European Development
Finance Institutions - EDFI ASBL
Rue de la Loi 81A 3
B-1040 Brussels
Belgium

Tel. : + 32 (0)2 230 23 69
Fax : +32 (0)2 230 04 05
edfi@edfi.be
www.edfi.be

Brussels, 2 June 2014

Evaluation of the Effectiveness of EDFI Support for SME Development in Africa;

EDFI Board of Directors' comments to the Report by Horus Development Finance

The members of the association of European Development Finance Institutions, EDFI, have jointly commissioned an evaluation of the effectiveness of EDFI members' support for SME development through financial institutions in Africa. In the course of 2013, this evaluation has been carried out by Horus Development Finance (Horus). The consultants have recently submitted their final report.

The Horus researchers have explored the effects of financing and technical assistance provided by EDFIs to six financial institutions in Africa, on their provision of credit and other financial services to SMEs, and, ultimately, on the SME clients of these financial intermediaries.

The researchers' assignment turned out to be more challenging than expected, as there were not only gaps in data availability from the studied banks, but data obtained from the different banks was also hard to compare, among others because of different SME definitions and client segmentations employed by the different banks. It should be kept in mind that not all EDFI support to these banks had SME financing objectives. Effectively, the researchers ended up with six case studies, built on mixed data collection methods that yielded largely qualitative information. Clearly, this places limitations on the firmness of the findings that can be brought out by the study, and the small number of banks studied also limits the extent to which findings may be generalized beyond the studied banks and the EDFI support they received.

Despite these challenges, the researchers have been able to analyse their findings, and to bring out a number of interesting conclusions regarding the effects of EDFI financing on their African bank clients, on their lending to SMEs and, ultimately, on the SMEs aimed to be reached. They have also been able to show how the effectiveness of EDFI funding for SME financing is influenced by the type of financial intermediary selected, by the types of financing and technical assistance inputs provided to these intermediaries by EDFIs, and by the conduciveness of the sector- and macro-economic environment in which financial intermediaries operate.

The EDFI Board was pleased to learn from the report that the financing and support that the EDFIs have provided to the studied financial institutions were found to have been highly relevant to these institutions' needs. The report finds that EDFI support has helped these banks' financial strength and sustainability, and their ability to serve their clients, including SMEs.

On the other hand, the report notes that, if and when the EDFIs specifically seek to address the SME finance gap (the 'missing middle'), there is still considerable scope for further improving the effectiveness of their financing. Financial intermediaries may be more critically selected on (and helped with developing) their willingness and capacity to serve SMEs. The funding and assistance provided by EDFIs may be better geared to addressing banks' constraints with respect to SME banking specifically. And assistance may be better structured, so as to incentivize banks to further develop and expand their SME lending. The study also highlights the need for better data to be collected by and from our financial intermediary clients, and for improvements in their Management Information Systems (MIS), so that our clients and the EDFIs themselves can better demonstrate and manage for results in SME

European Development
Finance Institutions - EDFI ASBL
Rue de la Loi 81A 3
B-1040 Brussels
Belgium

Tel. : + 32 (0)2 230 23 69
Fax : +32 (0)2 230 04 05
edfi@edfi.be
www.edfi.be

outreach. Such MIS improvements may also help clients to better appreciate the value that SMEs bring to their business.

The EDFI Board of Directors wants to bring this report's findings and its recommendations for improved effectiveness to the attention of all EDFI members' staff that works on financial institutions and SMEs and therefore welcome the plan to organize an EDFI practitioners' workshop on support for SME development through FIs, to discuss this study and its recommendations as well as other recent research by EDFIs on the subject.

For inquiries and comments, please address following staff of the EDFI members:

DEG: Julian Frede, Julian.Frede@deginvest.de
FMO: Stan Stavenuiter, S.Stavenuiter@fmo.nl
Norfund: Sarita Bartlett, Sarita.Bartlett@norfund.no
Proparco: Jeanne Henin, Heninj@proparco.fr

On behalf of the Board of Directors,

Jaakko Kangasniemi
Chairman

A report prepared for the association of bilateral European Development Finance Institutions, EDFI

Evaluation of the Effectiveness of EDFI Support to SME Development through Financial Institutions in Africa

Final Report

May 2014

TABLE OF CONTENTS

Summary 4
Background 4
Study's objectives and methods 4
Findings 5
Conclusions and recommendations 7
1. Introduction 9
2. Promoting SME finance via supply-side approaches – a review of the literature 11
3. Research design and methodology 17
3.1 General approach 17
3.2 Key questions and contribution chain 18
3.3 Research questions and methodology 21
3.3.1 Research questions 21
3.3.2 Methodology 21
3.4 Sample 25
3.5 Data collection 28
4. Project assessments 29
4.1 Overview 29
4.2 Bank of Africa in Uganda 33
4.3 DFCU in Uganda 38
4.4 Exim Bank Tanzania 43
4.5 I&M Bank in Kenya 48
4.6 Zanaco in Zambia 53
4.7 CAL Bank in Ghana 57
5. Findings 61
5.1 Preliminary remarks 61
5.2 Summary of evaluations of elements in the contribution chain 62
5.3 Evaluation of determinant factors 63
5.3.1 Were the inputs relevant? 63
5.3.2 What were the types of financial institutions? 64
5.3.3 Were the environments favorable? 65
5.4 Evaluation of outputs, outcomes and impacts 66

5.4.1 Have the FIs increased capacity to provide financial services and specifically credit in forms accessible and attractive to SMEs? ... 66

5.4.2 Have the FIs increased the number and/or volume of their transactions with SMEs? ... 67

5.4.3 Is access to finance for SMEs sustainable? ... 68

5.4.4 What was the impact on SME customers? ... 69

5.5. Identification and analysis of determinant factors ... 69

5.5.1. How did the types of inputs influence projects' outcomes? ... 69

5.5.2. How did the type of financial institution influence projects' outcomes? ... 72

5.5.3. How did the environment influence projects' outcomes? ... 73

5.6. Conclusions ... 75

6. Recommendations ... 77

6.1 Recommendations for the design of projects ... 77

6.2 Recommendations for cooperation and further research ... 79

Appendices in separate documents

LIST OF MAIN ACRONYMS USED

AfDB	African Development Bank
ATM	Automatic Teller Machine
BOA	Bank of Africa
BOA - U	Bank of Africa - Uganda
BoG	Bank of Ghana (BoG)
CB	Consumer Banking (CB),
CDC	Commonwealth Development Corporation (CDC)
CEO	Chief Executive Officer
CIS	Commonwealth of Independent States
DEG	Deutsche Investitions- und Entwicklungsgesellschaft
DFCU	Development Finance Company of Uganda Bank Limited
DIB	Development and Institutions Business
EDFI	European Development Finance Institutions
EIB	European Development Bank
ESM	Environmental and Social Management
FCY	Foreign Currency
FI	Financial Institution
FMO	Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V
GDP	Gross Domestic Product
HR	Human Resources
IFC	International Finance Corporation
IPO	Initial Public Offering
IT	Information technologies
LCY	Local Currency
LT	Long Term
MIS	Management Information System
MLT	Medium and Long Term
MSME	Micro, Small and Medium sized Enterprises
MT	Medium Term
NBFI	Non Bank Financial Institution
NORFUND	Statens Investeringsfond for Næringsvirksomhet i Utviklingsland (the Norwegian
NPL	Non Performing Loans
PF	Portfolio
PROPARCO	Société de Promotion et de Participation pour la Coopération Economique
ROA	Return on average Assets
ROE	Return on average Equity
SL	Large Sized
SM	Medium Sized
SME	Small and Medium sized Enterprises
SS	Small Sized
TA	Technical Assistance
UDC	Uganda Development Corporation
Zanaco	Zambia National Commercial Bank

Summary

Background

Providing support to the SME sector is viewed by development finance institutions as a powerful means for achieving economic and social development objectives. As direct forms of SME support have been found relatively costly and prone to failure, indirect approaches have been preferred. One of them consists of augmenting the provision of financial services accessible to SME, including credit, by strengthening local financial intermediaries ("supply-side approach"). Using this approach, European Development Finance Institutions (EDFIs) are important financiers of local SME lenders, acting in individual, joint or parallel transactions. To date, however, little evaluative evidence is available on whether and how such projects contribute to increased supply of credit to SMEs.

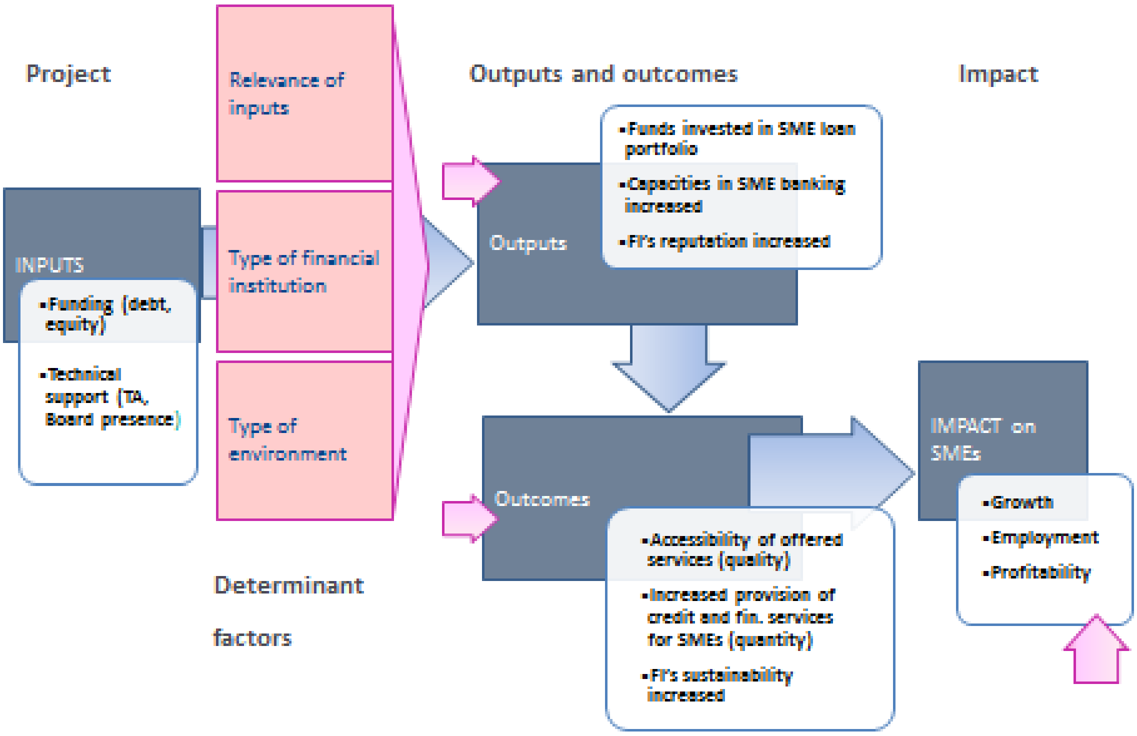
Study's objectives and methods

This present study, carried out on behalf of EDFI, explores three key questions:

- Is EDFI support effective in terms of increased access for SMEs to financial services?
- Which factors are determinant with regard to the effectiveness of EDFI support?
- What impact has EDFI support had on supported FIs' SME clients?

This study looked at projects in sub-Saharan Africa, where much of the SME sector-oriented support granted by development finance institutions is directed, and where capital and debt markets are less advanced than elsewhere, making access to credit in these countries particularly difficult for SMEs. The study sample included four medium-sized and two large commercial banks, operating in West Africa (Ghana), East Africa (Kenya, Uganda, Tanzania), and Southern Africa (Zambia). They had received funding from more than one EDFI (DEG, FMO, NORFUND and PROPARCO) in various forms (equity, senior or subordinated loans or a combination of these) and in five cases also benefited from EDFI-sponsored technical assistance. Not all EDFI assistance was implicitly or explicitly aimed at improved SME access to financial services, but, for each bank, at least one EDFI had provided at least one facility with this objective.

The research design is building on a contribution chain in which three factors are assumed to strongly influence whether support provided to the financial intermediaries leads to the results that are aimed for, i.e., (i) the relevance of the inputs provided, (ii) the type of local financial institution worked with, and (iii) the conduciveness of the environment in which the projects take place:



Based on a set of indicators or sub-questions, the three determinant factors and the expected results (outputs, outcomes and impacts) were assessed, independently from each other. Then, looking at all cases studied, relationships between factors and results were explored.

Because the sample of cases studied is small and the data obtained from the different banks is not entirely comparable, these relationships were analyzed using qualitative methods: when the data collected from the sample suggested that a relationship between explaining factors and results existed, this was subjected to a reasoned plausibility check, based on economic reasoning.

The present work thus explores the research questions, employing methods that are highly valid within the sample but may have limited external validity; it cannot provide definitive answers to the research questions, backed by strong evidence.

Findings

Has EDFI support effectively led to increased access to financial services for SMEs?

- During the period under consideration, the banks under review that benefited from EDFI support all improved their financial strength. They reduced their maturity and currency mismatches, improved their capital adequacy and were successful in domestic deposit mobilization. Therefore, due to EDFI funding, these banks were placed in a better position to sustainably offer financial services to their clients, including their SME clients.

- At the same time, though, it is hard to establish the contribution the banks' SME business lines made to their profitability, as, with one exception, none of them have been able to measure this.
- Most of the supported banks did not have a dedicated strategy for the SME market, and most did not set up or strengthen dedicated structures (distribution channels, business units or staff). Specific SME banking capacity was not strengthened significantly in response to EDFI support.
- While banks do offer products (including medium to long-term loans) that respond to SME needs and have built up their branch networks, they typically offer their credit in a rather conservative manner, relying on relationship banking approaches and assets pledged as guarantees. The banks that were studied typically chose to keep serving a relatively small number of select SME clients, and not to develop methods aimed at expanding credit provision to large numbers of SME customers.

What determines the effectiveness of EDFI support through financial intermediaries?

