in the right direction.

Organization of Operations. Improvements in the strategic approach and in the design and implementation of operations need to be supported by appropriate changes in the organizational setting and in relevant procedures. To this effect, the Bank may wish to consider the following recommendations:

Recommendation 8 – Improve coordination among services involved in SME assistance.

The coherence of SME assistance would benefit from mechanisms being put in place to achieve a

greater integration among the various Bank services concerned. This could be done through the creation of a community of practice, linking all the staff involved in SME-related operations and facilitating the sharing of experiences and best practices. Ideally, this community of practice should be coordinated by a small SME cell modeled after the Small Business Initiative Unit recently established at the European Bank for Reconstruction and Development (but on a smaller scale given the vastly different scale of SME operations).

Recommendation 9 – Simplify project approval procedures.

Building upon the experience gained through the simpler procedures exhibited in the ASMEP, the Bank should consider simplifying internal procedures for SME assistance projects, including (i) reducing the number of gates through which project proposals have to pass; and (ii) introducing streamlined approval procedures based on no-objection mechanisms or on the delegation of powers to senior management. The specific parameters for this reform could benefit from the experience of other MDBs, in particular the European Bank for Reconstruction and Development and the International Finance Corporation.

Monitoring and Evaluation Arrangements.

The monitoring and evaluation of the Bank's SME assistance would benefit from the availability of more detailed information on the results achieved by individual operations. To this effect, the Bank may wish to consider the following recommendations:

Recommendation 10 – Improve the collection of information on project achievements.

In order to accurately assess the performance of Bank assistance operations, the Bank needs to collect credible information on both financial intermediaries and ultimate beneficiaries. Loan agreements should require PFIs to provide information on their lending or investment activities. At a minimum, PFIs should have to provide: (i) the number and basic features of the sub-loans; (ii) detailed data on the composition

of their portfolio, with a separate indication of the number and value of operations with SMEs (based on a uniform definition of SMEs); and (iii) data on non-performing operations, again with a separate indication of the relevant parameters for SMEs. Whenever feasible, PFIs should also be required to collect information on client SMEs for at least some basic variables (turnover, employment, exports). Although not exhaustive, this information would be useful to establish a baseline for future impact assessment exercises.

Recommendation 11 – Establish a Results Tracking and Reporting System.

In order to improve results reporting, the Bank should establish a results reporting system for tracking, monitoring and reporting development results. Such systems are currently standard in most MDBs (e.g. the Development Outcome Tracking System in the International Finance Corporation, and the Transition Impact Monitoring System in the European Bank for Reconstruction and Development).



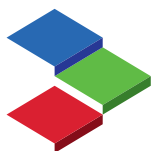
About this Publication

This evaluation report reviews the African Development Bank's assistance to Small and Medium Enterprises (SMEs) over the 2006-2013 period. It draws on a combination of desk work, including review of all relevant documents from various sources, and field work, including missions to six countries (Ghana, Kenya, Morocco, Tanzania, Togo, and Zambia). The evaluation focuses on SME financing through financial intermediaries as well as on the non-financial assistance the AfDB provides to SMEs. Moreover, it benchmarks the Bank's operations against other multilateral development banks.

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