The study sought to analyze how the effectiveness of EDFIs' projects - in terms of reaching out to SMEs - was determined by (i) different types of input provided, (ii) the type of financial intermediary selected, and (iii) the conduciveness of the business environment. It was found that:

- Inputs provided by the EDFIs addressed client banks' needs and weaknesses overall. The equity, loans and technical assistance provided thus significantly strengthened the banks' financial sustainability.
- The long-term funding provided by EDFIs did lead directly to banks expanding their medium to long-term lending. However, the EDFI inputs typically were not specifically geared to addressing constraints with respect to SME banking, or to incentivizing banks to further develop their SME lending. As a result, a link between the type of inputs provided and outcomes in terms of SME banking capacity created and SME portfolio growth could not be confirmed.
- What financial intermediaries the EDFI members choose to work with is an important determining factor of effectiveness. The financial intermediaries that had already invested in their SME business line and had built specific SME capacity have been more successful in further expanding their SME banking capacity and financing when they receive funding. Working with small banks, which tend to have a higher strategic interest in serving SMEs, may also be relatively more effective for improving SME access to finance.
- Our findings suggest that EDFI client FIs are more inclined to develop SME banking capacity if the business environment develops positively, and that they tend to expand SME loan portfolios in times of favorable financial sector development. We have also seen that, under worsening economic conditions, banks have tended to shift their attention away from small enterprises and towards the relatively larger medium-sized enterprises that have a stronger asset base and are seen to be more solid.

What impact has EDFI support had on the financial intermediaries' SME clients?

Given the scope of the study, it was clear from the outset that no impact evaluation work could be undertaken at the level of the ultimate beneficiaries of the EDFI support, namely the SMEs indirectly financed. However, some inferences could be made on the basis of the study's findings:

- The EDFI client banks under review have increased their provision of medium to long-term loans. The availability of longer tenors positively affects SMEs' balance sheets and growth potential.
- Information obtained on the composition of the banks' business loan portfolios, including loans to SMEs, showed that growth in lending often occurred in the relatively more labor-intensive sectors, which is likely to have had positive effects on job creation.

Conclusions and recommendations

EDFIs may work with and through local financial institutions for a variety of reasons and developmental objectives. These may range from financial sector development, financial inclusion and providing trade finance to supporting SME development. Most, but not all, EDFI funding that was provided to the banks studied here was aimed at SME development, and at each of the banks, at least one of the EDFIs involved provided a facility aimed to enhancing access to finance for local SMEs.

The reviewed literature confirmed that increased provision of credit and other financial services to SMEs can make a significant contribution to development: SMEs have strong employment and income generation potential, and their growth and development – especially in Africa - is constrained by limited access to appropriate financial services.

EDFIs have been funding and supporting African financial intermediaries that serve a variety of customers, including SMEs. This funding has strengthened these financial institutions, thus enabling them to better serve their clients. Hence, even funding and support that is not specifically aimed at increasing access to finance to SMEs can help this segment. But when EDFIs specifically want to aim for improved access to finance for SMEs, there are ways in which they can increase the effectiveness of their work with local financial intermediaries. To this end:

- EDFIs should seek to choose, and work more with, financial intermediaries - preferably small or medium-sized banks - that have already developed a strategy for their SME business and have committed dedicated investments to this business line. Such institutions are more likely to be successful in further developing this business avenue. Nonetheless, working with large banks should not be ruled out as they may be able to develop innovative products and approaches for reaching large numbers of SMEs when the environment allows.
- Having found SME-oriented institutions that can and want to make use of their support, EDFIs should assess their business plans and strategies against the potential of, and the limitations and risks in, the SME environment. Client financial institutions that have not yet invested significantly in development of their SME business should be offered support to do so, specifically in the areas of strategy, marketing, cost and risk management, and in managing MIS development projects.
- While EDFI funding can be granted primarily with the objective of contributing to local financial intermediaries' overall strategy and needs, financial intermediaries supported for the purpose of SME development should demonstrate that, in return for the funding they receive, they are

increasing access for SMEs to their credit and financial services, using either the resources provided by EDFI members, or other resources. This would help the EDFIs to better know, and report on, the results achievement of projects that are specifically aimed at increasing access to credit and financial services for SMEs.

- To this end, EDFIs would have to request baseline data and then to monitor progress on client financial institutions' SME financing, both in qualitative (e.g. innovations in products and service delivery relevant for SME clients) and quantitative terms (e.g. number of SME clients/loans).
- Baseline and monitoring will then also allow EDFIs to more actively manage their investments with respect to results in terms of improved SME finance. Loans to local financial intermediaries may, for example, be disbursed in tranches, with disbursements of later tranches made conditional on specific SME financing or banking milestones being achieved. Local financial institutions may be particularly motivated when such funding is provided by way of framework agreements in which a relatively large maximum loan amount is earmarked to be disbursed in the event of good achievements.
- The fact that most of the banks under review were unable to adequately identify their SME clients in their IMS and to determine the contribution their SME business lines made to their profitability further underlines the desirability of focused support for MIS development projects.
- To the extent that the above provides EDFIs with better data and information on the effectiveness of their support, they should seek to share such information. Harmonization – along the lines of the IFI harmonization initiative – will help the development of shared methods (e.g. baseline studies) and the communication of results achieved.

The present exploration of questions related to the effectiveness of support for SME development through financial intermediaries should ideally be followed up by further research, covering various types of financial intermediaries and using a larger sample. This would allow for more in-depth investigation of some of the hypotheses that could not be sufficiently tested within this study, notably the type and size of the financial institution and of the environment as factors influencing project achievement.

1. Introduction

Throughout the world, small and medium-sized enterprises (SMEs) represent a significant part of the private sector; they play a key role in the economic growth process and are prime creators of salaried and non-salaried employment. Moreover, SMEs are very adaptable to change occurring on markets, and the role they play in the economic fabric by building links with larger enterprises is crucial.

While SMEs, taken as a whole, are a very adaptable, and therefore resilient, form of economic entity, their small size and the fact that they are often new enterprises make them more fragile than larger firms when taken individually. The smaller scale and relatively higher failure risk are also the main reasons for more difficult access to external funding. This is true for equity, where fixed compliance and transaction costs are high compared to financial needs, and in the case of debt, due to the risk perceived by lenders. This situation is worse in developing countries, where a number of factors in the legal, regulatory and economic framework and the scarcity of institutions fostering financial intermediation make the access-to-funding issue a major obstacle in the development of SMEs, and frequently the major obstacle.

Providing support to the SME sector is viewed by development agencies as a powerful means for achieving economic and social development objectives and, ultimately, reducing poverty. As direct forms of SME support have been found relatively costly and prone to failure, indirect approaches that consists of favoring the emergence of markets for services useful for SMEs have been preferred. One of these approaches consists of augmenting the provision of financial services accessible to SMEs, including credit, by strengthening financial intermediaries. This approach, usually referred to as the "supply-side approach" to SME finance, uses banks and other credit-granting institutions first and foremost, because these financial intermediaries are the prime providers of SME finance, in developing countries and in developed countries alike.

Members of the association of European Development Finance Institutions (EDFI), established to promote private-sector development, have to varying degrees sought to further their development objectives by supporting local financial institutions (FIs). By doing so, not only have they supported the development of healthy and responsible local financial sectors, but, by working with and through financial institutions, they have also sought to increase SMEs' access to finance and financial services.

To date, not enough evaluative evidence is available on the impact of working with financial intermediaries on the increased supply of credit to SMEs. A recent study by Dalberg[1] recommends that additional research is done on the effectiveness of interventions by international financial institutions (IFIs) and on the optimal structure of interventions.

[1] Dalberg, Report on Support to SME in Developing Countries Through Financial Intermediaries, November 2011, Geneva

This present study, carried out on behalf of EDFI, explores three key questions:

- Has EDFI support effectively led to increased access to financial services for SMEs?
- What determines the effectiveness of EDFI support through financial intermediaries?
- What impact has EDFI support had on the financial intermediaries' SME clients?

This study only looks at projects in African countries south of the Sahara. This geographical focus is justified by the fact that these countries receive most of the support from development agencies with respect to endorsement of the SME sector, and that capital and debt markets in Africa are considered to be less advanced in SME lending than is the case elsewhere[2], making access to credit in these countries particularly difficult for SMEs. In its latest report on access to finance[3], IFC estimates that the potential for increasing credit provision to the formal SME sector in Africa amounts to 270% to 320% of the existing outstanding credit to this sector, which is thus the largest potential after the Middle East and North Africa.

In the next section of this report, we present a review of selected literature from which insights into the researched subject have been gained and used to orient the research design. Section 3 presents the research design and the methodology used to collect and process data and to obtain the research results. The results for each financial institution included in the sample are summarized in section 4 and the consolidated results are presented in section 5. Section 6 contains a set of recommendations.

We thank the management and the key staff of the visited financial institutions for the time spent with us discussing the EDFIs' contributions to their respective institutions and ensuring that the requested data was provided to us. We also thank the staff of DEG, FMO, NORFUND and PROPARCO for their support, introductions and insights on the projects carried out with these financial intermediaries.

We are also grateful for the helpful comments and reviews provided by the members of the EDFI Steering Committee. We would like to specially thank Stan Stavenuiter (FMO) who had the challenging task of synthetizing the reviewers' comments, and who tirelessly challenged us to improve on the report's clarity.

2 Idem

3 IFC: Closing the Credit Gap for Formal and Informal Micro, Small, and Medium Enterprises, Washington, D.C., 2013

2. Promoting SME finance via supply-side approaches – a review of the literature

(1) Whilst access to finance remains a key constraint on SME development in emerging economies, accessing long-term external finance is an even greater challenge. The provision of long-term financial resources to the right financial intermediaries can help remove this constraint.

Various data sources and studies analyzed by the IFC indicate that the likelihood of a small firm having access to a bank loan in low-income countries is about one-third that for a medium-sized firm, and less than half that for a larger firm[4]. The smaller size of loans requested and the risk perceived by financial institutions are factors that work against smaller firms with regard to easy access to credit. In developing countries, this situation is worsened by a number of factors such as unfavorable legal and regulatory frameworks, unstable business and economic environments, and the absence of institutions fostering financial intermediation, such as credit bureaus and registers for land and assets pledged against loans. Microfinance loans, on the other hand, may be too small to meet SMEs' financial needs. For example, if a restaurant needs a USD 25,000 loan to renovate its dining room, this request may be too large for the local microfinance institutions and too small for commercial banks. This financing gap is referred to as the "missing middle".

Thanks to market forces, this gap is continuously diminishing, as microfinance institutions venture up market, and commercial banks move down. But access to long-term funding remains difficult, especially for SMEs operating in developing countries: a study carried out in 2007 on a sample of 91 large banks in developed and developing countries found that the share of SME lending devoted to investments (i.e., longer-run lending) was significantly lower (28 percentage points) in developing countries[5]. Debt financing is provided mainly by the banking sector, while banks find it difficult to build up long-term domestic deposits at reasonable cost due to high opportunity costs. When households are not convinced about the stability of the political, legal and economic environment, they tend to invest their - meager on average in developing countries - savings in property or in high yield yet near-liquid investments such as cattle or informal loans to business owners belonging to their community. Yields in the debt market thus increase strongly with maturity. Leasing is in most cases not very developed, if at all, due to unfavorable legislation and the lack of secondary markets. Access to externally funded equity capital is very rare, due to underdeveloped capital markets (and primarily the absence of well-managed and large-scale pension funds and a large insurance sector)[6]. Separate trading platforms for the SME sector have rarely been established in the developing world, with the exception of some Asian countries.

4 IFC: Scaling-Up SME Access to Financial Services in the Developing World, October 2010

5 T. Beck, A. Demirgüç-Kunt, M.S. Martínez- Pería: Bank Financing for SMEs: Evidence Across Countries and Bank-Ownership Types, 2008

6 Access to the capital market is limited for SME across the world, as SME find the all-in cost of using this market prohibitive. In developing countries, an additional challenge to equity finance with SME may come from the reluctance of many owners to engage in a process that might result in equity providers or associates interfering with the day-to-day running of their business

Hence, the provision of long-term funds to financial intermediaries targeting the SME market can be a promising approach to increasing access to credit for SMEs.

(2) There are no definitive answers in the literature to the question of the "right" financial intermediaries to reach out to SMEs. Whilst all types of financial institutions may have good reasons to target the SME market, there is some evidence that smaller banks are prone to be more open to small enterprises than large banks.

There are two contradicting theoretical models regarding the size of the "ideal" partner financial institution for SME finance, one arguing that small and domestic banks are more prone to finance SME because they are better suited to engaging in "relationship lending"[7] and the other, more recent, proposing a new paradigm for bank SME finance, arguing that large foreign banks, relative to other institutions, may have a comparative advantage in financing SMEs through "arms-length" lending methods instead of expensive relationship lending.

A study carried out in 2007 on a sample of 11 large banks in developed countries and 80 large banks in developing countries found that foreign banks were more likely to use hard information compared to private-sector domestic banks and that the proportion of secured SME loans was higher at foreign banks compared to domestic ones, and higher in developing than in developed countries[8]. Given that banks overcome the lack of valuable assets that can be pledged against loans by investing in knowledge about their clients, these findings indicate a predominance of relationship banking approaches at domestic banks, which may thus be more open to enterprises unable to pledge valuable assets as loan collaterals.

Another 2007 study on a sample of 63 banks in Eastern European and former CIS countries found that foreign banks were relatively heavily involved in mortgage finance and providing credit to subsidiaries of foreign firms, while lending relatively less to large domestic firms, and that the size of the bank mattered for customer focus, notably, small banks lent relatively more to SMEs than large banks did[9].

These empirical findings give some credence to the theoretically-derived expectation that small, domestic banks will be more open to most SMEs than larger and foreign banks will. But the empirical evidence is still too scarce.

7 "Relationship banking" can be described as an approach in which a financial institution will rely more on soft information on SME clients, gathered over time by its own staff, as opposed to "arm's length" approaches which rely on more systematic methods, involving credit scoring, asset-based lending, factoring, leasing, fixed-asset lending, etc.) or other methods that do not require collecting and processing detailed data on the customer

8 T. Beck, A. Demirgüç-Kunt, M.S. Martínez-Pería, Bank Financing for SMEs: Evidence Across Countries and Bank-Ownership Types, 2008

9 R. De Haas, D. Ferreira, A. Taci: What determines banks' customer choice? Evidence from transition countries, EBRD Working Paper No. 104, November 2007

Although no predictions can be made as to which type of financial institution should be considered best suited to reach out to SMEs, the type of institution appears to be a factor worth taking into account in the present study.

(3) The strategies developed by financial institutions for the SME market will depend on the type of environment in which they operate.

The legal and regulatory framework is viewed as having a critical role to play in improving the SME finance landscape[10]. For example, banking regulations that allow the entry of sound and efficient banks and promote market competition are expected to reduce margins in traditional business lines and induce banks to develop SME banking. This effect of increased competition is confirmed by empirical research from Chile and Argentina showing that bank interest in SMEs was triggered first and foremost by opportunities that arose given the fact that other market segments (corporate finance and retail) became more competitive[11]. Hence, competition in the financial market can be seen as an important condition for the implementation of projects with local banks, which can then use project inputs to play a significant role in the development of SME finance and develop methods and products that are going to be imitated by others.

In addition, the quality of financial infrastructure[12] is considered as having a significant impact on access to finance for SMEs. By way of example, IFC reports the result of a study according to which, in countries where credit bureaus operate, small firms have a 40% probability of obtaining a bank loan compared to 28% in countries with no credit bureaus[13]. Another study on determinants for banks' SME finance performances found that, in countries with a higher cost of registering collateral, banks grant a smaller share of loans to SMEs, devote a smaller share of those loans to investment purposes, and charge higher fees[14].

The same study found no significant differences across bank types in terms of using scoring as a lending technology and the authors of this study suspect that the environment plays a predominant role in the banks' choice of approach to SME lending. There are theoretical arguments in favor of this hypothesis: the lower the quality of the contractual and informational environment, the more difficult it will be for creditors to mitigate information asymmetry and contract enforcement problems in "arms-length" credit transactions[15] and, hence, the more they will resort to non-price screening and monitoring mechanisms, such as highly personalized (and expensive) "relationship lending" and/or heavy reliance on fixed (mainly real estate) collateral from debtors. In the case of SME borrowers,

---

[10] Idem

[11] A. de la Torre, M.S. Martinez Peria, S. L. Schmukler: *Drivers and Obstacles to Banking SME: The Role of Competition and the Institutional Framework*. In: CESIFO Working Paper No. 2651, May 2009

[12] e.g. the presence of institutions in charge of setting accounting and auditing standards, running credit reporting systems (credit registries and bureaus), the existence of collateral and insolvency regimes, of payments and settlement system, etc.

[13] IFC, Financial Inclusion Expert Group, SME Finance Sub-Group: *Scaling-Up SME Access to Financial Services in the Developing World*, October 2010

[14] T. Beck, A. Demirgüç-Kunt, M.S. Martínez Pería, *Bank Financing for SME: Evidence Across Countries and Bank-Ownership Types*, 2008

[15] See note 7

which have limited access to bankable collaterals and are enticed to conceal their true financial situation due to risk of information misuse and high cost of disclosure, this situation results in credit rationing. Moreover, high risk premiums exacerbate agency problems[16], further enlarging the set of debtors that is rationed out of the loan market[17].

Finally, there are a number of factors in the environment that are seen as highly detrimental to the development of the private sector and therefore to SME finance. High levels of crime and a highly unstable political framework are considered such factors, as they have a direct association with the growth rate of firms[18]. Also, financial institutions will not find much incentive to target SMEs in countries where the government borrows locally at high rates, a phenomenon known as "crowding out" the private sector.

The environment in which financial institutions operate is not only *likely* to set boundaries for their efforts to develop SME finance but may also be determinant in their choice of strategies. Environmental factors are therefore interesting to investigate in the framework of this study.

(4) Regardless of questions about the type of financial institution and type of environment, practitioners consider that SMEs form a specific market segment for which financial institutions should develop and implement specific strategies, if they want to be successful in it.

One such seasoned practitioner, the former CEO of the Bank of Africa group, believes that, *"in most cases, banks continue to suffer from a lack of departments specialized in SMEs, a lack of procedures adapted to the limited available financial information and supervision indicators, limited innovation capacities in terms of acceptable guarantees, and a total absence of specific training in SME financing for credit analysts and client advisors."* [19]

The IFC, one of the major development agencies in terms of investment in development of the SME sector, also suggests that effective business models for SME banking should be developed through a clear strategy, which may translate into dedicated business units with specialized staff, a standardized set of products, etc.[20] In its "*SME Banking Knowledge Guide*", the IFC states that: *"While there is no single formula for successful SME banking, there are lessons and good practices that apply to five areas: (1) strategy, SME focus, and execution capabilities; (2) market segmentation, products, and services; (3) sales culture and delivery channels; (4) credit risk management; and (5) IT and MIS"*. The "Guide" adds *that "banks that want to implement these lessons, as they enter or expand their*

---

[16] In the case of bank lending to SME, the agency problem refers to the incentives, or the lack of them, for the owner of a small firm (the agent) to employ the financial resources obtained from the bank (the principal) with as much care as he/she would when using his/her own funds

[17] T. Beck, A. de la Torre: *The Basic Analytics of Access to Financial Services, World Bank Policy Research Working Paper 4026*, October 2006

[18] T. Beck, A. Demirguc-Kunt: *Access to Finance – An Unfinished Agenda*, July 2008

[19] *The difficulties banks face in financing SMEs in Sub-Saharan Africa: who is to blame?* by Paul Derreumaux, Chairman and CEO of Bank of Africa. In: Private Sector & Development, PROPARCO Magazine, May 2009

[20] IFC, Financial Inclusion Expert Group, SME Finance Sub-Group: *Scaling-Up SME Access to Financial Services in the Developing World*, October 2010

operations in the SME market, need to follow a market entry process that begins with understanding the specific opportunity in the SME sector and ends with developing a strategy and implementation plan." [21]

Whereas the importance of a dedicated strategy and dedicated resources for SME banking cannot be doubted, financial institutions targeting the SME sector, or certain segments in it, may not be expected to invest right away in a full range of structures, products, methods and tools to go about these clients; they will prefer a step-by-step approach, deciding on further investments based on results. Nonetheless, it appears reasonable to expect that financial institutions that seriously aim to serve SME clients will have at least defined their targeted market, set objectives, specified the resources they plan to invest in the development of this line of business, and actually have invested some of them.

Financial institutions that claim to be interested in the SME market should have developed a strategy, drawn up appropriate plans and made investments in this line of business.

Conclusion

(5) Based on the literature review, three types of factors are assumed to play a significant role in the achievement of objectives for projects aimed at increasing SME access to financial services via the provision of inputs to local financial institutions:

- **The relevance of the inputs provided,**
- **the type of local financial institution, and**
- **the type of environment in which these projects take place.**

The literature review yielded the following hypotheses:

On project inputs:

1) Since (a) long-term resources are not available, or very expensive, in local debt markets and (b) credit institutions are the main financing partners of SMEs, the provision of long-term funds to these institutions targeting the SME market should be a promising approach to increasing access to credit for SMEs.
2) Investments in SME banking by local financial institutions may be encouraged by a transfer of internationally-recognized know-how along with cost-sharing mechanisms.

On the type of local financial institution:

3) Although no predictions can be made as to which type of financial institution is best suited to reaching out to SMEs, the type of financial institution is likely to be a factor explaining differences in project achievements.

[21] IFC, *SME Banking Knowledge Guide*, second edition, 2010

4) Financial institutions that have developed a strategy, drawn up plans and made investments in this line of business can be regarded as being genuinely interested in the SME market and thus to be better project partners.

On the environment:

5) The environment in which financial institutions operate is not only likely to place absolute boundaries on their efforts to develop SME finance but may also be determinant in their choice of strategies. Environmental factors are therefore likely to explain differences in project achievements.

These hypotheses will be used to orient the research design presented in the next section.

3. Research design and methodology

3.1 General approach

This study is based on a sample of six financial institutions receiving funding from EDFI members. These financial institutions can be considered as typical for the type of financial intermediaries EDFI members work with, and the financing projects with these financial institutions are also typical for the type of support provided by EDFIs to their client financial institutions. Nonetheless, this is a small sample and, therefore, the facts observed on this basis cannot be considered as representative of all similar projects carried out by EDFI members with a determined degree of certainty.

In view of the fact that this is a small sample, the findings were obtained by making observation and collecting data along the contribution chain, linking determinant factors to observable results and, whenever these observations suggested a relationship between determinant factors and results, this link was subjected to a reasoned plausibility check[22]. This methodology is well-suited to exploring research questions based on small samples and to strengthening hypotheses about possible causal links between determinant and determined variables.

In the next section, we present the contribution chain used in this study and the factors assumed to have a determinant effect on project results. Section 3.3 specifies the research questions and explains how determinant factors were qualified, opinions on the achievements of project results were arrived at, and links between factors and results were identified. Section 3.4 explains how the financial institutions in the sample were chosen, and section 3.5 provides explanations on the methods used to collect data and information.

[22] This method is referred to as “contribution analysis”. It considers that a suspected causal link between project inputs and project results is plausible if (i) the project’s activities were implemented as planned, (ii) the causal link can be supported by a theory of change and (iii) other influencing factors / plausible alternative explanations have been assessed and accounted for. See for example: J. Mayne: Contribution analysis: An approach to exploring cause and effect, Institutional Learning and Change (ILAC) Initiative Brief n° 16, May 2008

3.2 Key questions and contribution chain

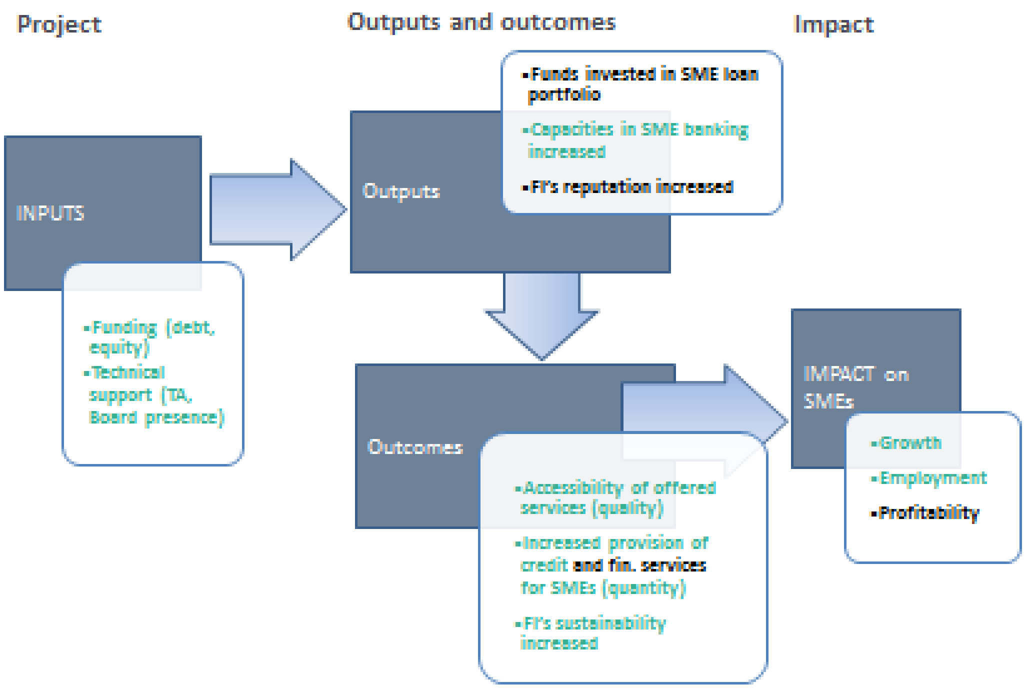
(1) The present study explores three key questions:

- **Has EDFI support effectively led to increased access to financial services for SMEs?**
- **What determines the effectiveness of EDFI support through financial intermediaries?**
- **What impact has EDFI support had on the financial intermediaries' SME clients?**

(2) The supply side approach to SME finance relies on the assumption that technical and financial inputs will lead to enhanced capacities (outputs) at financial institutions, which will result in increased access to finance for SMEs (outcome), eventually impacting the SME sector.

The projects studied here provide inputs in the form of debt (including subordinated debt) and/or equity, and/or technical support (in most cases sponsored with a 50% subsidy). These inputs are expected to contribute to funding the local financial institution's loan portfolio and thereby to increased provision of credit to the targeted enterprises (outcome). Technical support can lead to increased capacities in SME banking (output) and then to a quantitative increase in the FI's business with SMEs as well as to qualitative improvement of the FI's credit offer, i.e. more accessible and/or longer-term credit (outcomes). At the same time, funding and the technical support provided by EDFI partners can help strengthen the FI's sustainability, e.g. by reducing maturity or currency mismatches or by improving on the risk management framework (outputs). This, in turn, will affect the durability of the financial services offered and accessible to SMEs (outcome). The increased quantity and quality of credit for SME customers is expected to impact their decisions with regard to growth strategies (investments) and staff employment.

The following graph indicates the basic contribution chain:



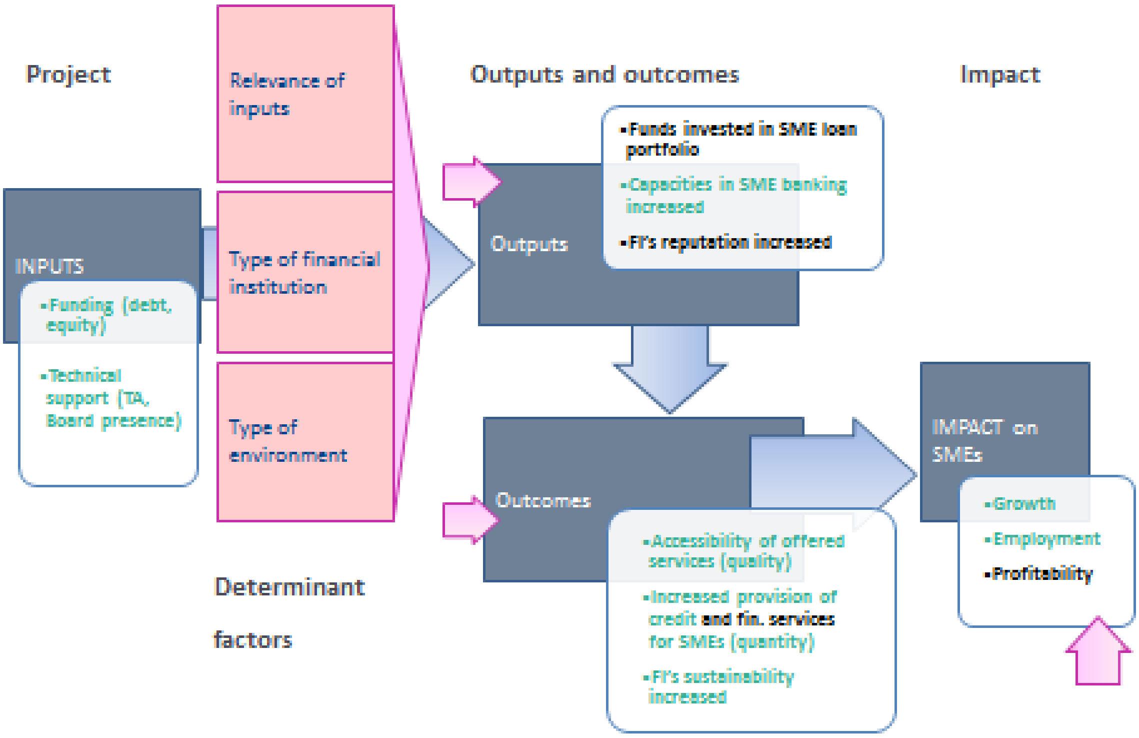
The factors highlighted in green in the graph are those on which the study focuses: it is expected that the output "funds invested in SME loan portfolio" will automatically translate into the outcome "increased provision of credit for SMEs". Likewise, the output "FI's reputation increased" is expected to facilitate the search for further funding by the financial institution, thereby contributing to increased sustainability (outcome). The study focuses on the increased provision of credit to SMEs, less on the increased provision of other financial services, because credit is what contributes most to the development of SMEs, and also because it is easier to get data on the provision of credit than on the provision of other financial services. On the impact side, we have not sought to measure trends in the profitability of SMEs as this would have required sets of data that could not be collected in the framework of this study, whereas impacts on growth and employment were easier to assess.

(3) The contribution chain needs to be completed by the factors assumed to play a significant role in the achievement of objectives.

Based on the literature and available empirical research (see section 2), three factors are assumed to play a significant role in the achievement of objectives for projects aimed at increasing SME access to financial services via the provision of inputs to local financial institutions:

- The relevance of the inputs provided;
- The type of local financial institution; and
- The type of environment in which these projects take place.

The contribution chain is thus completed as follows:



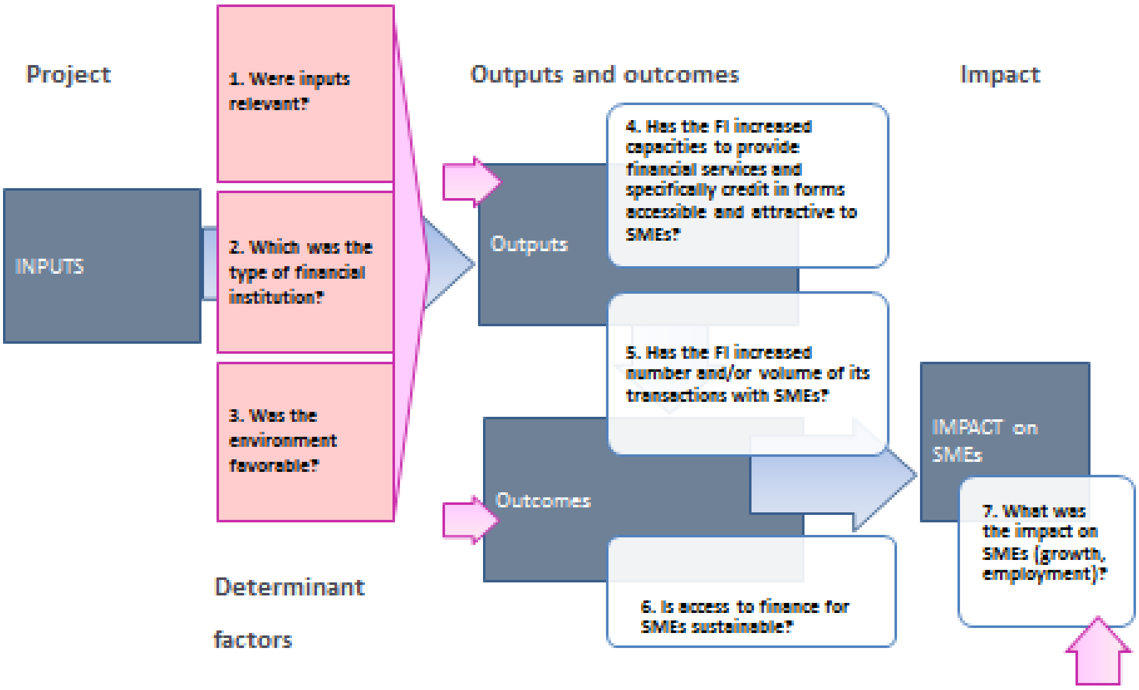
Determinant factors may also directly influence impacts (for example, a low inflation will have a positive impact on the development of private enterprises).

3.3 Research questions and methodology

3.3.1 Research questions

(1) Based on the contribution chain described in the previous section, seven research questions were formulated to orient the collection and the analysis of data.

The research questions are presented in the following graph:



3.3.2 Methodology

(1) In order to obtain consistent assessments or appraisals, each research question was subdivided into its main dimensions, and the indicators to be looked at in order to support assessments and appraisals were specified.

Sub-questions on determinant factors:

In analyzing **factors** believed to have an influence on the effectiveness of projects, we aimed to qualify them, as follows:

- ***Types of input*** and input combinations (equity, loan, technical support, etc.): In order to assess to what extent this factor may positively influence project effectiveness, the research question concerned:
  - the mix of inputs provided (input combination); and
  - the project inputs' *relevance* with respect to
    - ✓ the FI's *specific* needs and constraints *for the development of its SME business*[23], and
    - ✓ the FI's *overall* financial, institutional and managerial needs and constraints.
- ***Type of financial institution***: we considered (i) the *size* of the FI (small, medium, large) and (ii) how far it had defined a strategy for the SME market and implemented this *strategy* at the moment the projects' inputs were provided, i.e. when the project started. Also considered was the *duration of the relationship* of the FI with one or more EDFI members prior to the project's inception.
- ***Type of environment:*** we considered both the situation and the observable trends in the *macroeconomic, sector and business environment* at the moment the inputs were provided, and the observable trends thereafter. The specific environment for the *SME sector* was also considered.

Sub-questions on outputs, outcomes and impacts:

In analyzing **outputs**, we considered (i) the *capacities* created since project inception at the client FI to serve SMEs (specifically: dedicated credit products, distribution channels, organizational structures and staff) considering that when such capacities are increased, it indicates the actual implementation of a strategy aimed at expanding the FI's SME business. Focusing on credit, we also looked at (ii) the *quality of facilities offered*, i.e. their accessibility and attractiveness for SME.

In analyzing **outcomes**, we aimed to:

- assess (i) the actual performances of the FI in its SME business line (outcome 1) by looking at the *growth of the FI's business with* SMEs[24] in both number and volume terms and (ii) the *quality of the SME loan portfolio*, and
- assess the FI's capacity to lastingly serve SMEs (outcome 2), which depends (i) on the FI's *overall financial and institutional strength,* (ii) its *ability to secure domestic resources* and (iii) the *efficiency and profitability of its SME business*.

Within the limited time budget for this research and limited data available at the visited banks, we were not able to analyze growth, financials and employment at the FIs' SME clients. **Impacts** on SME customers were thus tentatively assessed by looking at trends in the tenor and in the breakdown by sectors of the FIs' business loans. We assumed that the longer the offered loans' tenor, the more are businesses able to finance investments and thus growth. We further assumed that some sectors in the economy (agriculture, construction and manufacturing) are more labor-intensive than others.

---

[23] For the purpose of the present study, we used the definition of SME as defined by the Client FIs themselves as we considered that the they were in a better position to define market segments in line with the actual structure of the enterprise landscape and with their overall business strategy

[24] All Client FIs in the sample defined what they understood by SME clients but they were not all able to provide data on their operations with these enterprises. In such cases, we used data on their business enterprise portfolio and separated the corporate customers

The following schedule summarizes this research framework:

Research questions	Dimensions
Factors	
1. Were the project inputs relevant?	Relevance with respect to the FI's specific needs and constraints for the development of its SME business
	Relevance with respect to the FI's overall financial, institutional and managerial needs and constraints
	Type of input combination
2. What was the type of financial institution?	Size of Client FI
	Existence and implementation of SME banking strategy
	History of co-operation with EDFI members
3. Was the environment favorable?	Macroeconomic
	Financial sector
	Business
	SME sector
Outputs	
4. Has the FI increased capacity to provide financial services and specifically credit in forms accessible and attractive to SMEs?	Capacity increase in SME banking
	Accessibility of credit products for SMEs
	Attractiveness of credit products for SMEs
Outcomes	
Outcome 1: 5. Has the FI increased the number and/or volume of its transactions with SME?	SME portfolio (number and volume)
	Quality of SME loan portfolio
Outcome 2: 6. Is access to finance for SMEs sustainable?	Client FI's financial strength
	Client FI's ability to secure domestic resources
	Contribution of SME business line to FI's profitability
Impact	
7. What was the impact on SMEs?	Employment generation
	Growth

The indicators used are presented in detail in Appendix 2. The following schedules provide, as examples, the detail for the "relevance of project inputs with respect to the FI's specific needs and constraints for the development of its SME business" (factor) and for the "evolution in the volume SME portfolio" (outcome):

Relevance of project inputs with respect to the Client FI's needs for the development of its SME business line:

The consultant's expert opinion was formed on the basis of the following questions:

- Have the financial instruments and terms been resolving the FI's constraints with regard to SME finance?
- Have the conditions (covenants, reporting requirements, etc.) incentivized the FI to develop its SME business?
- Have technical inputs been in line with the FI's constraints with regard to SME finance?
- Have other inputs been in line with the FI's constraints with regard to SME finance?

Trends in the Client FI's SME portfolio:

The consultant's expert opinion was formed on the basis of the following indicators:

- Growth in the number of SME clients since T0
- Growth in volume terms of the Client FI's portfolio of loans to SME clients since T0
- Trend in the share of SME loans in the Client FI's global loan portfolio since T0
- Achievement of the Client FI's targets for its SME business line (when available)

Quality of the Client FI's SME loan portfolio:

The consultant's expert opinion was formed on the basis of the following indicator:

- Trend and level of NPLs in the Client FI's SME loan portfolio

(2) Scores were used to express our assessments or appraisals of determinant factors and project results (outputs, outcomes, impacts).

These scores, derived from our qualitative analyses, were in most cases expressed with numbers ranging from 0 to 3. For example, when we found that the project's inputs were entirely relevant with respect to the Client FI's needs for the development of its SME business line, we attributed a "3" to this question. When we found that they were partly relevant, the attributed score was 2 or 1, depending on the answers to the sub-questions for this factor (see schedule above), and when there was no positive answer to none of the sub-questions, the score was "0". For the achievement of outputs, outcomes and impacts, a similar logic was followed: in the example above ("trends in the client FI's SME portfolio"), a score of "3" was attributed when we found that both the number and the volume of the SME deposits and loans had grown, the share of the SME loans in the FI's total loan portfolio had increased and the FI had achieved its targets in this respect.

Some factors were qualified using codes. This was the case for the size of the financial institution (small, medium, large) and for the types of input combinations.

It should be noted that the attribution of scores does not infer that this study uses quantitative methods; the scores are just a method to reflect the consultants' expert opinions.

(3) Using the system described above, the first step consisted of considering each research question separately for each project in the sample: the quality of determinant factors was assessed, on the one hand, and, the achievement of project outputs, outcomes and impacts was appraised on the other.

For all six financial institutions in the sample, all determinant factors, outputs, outcomes and impacts were attributed scores reflecting the consultants' opinion. The result of this work is presented in Appendix 3 and discussed in section 5.3 and 5.4 of this report.

(4) In a second step, in order to explore key question 2, we analyzed the relationship between (i) factors and (ii) outputs, outcomes and impacts, in order to identify the determinant factors influencing project effectiveness.

Having analyzed the contribution chain components separately, we then considered the relationships between factors and results.

Relationships between determinant factors and project results (outputs, outcomes, impacts) are to be understood as possible causal links between these components in the contribution chain, i.e. cases where, based on the observations made, one determinant factor appears to have had an influence on project results. This analysis was first carried out for each financial institution in the sample (see section 4 and details in Appendix 3) and then for all financial institutions (see sections 5.2 and 5.5).

3.4 Sample

(1) For the purpose of the present study, a sample of six to eight financial institutions was targeted, including FIs supported by various financial instruments, and operating in different African environments.

A short list provided by the EDFI Steering Committee included nineteen FIs in Western, Eastern and Southern Africa (see appendix 2), out of which six to eight institutions had to be selected.

At the kick-off meeting for this study, the Steering Committee highlighted several objectives for the final sample. Selected investment projects should:

- include projects where more than one EDFI was involved,
- be representative of a variety of financial instruments (lines of credit, equity, guarantees, etc.),
- be located in countries from the three African regions in order to ensure geographic diversity.

(2) First of all, we removed inconclusive cases from the short list, namely those in which timing, data availability, lack of focus or bias issues emerged.

We used four key criteria to remove inconclusive cases:

- **Timing** – the start of EDFI investment took place in 2011 or sooner. It was reasonable to conclude that investments that took place at a later date would not have had time to result in noticeable changes at the client FIs.
- **Availability** of at least a feasibility study and regular reporting thereafter. Projects with insufficient levels of information on investments and on client FIs would not have allowed us to relate outcomes to objectives or to draw conclusions on their impacts.
- **SME finance focus** – at least one EDFI investment explicitly devoted to the promotion of the client FI's SME business was deemed necessary for the purpose of this study.
- **Bias** – timing and amount of support from non-EDFI members should be compatible with the aim of attributing clear results to EDFI support, which translates into the following conditions:
    - EDFI support within the past 10 years should have started a few years before non-EDFI support,
    - the total amount of EDFI support is greater than the amount of non EDFI support.

This step resulted in a sample of seven client financial institutions, one of which eventually decided not to participate in the study. The Steering Committee then chose to carry on the work with only six financial institutions.

(3) The final sample included six financial institutions having received various types of support from EDFI members, in five countries in Western, Eastern and Southern Africa.

The final sample included four medium-sized and two large commercial banks, operating in three African regions: West Africa (Ghana), East Africa (Kenya, Uganda, Tanzania), and Southern Africa (Zambia). It included both independent banks and regional or international banking groups' subsidiaries (BOA, Rabobank), with diverse strategies.

The projects considered in the present study take the form of the provision of various types of inputs, including equity capital, several types of loans and technical support, to the selected African financial institutions. We considered inputs received from EDFI members that were still active or provided in the past five years, and for which project documentation was provided by EDFI members.

For each of the inputs provided, the EDFI project document specified specific purposes, which were in many cases not explicitly targeted at the SME banking business. It was however assumed that in all cases, an outcome was expected in terms of increased access to finance for SMEs.

Key data on the selected sample is included in the appendices. The table below summarizes key data on the sample projects:

Financial Institution	Project	Loan objectives
BOA –U Country: Uganda Size: Medium	**Equity:** FMO **Loans:** 1. EUR 2.58m – 5 yrs- UGX- (FMO 2008) 2. USD 3m – **subordinated** - 7 yrs- USD- (PROPARCO, 2008) 3. USD 10m – 5 yrs- USD- (FMO, 2011) **Technical support:** Capacity building (SME finance) FMO 2007	1. **SME Portfolio growth** 2. Support bank's growth strategy 3. **SME** + private sector in general
DFCU Country: Uganda Size: Medium	**Equity:** DEG, NORFUND **Loans:** 1. USD 3m – **subordinated**- 6 yrs – USD- (Norfund, 2007) 2. USD 15m – 7 yrs - USD – (FMO 2007) 3. USD 7m – 10 yrs – UGX- (FMO 2009) 4. USD 15m – 7 yrs – USD – (Proparco 2010) 5. USD 10m – 10 yrs- UGX- (Norfund, 2010) 6. USD 15m – 6 yrs - USD- (FMO 2011) 7. USD 10m – subordinated – 7 yrs - USD- (DEG 2012) **Technical support:** E&S management, training in trade finance, coaching of senior management; business analysis (all sponsored by FMO)	1. Overall business growth 2. FCY earning enterprises 3. **SME** in specific sectors 4. Overall PF growth (LT) 5. **SME** + other business: MLT loans 6. FCY earning **SMEs** 7. SME + other business growth
Eximbank Country: Tanzania Size: Large	**Loans:** 1. USD 5m – 7 yrs- USD- (Proparco 2006) 2. USD 20m – 7 yrs- USD- (Proparco, N/A) 3. USD 3m – 5 yrs – USD- (Norfund 2007) 4. USD 5m – **subordinated** - 7 yrs- USD- (Norfund 2008) 5. USD 10m – 7 yrs - USD- (FMO 2011) **Technical support:** ESM (Proparco)	1. Private sector 2. N/A 3. Increase bank's liquidity 4. **SME** + liquidity 5. **SME** + agriculture

Financial Institution	Project	Loans' objectives
I&M Country: Kenya Size : Medium	**Equity:** Proparco (since 2004) & DEG (since 2007) Total EDFI shares: 19,7% as at Dec. 2012 **Loans:** 1. EUR 1m – 5yrs – EUR - (Proparco 2008 2. USD 5.5m – 5yrs - USD – (Proparco 2008) 3. USD 10m - 7yrs – USD - (FMO 2010) 4. USD 15m - 7yrs – USD - (FMO 2011) 5. USD 15m – 5yrs – USD - (DEG 2012) **Technical support:** Capacity building (Strategic planning, MIS, Risk management, ESM), DEG 2009-2012.	1. MLT loans to exporting companies 2. MLT loans to exporting companies 3. Exporting **SME** + overall financial strength 4. **Same** 5. **SMEs**
Zanaco Country: Zambia Size : Large	**Loans:** USD 25m – 5yrs- USD (FMO 50% - Proparco 50%, 2008) USD 10m – 5yrs- USD (FMO 50% - Proparco 50%, 2009) USD 50m – 5yrs- USD (FMO 70% - Proparco 30%, 2011) **Technical support:** ESM training (FMO)	Support overall bank strategy, expected impact on USD-earning **MEs** and agribusinesses
CAL Bank Country: Ghana Size : Medium	**Equity:** Proparco (since 2012) : GHS 9m (EUR 4m) – 6,9% shares **Loans:** 1. USD 15m – 8yrs- USD - (DEG 67% Proparco 33%, 2008) 2. USD 10m – 7yrs- USD – (Proparco 2011)	1. USD-earning **SMEs** 2. Overall portfolio growth, especially **SMEs**

3.5 Data collection

(1) EDFI project managers were interviewed to get their views on the achievement of project objectives and on project design elements deemed to have incentivized the client financial institutions to invest in the SME market.

These interviews were also an opportunity to collect elements to complete the analysis of project documents (clarification of objectives, main assumptions, perceived risks, questions as to whether the project was implemented as planned, etc.) sent to us by EDFI members.

(2) Prior to the field visits, a questionnaire was sent to client financial institutions to:

- **collect some of the data needed to carry out the planned investigations and**
- **to gauge the banks' willingness to cooperate.**

Getting answers ahead of visits was useful in order to understand whether the selected banks intended to be cooperative. Sending the questionnaire was also an opportunity to explain what the consultants intended to investigate.

(3) The interviews with client financial institution managers and with some of their SME customers took place in the field under previously-defined guidelines.

During the field visits, managers and staff involved in the SME business were interviewed at head office and branch level. At each bank visited, we met:

- Members of top management with whom we discussed the bank's overall strategy, including its orientations with regard to the SME sector, as well as their perception of EDFI partners' support,
- The head of the department(s) in charge of SME banking, in order to understand how the SME business is run and to assess performances in this field;
- Branch managers and staff, to understand actual field practices with SME clients and to collect field staff views on the targeted SME customers,
- The head of the department(s) in charge of risk management, to gauge the banks' risk management policies and practices overall and with respect to SME credit operations,
- The head of the HR department to collect data on staff capacity dedicated to the SME business,
- The head of Finance, to collect data on the bank's overall financial situation and constraints as well as on the profitability of the SME business.

SME clients interviewed were asked about their perception of the bank's products and services, as well as the impact on their businesses.

Other resource persons were met (Bankers' Associations' representatives, etc.) to collect sector data.

Specific guidelines for each type of interview were developed to allow the data collected from the banks to be as homogeneous as possible.

4. Project assessments

Using the method described in the previous section, the selected six banks, the environment in which they operate, the inputs provided by their EDFI partners and the effects these inputs had on their SME business and their SME clients were analyzed. In this section, the main findings on the research questions (see section 3.3) are reported for each bank. The detailed findings on which these summaries are based are in Appendix 3.

4.1 Overview

The following schedule contains key data for the banks in the sample, their definition of SME clients and the evolutions in their SME loan portfolio:

Bank of Africa (Uganda)		
Key data	Size category	Medium
	Total assets 31/12/2012 (USD)	167m
	Asset growth	2007 – 2012: 178%
	Total (net) loan portfolio as of 31/12/2012 (USD)	90m
Outreach	Banks' definition of SMEs	• Assets: USD 135,000 to 7.0m • Loan sizes: USD 15,000 to 386,000
	Number of outstanding loans	2008 – 2012: 500 ➔ 2,600
	Volume of outst. loans (USD)	2008 – 2012: 7m ➔ 24m
	Share of SME loans in the bank's total loan portfolio	2008 – 2012: 16% ➔ 26%
DFCU (Uganda)		
Key data	Size category	Medium
	Total assets 31/12/2012 (USD)	374m
	Asset growth	2007 – 2012: 67%
	Total (net) loan portfolio as of 31/12/2012 (USD)	214m

Outreach	Banks' definition of SMEs	• Turnover/year: USD 4,600 - 11.5m • Staff: 5 – 100 • Loan size: o Microloans < USD 55,000 o SME loans: no limit set (but the bank considers that all of its enterprise clients are SMEs)
	Number of outstanding loans	2010 – 2012: 1,030 ➔ 790
	Volume of outst. loans (USD)	2010 – 2012: 60m ➔ 52m
	Share of SME loans in the bank's total loan portfolio	2010 – 2012: 34% ➔ 24% (loans with sizes between USD 10,001 and USD 300,000)
EXIMBANK (Tanzania)		
Key data	Size category	Large
	Total assets 31/12/2012 (USD)	578m
	Asset growth	2007 – 2012: 74%
	Total (net) loan portfolio as of 31/12/2012 (USD)	260m
Outreach	Banks' definition of SMEs	• Turnover/year: o Trade: USD 31,000 - USD 4.75m o Manuf../agricult.: USD 31,000 - USD 1.58m
	Number of outstanding loans	Q1-2013: 1,870
	Volume of outst. loans (USD)	2007 – 2012: 63m ➔ 76m
	Share of SME loans in the bank's total loan portfolio	2007 – 2012: 43% ➔ 28%

I&M (Kenya)		
Key data	Size category	Medium
	Total assets 31/12/2012 (USD)	1,064m
	Asset growth	2007 – 2012: 130%
	Total (net) loan portfolio as of 31/12/2012 (USD)	644m
Outreach	Banks' definition of SMEs	• Turnover/year: USD 300,000 – 5.5m • Staff: 10 – 100 • Loan sizes: up to USD 850,000
	Number of outstanding loans	Q 2-2013: about 1,000
	Volume of outst. loans (USD)	Q 2-2013: 282m
	Share of SME loans in the bank's total loan portfolio	Q 2-013: 36% (no historical data; positive development over 2008 – 2013 assumed)
Zanaco (Zambia)		
Key data	Size category	Large
	Total assets 31/12/2012 (USD)	1,121m
	Asset growth	2007 – 2012 : 99%
	Total (net) loan portfolio as of 31/12/2012 (USD)	509m
Outreach	Banks' definition of SMEs	• Turnover/year < USD 3.6m • Loan sizes: up to USD 1m
	Number of outstanding loans	2008 – 2012: 967 → 1,112
	Volume of outst. loans (USD)	2008 – 2012: 13m → 21m
	Share of SME loans in the bank's total loan portfolio	2008 – 2012: 5.9% → 3.5%

CAL Bank (Ghana)		
Key data	Size category	Medium
	Total assets 31/12/2012 (USD)	611m
	Asset growth	2007 – 2012: 393%
	Total (net) loan portfolio as of 31/12/2012 (USD)	393m
Outreach	Banks' definition of SMEs	• Turnover/year: USD 25,000 – 1.1m • Loan sizes: USD 4,500 – 230,000
	Number of outstanding loans	2010 – Q1-2013: 270 ➔ 330
	Volume of outst. loans (USD)	2010 – Q1-2013: 4.8m ➔ 8.8m
	Share of SME loans in the bank's total loan portfolio	2010 – 2012: 3% ➔ 1%

4.2 Bank of Africa in Uganda

Name	Size	Total assets (USD m) as at 31/12/2012	EDFI shareholder(s) as at 31/12/2012
Bank of Africa Uganda	Medium-sized	167	FMO
Active loans granted by EDFI members (1)	**SME promotion (2)**	**TA provided**	**SME promotion (3)**
EUR 2.58m / 5yrs / UGX USD 10m / 5yrs / USD USD 3m / sub. debt 7yrs / USD	Yes Yes No	Yes	Yes (before 2007) No (2009)
Bank's SME definition		**No. and vol. SME loans end of 2008 and 2012 (4)**	**Share of SME loans in total loans end of 2008 and 2012 (4)**
Assets: USD 135,000 - 7.0m Loan sizes: USD 15,000 to 386,000		Nr.: 500 ➔ 2,600 Vol.: USD 7m ➔ 24m	16% ➔ 26%

(1) Face value of the loans which were still active as of end of 2012 / loan tenor / loan currency

(2) SME promotion is defined as an objective as per project documents

(3) Contribution to capacity-building in SME banking

(4) Outstanding loans

The bank and its strategy toward SMEs

Bank of Africa Uganda is an "all public" bank in the process of reorienting its SME strategy

Bank of Africa Uganda (BOA-U) was created in 2006 when the BOA Group purchased Belgolaise's stake in a Ugandan bank, which it had acquired together with FMO in 1996. BOA-U is a member of the Bank of Africa Group, formed nearly 30 years ago and currently operating in 14 African countries.

BOA-U describes itself as an "all public" bank providing a full range of banking products and services to large corporate companies, medium-sized local businesses and retail and small businesses. To that end, BOA-U has defined three business segments, including "Corporate", "Enterprises" and "Retail", where "Enterprises" is regarded by management as the bank's SME business line (loan sizes from USD 15,000 to USD 386,000). The bank has defined "SMEs" as enterprises with assets ranging from

USD 135,000 to USD 7.0m[25]. According to BOA's management, almost all the non-retail business of the bank (SME and Corporate) falls under the IFC/DEG SME definitions[26].

BOA-U is in the process of implementing a new business strategy in line with the Group's overall strategy and focusing on retail and corporate clients (where many of these corporate clients would qualify as "SME" according to DEG's or IFC's definitions). The focus on retail customers shall also allow the bank to increase its domestic funding base. BOA-U's management projects that the Enterprise segment will represent 35% of the loan book at the end of 2015 (vs. about 25% at present) whereas corporate customers shall account for 60% of the loan PF. However, reflecting on the credit risk, the bank wants to implement a more conservative approach to the Enterprise segment.

Were the inputs relevant?

A combination of equity and debt finance allowed the establishment of an SME-oriented bank in Uganda and successfully supported its growth, though SME-specific technical support could have complemented the range of inputs

EDFI members' combined equity and debt finance enabled the establishment in Uganda of a subsidiary of the BOA group known for its SME-orientation. From June 2008 to December 2011, two FCY loans totaling USD 13 m and one LCY loan equivalent to EUR 2.58 m were disbursed by FMO and PROPARCO. PROPARCO's loan disbursed in 2008 qualified as subordinated debt and was relevant to increasing the bank's ability to sustain its growth and grant larger loans. The funds from its EDFI partners were also aimed at reducing the risk accruing from currency mismatches. The TA provided in asset and liability management was also useful. BOA-U has now embarked on a complete overhaul of its underwriting methods and procedures with the technical assistance of the IFC. This support will directly contribute to strengthening its credit operations with SME clients.

What was the type of financial institution?

A small bank with a strong SME focus backed by a large Pan-African group known to EDFI members, BOA-U was rightly seen as a promising partner institution

BOA-U has, since inception, put in place structures and capacity dedicated to SME clients, as defined by the bank, so as to cover the majority of such enterprises in Uganda.

Despite its relatively small size at the start, given it was a bank belonging to a Group known to EDFI members as being a trusted partner with a known business strategy, BOA-U was a good choice for a partner bank through which SMEs would get finance. The bank had a business development plan including the development of a significant SME business line and was also planning to create a large branch network. Moreover, the BOA Group adds value to the relatively small BOA-U which can offer trans-border services in and outside the East African Community to its customers.

---

[25] Conversion in USD with exchange rate as of 31/12/2012

[26] IFC defines "SME" as enterprises matching two of the following three criteria: 10 to 300 employees; total assets and total sales between USD 100,000 and USD 15 m. DEG defines eligible SME sub-borrowers as enterprises with up to 300 employees and total assets and annual sales of up to the equivalent of EUR 15 m

Was the environment favorable?

Operating in a difficult but improving environment …

At the project's start in 2008, macroeconomic conditions were not favorable to motivate commercial banks to lend to the private sector. Uganda's business environment did not show much progress until 2009, when the government implemented a series of measures that contributed to raising Uganda's relative rank (Doing Business's "Distance To Frontier" indicator).

However, Uganda ranked among the 15 economies surveyed by "Doing Business" that had advanced the furthest since 2005 toward the frontier in regulatory practice in the area of getting credit. Uganda thus provided opportunities for programs aiming at easing access to credit for SMEs. With increasing competition among banks, a credit bureau that became operational in 2009, and several guarantee funds, the banking sector also offered favorable conditions for the implementation of such programs.

As in most African countries, the SME sector is dominated by small enterprises for which access to credit was and remains a limiting factor, mainly due to access barriers on the supply side, this being one more reason to implement projects with banks ("supply-side approach").

Has the FI increased capacity to provide financial services and specifically credit in forms accessible and attractive to SMEs?

… BOA-U improved outreach to SMEs thanks to branch network extension, adequate products, and a dedicated structure and staff; it was particularly open to small enterprises …

BOA-U expanded its branch network over the project timeframe to become one of Uganda's largests, and developed credit products accessible to the majority of Uganda's SMEs. The bank implemented the strategy for the SME market, which had been decided at inception of its business in 2006, and operated its SME business line from its "Enterprise Business Centre" (which also existed at inception).

Using a "relationship banking approach", BOA-U was particularly open to the majority of Ugandan SMEs, which are small enterprises.

Has the FI increased the number and/or volume of its transactions with SMEs?

… and achieved strong growth in the number and volume of loans to SMEs, even though EDFI funding went predominantly to BOA-U's corporate customers.

The number of BOA-U loans to Enterprise customers grew from 500 at end of 2008 to 2,600 at end 2012, while the share of SME loans in the bank's portfolio also increased over the period 2008–2012. Management's initial objective to build an SME loan portfolio equivalent to 30% of the total portfolio in 2011 was not achieved; a new objective of 35% was set for 2015.

EDFI funding in foreign currencies was predominantly allocated to the bank's corporate customers and thus only indirectly contributed to the development of BOA-U's SME business line. According to management, SME customers would require long-term funding in local currency, which the bank would not any longer receive from its EDFI partners at acceptable cost, but which is offered by the EIB ("multi-currency facility"). However, as loans in FCY have been strongly on the increase in BOA-U's global loan portfolio, one can infer that the provision of stable financial resources in FCY enabled the bank to free up liquidity to grow its SME lending business. This enabled the bank to implement its initial strategy focusing on small enterprises and to better understand the risks in the Uganda SME sector.

Is access to finance for SMEs sustainable?

But BOA-U's management admits that the credit risk in the SME segment was not well controlled, which resulted in a strong deterioration in the quality of this portfolio, and in the decision to tighten the bank's credit policy and reduce the share of term loans.

After seeing the SME loan portfolio deteriorate in the wake of the 2011/12 economic crisis, BOA-U's management decided to review and tighten credit policies and procedures. The bank is likely to become choosier, and therefore less open, to small enterprises in the future: the management plans to separate the small enterprise business from the Enterprise business line. Under this plan, the Enterprise line will deal with larger and more formalized entities, and will adopt a more prudent credit policy, while smaller enterprises will be transferred to the retail business segment and be dealt with at branch level. At the same time, the management plans to reduce the share of term loans and to rely more on less risky and more profitable trade finance products. It remains to be seen, however, if this will help control risks better in the small enterprise business segment.

EDFI funding contributed to strengthen the bank's financial situation and thus its ability to sustain its operations, ...

PROPARCO's subordinated loan and FMO's equity injections allowed the bank to prepare for further business growth. EDFI funding helped reduce the currency gaps in USD but its weight in the bank's balance sheet was too small to narrow the significant maturity gap between assets and liabilities in the 0-3 month range, which requires further attention.

Despite the difficult environment and mounting competition, BOA-U did well to increase profitability: returns on average assets and on average equity declined between 2008 and 2010 due to decreasing interest margins and a higher cost-to-income ratio but improved in 2011 due to economies of scale.

… and BOA-U is successfully collecting domestic deposits from the Ugandan public, which represent by far the largest portion of its resources.

A negative ("crowding out") effect of foreign funding on domestic resources cannot be assumed, as BOA-U has invested in both a large branch network and products and services, with a view to expanding and broadening its client base and collecting domestic deposits. Domestic deposits represented almost 70% of the bank's liabilities as at the end of 2012 and the management has plans to intensify the bank's efforts to collect these deposits.

What was the impact on SMEs?

Likely positive impacts on employment and SMEs' financial situation, while the bank considers reducing its MT and LT lending to SME customers.

BOA-U credit granted to the private sector (SMEs and corporate clients) can be assumed to have a positive effect on employment, as the weighting of labor-intensive sectors financed increased during the period under review. During the same period, the bank's MT and LT loans amounted to well over half of its loan portfolio and this proportion was positively correlated with EDFI funding. However, the management's opinion is that the bank needs to reduce the share of term loans in its portfolio and intensify the use of short-term credit facilities such as trade finance products to increase profitability and reduce risk.

Conclusion

EDFI support contributed indirectly to creating capacity for SME banking in Uganda …

EDFI members contributed to establishing a subsidiary of the BOA Group in Uganda and trusted that BOA-U would implement the Group's strategy which includes a focus on SMEs. Hence, no specific incentives were foreseen to encourage BOA-U to focus on SMEs, in the form of covenants to the financing agreements, or in the form of technical support. BOA-U actually developed and implemented a strategy that foresaw to build a loan portfolio of loans to SMEs representing 30% of its total loan book by end 2011, and built up capacity in its SME business line accordingly. Until the end of 2012, the bank was particularly open to small enterprises.

As for the development of its capacity to serve SMEs, the positive trend in BOA-U's business volume with SME customers was due to an endogenous factor, i.e. implementation of the bank's own strategy.

EDFI funding had a plausible, direct positive influence on BOA-U's capital adequacy ratio and profitability and it did not discourage the bank from collecting relatively cheap domestic deposits. Insofar, EDFI funding contributed to BOA-U's sustainability. But the bank's SME business, on which EDFI funding had no direct influence, most probably did not contribute much to its overall result, if at all, and is now in the process of being revamped, with the objective of improving credit risk management.

It can be concluded that EDFI support contributed indirectly to creating capacity for SME banking in Uganda by promoting a bank that has this objective in its overall strategy.

… but may have missed an opportunity to provide technical support to the bank in the area of SME lending, which could have prevented, or at least reduced, the deterioration in its SME loan portfolio during the economic crisis.

4.3 DFCU in Uganda

Name	Size	Total assets (USD m) as at 31/12/2012	EDFI shareholder(s) as at 31/12/2012
DFCU	Medium-sized	374	NORFUND
Active EDFI loans (1)	**SME promotion (2)**	**TA provided**	**SME promotion (3)**
USD 10m/sub. debt 7yrs/USD USD 10m/10yrs/UGX USD 3m/sub. debt 6yrs/USD USD 15m/7yrs/USD USD 15m/7yrs/USD USD 7m/10yrs/UGX USD 15m/6yrs/USD	Yes Yes No No No Yes Yes	Yes	Partly
Bank's SME definition		**No. and vol. SME loans (4) end of 2010 and 2012 (5)**	**Share of SME loans (4) in total loans end of 2010 and 2012 (4)**
Turnover/year: USD 4,600 - 11.5m Staff: 5 – 100 Loan size: • Retail loans < USD 55,000 • SME loans: no limit set (6)		Nr.: 1,030 ➔ 790 Vol.: USD 60m ➔ 52m	34% ➔ 24%

(1) Face value of the loans which were still active as of end of 2012/loan tenor/loan currency

(2) SME promotion is defined as an objective as per project documents

(3) Contribution to capacity-building in SME banking

(4) Loans from USD 10,001 to USD 300,000

(5) Outstanding loans

(6) DFCU considers all its loans as either retail or SME loans

The bank and its strategy toward SMEs

DFCU, originally a local development finance institution, was transformed into a commercial group focused on the provision of longer-term funding to the private sector

DFCU Limited was incorporated under the Laws of Uganda by the Commonwealth Development Corporation (CDC) and the Government-owned Uganda Development Corporation (UDC) in 1964. Later restructuring brought in DEG and International Finance Corporation (IFC) as equal partners with

CDC and UDC. DFCU's objective was to support long-term development projects whose financing needs and risk did not appeal to the then existing financial commercial lending institutions. NORFUND has been one of DFCU's main shareholders since 2004.

Over the past ten years, DFCU has been transformed into a commercially-driven financial group while maintaining its developmental focus. The bank has defined four core business lines, namely: Consumer Banking (CB), Development and Institutional Banking (DIB), Wholesale, and Treasury. DFCU Bank offers a broad range of products such as short and long-term finance, leasing and mortgages. Target clients are local corporates, SMEs, and middle class retail consumers. DFCU defined "SMEs" as businesses with a yearly turnover and total assets ranging from USD 4,600 and USD 11.5 m[27] and employing 5 to 100 persons. DFCU's management defines the bank as primarily SME focused. The bank now expects to increase its exposure in the agriculture sector with the expertise of Rabobank, which recently purchased a stake in the bank and entered into a technical assistance agreement.

Were the inputs relevant?

Over the period considered, DFCU's development benefited from multi-EDFI member support, including debt funding and technical support.

Over the period 2007-2012, DFCU received a number of loans from FMO, NORFUND, PROPARCO and DEG, both in foreign currency (five loans totaling USD 58 m) and local currency funding (two loans totaling USD 17 m). Technical support consisted of co-funding capacity-building plans submitted by the bank, including strong training and coaching components aimed at increasing specific technical skills and general management skills.

The funding provided was relevant to sustain DFCU's operations but was not specifically aimed at increasing capacity in its SME business.

The funding provided was relevant to sustaining DFCU's operations in the term loan and foreign currency loan markets and to maintaining liquidity and currency risks at acceptable levels. The presence of NORFUND's representatives on the Board of Directors is acknowledged by DFCU's management to have had, and to keep on having, a positive effect on the bank's governance.

Whereas not all of the funding by EDFI members was explicitly aimed at developing DFCU's SME client segment, it went to a bank that aims primarily at serving SME customers.

The technical support sponsored by EDFI members was not primarily aimed at building skills for the bank's SME credit business. Nonetheless, these inputs were partly relevant for DFCU's SME business (e.g. review of bank's product range and training in trade finance).

[27] Conversion in USD with exchange rate as of 31/12/2012

What was the type of financial institution?

A respected medium-sized bank, with a development background and products well suited to the needs of SMEs, DFCU had the potential to become a model in SME finance…

At the beginning of the time span considered for the purpose of this study (2007–2012), DFCU was the 6th largest bank in Uganda; it had the size and the reputation that allowed it to have significant outreach in the SME market and set examples in the financial sector.

… but it lacked an elaborate SME strategy.

The bank offered a broad product range, adapted to the needs of SMEs and it had defined what it understands as an SME customer, though with no upper limit for loan sizes and no elaborate strategy for the SME market. DFCU's implicit strategy was to finance all creditworthy enterprises in the broader SME market.

Was the environment favorable?

Operating in a difficult but improving environment …

See section 4.2.

Has the FI increased capacity to provide financial services and specifically credit in forms accessible and attractive to SMEs?

DFCU developed its branch network as well as its product range. The bank's credit offer remains particularly attractive for businesses seeking long-term finance.

Over the period under review (2007 -2012), DFCU developed its branch network as well as its range of credit facilities for working capital needs. It has also implemented a "Chinese desk" which is useful for its business clients, including SMEs. DFCU's credit appears to be very accessible, for small enterprises as well. But its processing of credit applications appears lengthy and may not allow for a rapid response to first-time credit applications. Nonetheless, customers visited were generally satisfied with DFCU's services and insisted that its "relationship banking" approach and long-term funding facilities are what differentiates it from its larger competitors.

But DFCU didn't progress in its plans to increase its share in the SME market.

Despite its plan to increase its share in the SME market, the bank has no detailed strategy or plans indicating how it intends to achieve this objective (market segments, products or product packages, marketing channels, etc.). SME customers are still dealt with by two separated units: "Consumer Banking" (CB) is in charge of retail customers and micro and small enterprises (loans up to USD 55,000) and "Development and Institutions Business" (DIB) serves larger enterprises, including medium-sized enterprises (most loans in the range of USD 200,000 to USD 400,000). According to DFCU's Management, most non-retail business of the bank (SME and Corporate) would fall under the SME definitions used by IFC and other DFIs.

Has the FI increased the number and/or volume of its transactions with SMEs?

DFCU achieved a relatively modest growth in its business credit portfolio; most of it was achieved with a small number of business customers who received loans over USD 700,000

DFCU could not provide operational and financial data on the customers it defines as "SMEs". Nonetheless, the data on the bank's total and business loan portfolio shows that between 2007 and 2012, DFCU's total loan portfolio, which is composed essentially of business loans, grew less than the banking sector's loans The bank's lending operations with small enterprises handled by its "Consumer Banking" unit were modest and, since 2012, have been dominated by "Youth Loans" (average loan size in 2012: USD 2,500) granted in the framework of public development scheme. The bulk of DFCU's lending to businesses was handled by its Development and Institutions Business unit. These larger loans, which represented about 98-99% of all business loans in volume, and increased in size since 2010, have been responsible for the growth in the bank's portfolio. In the period 2010 – 2011, typical SME loans in the range of USD 10,001 to USD 300,000 represented around 30% of DFCU's credit portfolio (and 86% of the number of business loans over USD 10,000). In 2012, the weight of these loans decreased to 24% as the bank allocated more credit to the upper segment of the SME spectrum, which the management considered less risky during the economic crisis: loans over USD 700,000 represented 50% of the total business loan portfolio at the end of 2012, compared to 41% and 30% at the end of 2011 and 2010. According to DFCU's management, a number of these loans were to SMEs that grew in the course of their relationship with DFCU.

Hence, whilst retail loans dominated in number, a relatively small number of larger loans have gained in importance.

DFCU successfully decreased the level of non-performing loans by adopting a very prudent lending policy

Like the other banks in Uganda, DFCU saw the level of its NPLs rising in the aftermath of the 2011/12 economic and financial crisis. But the management was able to reduce them to a sustainable level of 6% as at the end of 2012, by reducing its lending overall and particularly to small enterprises.

Is access to finance for SMEs sustainable?

EDFI funding enabled DFCU to maintain its outstanding position as a provider of MT and LT finance for the private sector in Uganda, and particularly as a provider of loans in foreign currency.

Whilst maintaining its position in the market as a prime provider of middle and long-term finance, DFCU was able to consolidate its financial strength by maintaining a satisfactory capital adequacy ratio and liquidity position, with the support of its foreign partners. At the same time, DFCU was able to increase its profitability by maintaining adequate margins and decreasing costs relative to income.

But the sustainability of its business with small enterprises is questioned by the bank's management

DFCU developed microfinance operations in its Consumer Banking unit and focused on medium-sized and large enterprises in its Development and Institutional Banking unit. Although the bank has no means to calculate the contribution of different customer segments to its overall result, its management believes that businesses in the lower range of the SME spectrum may not be profitable enough and would need a review. These evolutions underline the importance of a more elaborated strategy for the SME market, defining business segments, with respective operational and financial targets.

What was the impact on SMEs?

Positive signs of impact on private sector development, despite uncertain contribution to employment generation

The share of labor-intensive sectors in DFCU's total loan portfolio did not increase much during the period considered. However, DFCU remains an important provider of MT/LT and foreign currency loans in the Ugandan banking sector, with a growing share of LT loans. It can be considered that this has a positive impact on investments in the private sector.

Conclusion

EDFI funding helped establish, and then sustain the growth of, a medium-sized commercial bank in Uganda with strong experience in providing longer term finance to the private sector.

Before the period reviewed in the framework of this study, EDFI funding helped turn a development finance institution into a commercial bank with good potential to serve the Ugandan private sector. During the period considered here, EDFI funding contributed to growth of DFCU's LT loan portfolio and to the bank's ability to offer foreign currency loans. This benefited medium-sized and large enterprises first and foremost, enabling them to finance investments. Also, EDFI funding conditions represented an incentive for DFCU to intensify its efforts to collect domestic deposits. Finally, it can be assumed that the presence of EDFI members on the Board of Directors helped strengthen DFCU's corporate governance, and that EDFI involvement facilitated the RABOBANK's entry into its capital.

But it failed to establish an elaborate strategy for the SME market.

DFCU defines itself as an "SME bank" and developed a range of services that are attractive to SMEs. In the absence of specific data on the bank's business with the SME segment, as defined by DFCU, it is however difficult to measure the actual development of this business. The bank didn't elaborate its strategy in the SME market by defining market segments with specific objectives, products and structures attached. EDFI financial inputs were designed to support the bank globally; they were not incentives for the bank to focus on particular market segments or improve on its market strategy. Today, DFCU's management is not convinced that all of the bank's business with SMEs contributes enough to the bank's result and believes that this would need to be reviewed.

4.4 Exim Bank Tanzania

Name	Size	Total assets (USD m) as at 31/12/2012	EDFI shareholder(s) as at 31/12/2012
EXIMBANK	Large	578	-
Active EDFI loans (1)	**SME promotion (2)**	**TA provided**	**SME promotion (3)**
USD 10m / 7yrs / USD USD 5m / 7yrs / USD USD 20m / 7yrs / USD USD 3m / 5yrs / USD USD 5m / sub debt 7yrs / USD	Yes No N/a No Yes	Yes	No
Bank's SME definition		**No. and vol. SME loans end of 2007 and 2012 (4)**	**Share of SME loans in total loans end of 2007 and 2012 (4)**
Turnover/year: Trade: USD 31,000 - USD 4.75m; Manuf./agricul. USD 31,000 - USD 1.58m		Nr.: 1,870 (Q1-2013) Vol.: USD 63m ➔ 76m	43% ➔ 28%

(1) Face value of the loans which were still active as of end of 2012 / loan tenor / loan currency
(2) SME promotion is defined as an objective as per project documents
(3) Contribution to capacity-building in SME banking
(4) Outstanding loans

The bank and its strategy toward SMEs

EXIMBANK: a medium-sized bank focused on import/export with an ambition to become Tanzania's most dynamic bank, and supported by several EDFI members

Initially a foreign exchange bureau, EXIMBANK (Tanzania) Ltd. was established in 1997. With a strong base in the business community of Indian origin, the bank has been and remains particularly strong in the market for import/export finance and in agriculture value chains. The bank offers financial services to individual customers, corporate clients and SMEs, which it has defined as businesses with a maximum turnover of USD 4.75 m for trading enterprises and USD 1.58 m[28] for enterprises in the manufacturing and agriculture sectors.

[28] Conversion in USD with exchange rate as of 31/12/2012

EXIMBANK's overall strategy is to position itself as one of the most innovative banks in the country; it was the first bank to introduce credit and debit Master Cards and to issue VISA Platinum Cards in Tanzania, the first to launch Mobile ATMs, and the first local bank to establish a banking subsidiary overseas.

EXIMBANK's shareholding has been stable for many years and consists of five natural persons and two companies linked to one of the associates. So far, the bank has no plans to open up its capital to foreign shareholders.

EXIMBANK's earliest contact with an EDFI member was with PROPARCO which extended a loan to the bank in 2003. Since then, EXIMBANK has had financial relationships with several DFIs, including FMO, NORFUND, PROPARCO and IFC.

Were the inputs relevant?

The financial instruments and terms applying to EDFI funding were designed to generally support the bank's growth strategy, not specifically to provide incentives to develop structured SME banking.

EDFI members provided funding to EXIMBANK in the form of senior loans and subordinated debt. Their loans disbursed in the period September 2006 to December 2011 totaled USD 43 m and represented most of EXIMBANK's borrowed funds but still a small portion of the bank's assets. No technical support was requested or provided so far.

EDFIs' financial inputs were relevant to enable the bank to put its growth strategy on a stronger footing (capital adequacy with NORFUND's subordinated loan), to reduce liquidity risks, and to respond to a growing demand for FCY loans.

The financial instruments and terms applying to EDFI funding were primarily designed to support the bank's growth strategy and to respond to private sector demand for credit, not specifically to provide incentives to develop a structured SME banking line.

What was the type of financial institution?

EXIMBANK's fast-growing business, large size and implicit SME-orientation made it a promising partner for EDFI.

In 2005, EXIMBANK ranked number nine in term of assets, deposits and loans, and commanded approximately 8% of the entire banking sector's assets, at a time when this sector counted 22 banks, with the top 3 banks commanding 52% of total assets.

Prior to the project's start, during the period 2003 - 2005, EXIMBANK's 3-year strategy was aimed at expanding its existing activity with SMEs as well as foraging into the retail market, to build up a larger and more stable retail deposit base. During the same period, EXIMBANK's assets doubled and its loan portfolio had been multiplied by a factor of 1.3. This growth exhausted the bank's capital base and, since long-term funding was not available in the Tanzanian financial market, it made EXIMBANK a worthy partner to support the private sector in Tanzania.

However, whilst the bank was in the process of implementing upgraded credit procedures and implementing a credit rating system, a specific strategy for the SME market did not exist as of T0 (2006). It was implicitly considered that EXIMBANK's operations with business enterprises included a sizeable portion of small and medium-sized enterprises.

Was the environment favorable?

In an environment where investing in Treasury bills was more rewarding than lending to the private sector, the dynamic stance of EXIMBANK's owners was an important factor with regard to making the bank attractive as an EDFI client financial institution.

At the beginning of the project period (2006), despite a relatively unfavorable business environment, economic growth perspectives were positive, as were trends in the highly concentrated Tanzanian banking sector, where competition appeared to pick up, as well as in financial infrastructure (improved banking supervision, credit bureau in creation). Yet, banks invested to a large extent in government papers instead of loans and advances, as these assets had better yields than loans.

Under these conditions, the dynamic stance of EXIMBANK's owners was a crucial element for the choice of this client financial institution.

Has the FI increased capacity to provide financial services and specifically credit in forms accessible and attractive to SMEs?

EXIMBANK has no specific strategy and structures for the SME market; its overall strategy is to offer high-quality services to medium-sized enterprises and corporate clients, with a restrictive credit policy, …

Although it has not set up organization units or marketing channels, or developed products specifically for SME customers, EXIMBANK is an important provider of credit and other financial services for this customer segment. However, during the project period, EXIMBANK, decided to restrict its SME lending to top-quality medium-sized enterprises (setting a floor of USD 60,000 for business loans), capable of pledging assets against the loans they request. The bank implements a "relationship banking approach", with centralized decision-taking and a conservative attitude as regards credit risk. On the other hand, it puts much emphasis on the quality of its services and on customer care, which is highly valued by its SME clients.

Has the FI increased the number and/or volume of its transactions with SMEs?

… resulting in a very modest growth in the SME loan portfolio and in a satisfactory quality of its business loan portfolio.

There was robust growth in the number of loans to SME between December 2013 and March 2013. Nonetheless, the size of this portfolio did not grow much over the period 2007-2012, and the share of SME loans appears to have decreased in the bank's loan book. Although its management isn't sure about the accuracy of the data reported in its annual reports on the composition of its loan portfolio by type of clients, there are reasons to believe that most of the bank's credit has benefited larger medium-sized enterprises and corporate clients.

On the other hand, with its conservative credit policy, EXIMBANK was able to maintain a decent quality business loan portfolio, which was less the case for its consumer loans.

Is access to finance for SMEs sustainable?

A contribution to the bank's financial health supporting its overall development …

EDFI funding helped sustain the bank's capital base, less so to ease its tense liquidity situation in the short-term range (1-3 months). Despite declining ROE and ROA towards the end of the period reviewed, EXIMBANK has realistic prospects to increase profitability again to the previous very good levels. It can be assumed that the bank's SME business contributes positively to its overall result.

Moreover, EXIMBANK invested in its branch network and in the development of products and services to develop its retail business and to grow a broader deposit base; customers' deposits expressed in USD grew by 84% from 2007 to 2012. During the project period, the bank improved its risk management framework, which can plausibly have been influenced by EDFI financial covenants.

Finally, EXIMBANK invested in subsidiaries in the Comoros (2007) and in Djibouti (2011) and plans to increase the number of subsidiaries in the East-African region.

What was the impact on SMEs?

… with plausible positive impacts on employment generation, growth, and on the financial situation of medium-sized enterprises.

EXIMBANK's lending to the private sector is likely to have a positive effect on employment as an important and slightly growing portion of its loans went to labor-intensive sectors.

Even though the portion of SMEs that benefited from it cannot be readily evaluated, due to insufficient automation of this process at the bank, the fact is that EXIMBANK provided most of its credit (70%) to business customers in the form of medium-term loans (1-5 years tenor), durations which enable Tanzanian enterprises to finance most of their investment projects with matching resources.

Conclusion

EDFI funding, though small in proportion to the bank's size, has helped strengthen a powerful niche player with a promising regional agenda, but whose SME banking strategy would need to be more precisely defined.

With favorable opportunities in a growing economy where a vast majority of the population is still under-banked, EXIMBANK should be able to continue to grow, climb the productivity ladder and increase its profitability. Its business with SME customers, though not directed by a specific strategy, and ruling out small enterprises, is sustainable and has a positive impact on employment, growth and the financial situation of its clients.

As EDFI funding represented a very small share of the bank's assets, its effects on the bank's balance sheet structure was modest too, except for the significant contribution of subordinated debt to the bank's capital adequacy ratio.

The financial instruments and terms applying to EDFI funding were designed to generally support the bank's growth strategy and to respond to demand from the private sector for longer term loans and foreign currency loans, not specifically to provide incentives to develop a structured SME banking line. EDFI funding, even when SMEs were specified as end-borrowers in the credit agreements (FMO), enabled the bank to respond to credit demand emanating from medium-sized enterprises as well as corporate customers. Since EXIMBANK grants a significant portion of its loans in foreign currencies and in the middle-range tenor, EDFI funding enabled EXIMBANK to respond better to market demand.

EXIMBANK started to diversify its risk by investing abroad and has plans to expand in Eastern Africa, in which EDFI members could play a role.

4.5 I&M Bank in Kenya

Name	Size	Total assets (USD m) as at 31/12/2012	EDFI shareholder(s) as at 31/12/2012
I&M	Middle-sized	1,064 (5)	PROPARCO, DEG
Active EDFI loans (1)	**SME promotion (2)**	**TA provided**	**SME promotion (3)**
EUR 1m/5yrs/EUR USD 5.5m/5yrs/USD USD 10m/7yrs/USD USD 15m/7yrs/USD USD 15m/5yrs/USD	No No Yes Yes Yes	Yes	Indirectly
Bank's SME definition		**No. and vol. SME loans (4)**	**Share of SME loans in total loans (4)**
Turnover/y: USD 300,000 – 5.5m Staff: 10 – 100 Loan sizes: up to USD 850,000		Nr.: Q2-2013: about 1,000 Vol.: Q2-2013: USD 282m (no historical data)	2-2013: 36%; (positive development 2008 – 2013 assumed)

(1) Face value of the loans which were still active as of end of 2012/loan tenor/loan currency

(2) SME promotion is defined as an objective as per project documents

(3) Contribution to capacity-building in SME banking

(4) Outstanding loans

(5) Unconsolidated

The bank and its strategy toward SMEs

A niche bank that became a dynamic and important player in the Kenyan banking sector, accompanied by EDFI members in Kenya and abroad …

I&M Bank was founded in 1974 by a Kenyan businessman of Indian origin and became a fully-fledged commercial bank in 1996. In 2003, I&M acquired the assets of another Kenyan bank and significantly increased its branch network and market share.

I&M has established itself as an important player in the enterprise and retail sector, particularly among the Asian communities in Kenya. The bank is planning to strengthen its positioning in the Kenyan market where it seeks to attain an overall share of 4-5% in the medium-term and 5-8% in the longer term. I&M started to open up to SMEs in 2008, which it defined as enterprises with turnover between

USD 300,000 and USD 5.5 m[29] employing 10 to 100 persons and with credit needs up to USD 850,000. Its management explains the bank's interest in the SME market with the higher interest margins compared to corporate customers and with the need to seek and nurture first quality business clients.

The bank wants to become a regional player with a presence in all major countries in Eastern & Central Africa and started to implement this strategy in 2008 with the acquisition of a 50% shareholding in First City Bank of Mauritius, which obtained a USD 6m Tier II loan from PROPARCO. In 2010, I&M acquired a 55% stake in a Tanzanian bank now rebranded as I&M Tanzania. Then, in 2012, it acquired a majority stake in a Rwandese bank alongside PROPARCO and DEG. I&M now seeks an opportunity to enter the Ugandan market.

Were the inputs relevant?

… with a relevant mix of equity, debt and technical support …

I&M's cooperation with EDFIs started in 2004 by way of senior lines of credit, and equity investment by PROPARCO. In 2007, DEG and PROPARCO both acquired stakes in the bank. As of the end of December 2012, I&M benefited from five active senior loans granted by PROPARCO (EUR 1 million and USD 5 million), FMO (USD 25 million) and DEG (UDS 15 million). Additionally, I&M benefited from a significant amount of technical support sponsored by DEG to improve on its MIS, risk management framework and tools.

The financial instruments used by EDFI were not specifically geared to resolving constraints in the bank's SME business line; their prime objective was to support I&M's overall growth strategy and its ability to respond to demand from the private sector for longer term loans and loans in foreign currencies. Both equity and debt funding were relevant on these counts as the bank has demonstrated its ability to serve a dynamic segment of the Kenyan business community and was in need of capital to sustain its growth, with no acceptable alternatives in the Kenyan market. Debt funding was also to contribute to reducing existing currency and liquidity mismatches, though these effects were to be modest due to the relative size of this funding compared to the bank's assets. Whilst a portion of the EDFI debt funding was explicitly meant for SME end-borrowers, the definition of these borrowers encompassed SMEs as defined by the bank as well as corporate customers. Nevertheless, long-term and currency funding was relevant for the bank's SME clientele. As I&M had a rather basic MIS and risk management framework at the project's onset, DEG-sponsored technical support was relevant from the point of view of sustaining management power.

[29] Conversion in USD with exchange rate as of 31/12/2012

What was the type of financial institution?

… for a medium-sized bank that had just started to open up to SME, with no specific strategy, except a conservative credit policy …

With an intention to earn higher margins, I&M opened up to SMEs in 2008. Thus, at the beginning of the reviewed project period (2007), it had not implemented dedicated products and services for SME clientele, nor had it a specific strategy or plans showing how it intended to go about the SME market, except for a deliberate very prudent approach to credit and its good standing in the Asian business community.

Was the environment favorable?

… operating in hazardous political and macroeconomic environments and a competitive banking sector.

Kenya's economic outlook was dim in 2007, following election violence, and ensuing internal and external shocks. Nonetheless, Kenya's good location, strong human resources, and vibrant private sector represented reasons for hope. Despite erratic inflation and increasing domestic borrowing by the public sector, banks found lending attractive enough as reflected by an increasing bank-loans-to-GDP ratio and strong growth in the banking sector relative to growth in the economy. Despite a high concentration of assets in the hands of a small number of major banks and numerous niche banks, competition was increasing among the medium-sized and large banks, thereby creating incentives for SME banking as a strategy to maintain adequate interest margins. Compared to the other East African countries, Kenya's business environment had not improved. In the banking sector, a major development was the creation of a credit bureau.

Has the FI increased capacity to provide financial services and specifically credit in forms accessible and attractive to SMEs?

To date, I&M's SME business has grown organically, with no specific targets, strategy and structures dedicated to it.

I&M has confirmed its reputation as a dynamic bank by broadening its product range to respond to the needs of its business clientele. Apart from having defined what it understands as an SME customer the bank has elaborated a strategy for its Commercial Segment, in which SMEs are included, and which has its own staffing and marketing policy. However, the SME strategy could be further refined by e.g. defining client segments or implementing additional marketing channels.

But EDFI technical inputs are meant to create conditions enabling the bank to structure its strategies for different customer segments.

The technical support sponsored by DEG should enable the bank to organize its MIS by customer segments, and I&M's management has decided that SMEs will be one of these segments. As a result of this, the bank was able to report on the composition of its loan portfolio by customer segments as of the end of March 2013.

Has the FI increased the number and/or volume of its transactions with SMEs?

Meanwhile, I&M has attracted a significant number of SME customers, to whom it granted loans, including long-term and foreign currency loans.

Despite the lack of historical data on the bank's operations with the clientele it defined as "SME", it can be estimated that I&M has achieved good results in terms of outreach. Even though it has a restrictive credit policy, I&M attracted a significant stock of SME customers (about 1,000), to which it also extended longer term loans and foreign currency loans. As of the end of March 2013, loans to SME customers represented 36% of the bank's total loan portfolio. The increase in the share of longer term loans in the bank's overall portfolio was concomitant to the increase in EDFI funding.

Is access to finance for SMEs sustainable?

I&M looks at the SME market as a source of future growth; its overall good results should ensure that the bank can maintain and develop this strategic business line…

EDFI funding helped maintain the bank's capital adequacy ratio at a high level. These investments had also a very positive effect on the bank's reputation and corporate governance. Less obvious was the contribution to reducing maturity and currency mismatches, due to the relative size of this funding compared to the bank's assets; as of the end of the reviewed period, I&M carried forward high liquidity mismatches in the 0-3 months bracket that needed close monitoring.

I&M did well in improving profitability on the back of increasing productivity. It also improved its risk management framework and performed better than the Kenyan banking sector in collecting deposits from the public, a task which might be difficult to sustain for a bank focused on clienteles that are structurally net debtors.

The bank's regional expansion strategy, supported by EDFI members, is set to help reduce risks for shareholders and lenders, and to improve services for customers.

What was the impact on SMEs?

… with plausible positive impacts on the development of Kenyan SMEs.

EDFI funding helped increase I&M's offer of MT and LT loans to its business customers, most likely also to SMEs, thereby facilitating the implementation of investment projects by the private sector in Kenya. I&M's SME clients appear to have grown at a stronger pace than the Kenyan economy as a whole, but this may have been caused by the fact that I&M grants its credit to best performers. The positive effect on employment cannot be ascertained as the share of labor-intensive sectors in the bank's loan portfolio remained unchanged during the considered period.

Conclusion

EDFI inputs were relevant and effective as to their effects on the development and sustainability of a dynamic bank.

The financial instruments and terms applying to EDFI funding were designed to generally support the growth strategy of a medium-sized and fast-growing bank well implanted in the Kenyan business community. Financial and technical inputs were well calibrated to improve on the bank's response to credit demand, maintain a high solvency ratio and improve on its management capacity.

The effectiveness of EDFI inputs on access to credit for SMEs was indirect, mainly by the right choice of partner financial institution.

By making a good choice of client financial institution, EDFI inputs, which were not specifically designed to provide incentive to develop I&M's SME business line, partly contributed to the bank's increasing its outreach to SME customers. Notably, I&M's good position in the market for import and export finance enabled it to allocate the foreign currency resources it borrowed to SMEs. EDFI inputs also contributed to strengthen I&M financial structure and management capability.

More focused instruments will be required for future cooperation targeting the SME market.

I&M has already drawn up a strategy and plans for the development of its SME business, which it considers as strategic. However, both strategy and plans could be further elaborated. Technical improvements in the bank's MIS are expected to soon put its management in a better position to analyze the contribution of SME clients to the bank's overall result and strategy. This will provide an opportunity for future cooperation with EDFI members to be more focused on the development of the bank's SME business line, in terms of type of inputs and covenants.

4.6 Zanaco in Zambia

Name	Size	Total assets (USD m) as at 31/12/2012	EDFI shareholder(s) as at 31/12/2012
Zambia national Commercial Bank (Zanaco)	Large	1,121	-
Active EDFI loans (1)	**SME promotion (2)**	**TA provided**	**SME promotion (3)**
USD 25m/5yrs/USD USD 10m/5yrs/USD USD 50m/5yrs/USD	Medium-sized enterprises	Yes	No
Bank's SME definition		**No. and vol. SME loans end of 2008 and 2012 (4)**	**Share of SME loans in total loans end of 2008 and 2012 (4)**
Turnover/year < USD 3.6m Loan sizes: up to USD 1m		Nr.: 967 → 1,112 Vol.: USD 13m → 21m	5.9% → 3.5%

(1) Face value of the loans which were still active as of end of 2012/loan tenor/loan currency

(2) SME promotion is defined as an objective as per project documents

(3) Contribution to capacity-building in SME banking

(4) Outstanding loans

The bank and its strategy toward SMEs

Zanaco: a newly privatized bank serving all segments of the Zambian population.

Zambia National Commercial Bank (Zanaco) started operating in 1969 as a state-owned bank, with the initial mission of delivering government payments, providing banking services to parastatals, and serving the lower to middle segments of the Zambian population through a large branch network. Zanaco was partially privatized in 2007, with the entry of Rabo Development (100% owned by Rabobank), which acquired 49% of the share capital and took over management control. In 2008, the privatization process was completed with a successful IPO.

Following Rabobank's arrival, the bank started a restructuring process that enabled it to become a leading commercial bank, serving all segments of the Zambian population as the "People's Bank".

The bank had started to serve SMEs before its privatization. However, due to inadequate methods, the portfolio quality was very poor. In 2008, the bank decided to implement dedicated business lines to target: (i) SMEs (defined as enterprises generating an annual turnover of less than USD 3.6m, which can be granted loan amounts of up to USD 1 million); and (ii) agricultural clients, ranging from small-scale farmers to large agricultural corporates.

Zanaco's management states that serving SMEs falls within its mission. In this market, the bank has been focusing on (i) providing funding but also banking services, and (ii) controlling credit risk, the SME segment being considered as particularly risky. It now intends to introduce and focus on secured financing schemes, taking advantage of the opportunities offered by partnerships with its corporate clients (e.g. invoice discounting, secured order financing, buyer financing, etc.).

Were the inputs relevant?

Three USD-denominated senior loans to support the Bank's overall restructuring: inputs were relevant with regard to Zanaco's needs, though not specifically geared to SMEs.

FMO and PROPARCO's relationship with Zanaco started in 2008, right after the privatization, when Zanaco was looking for long-term funding to finance its restructuring and grow its loan book. Since 2008, FMO and PROPARCO have together provided three senior loans, in 2008, 2009 and 2011, for a total of USD 85m. All three loans were provided jointly, under the lead of FMO.

The project's objective was to support Zanaco's restructuring process to become a strong profitable bank that would support private-sector development in Zambia. An impact on medium-sized enterprises and agribusinesses was expected, in view of the bank's overall strategy.

EDFI loans, which were the bank's first external borrowings, addressed the bank's two main financial constraints: the need for USD- and long-term funding, which was not available locally. The bank was thus facing a significant exchange rate risk and a very high liquidity risk. However, when considering the SME business specifically, the constraints faced by Zanaco in 2008 were more on a technical side than on a financial side: with a poor-quality existing SME portfolio, the main challenge was to build capacity and to change clients' minds by fostering a strong reputation in professional portfolio management. Since SMEs (as defined by the bank) only borrowed in local currency, EDFI funding could not be directly used to grow the segment's portfolio.

What was the type of financial institution?

A well-suited partner institution: large-sized bank, just taken over by a SME and agriculture-oriented reputable group.

The recent entry of Rabo Development as lead shareholder taking over the bank's management was a key advantage. As a reputable international group, Rabobank had shown its capacity to implement professional approaches, and demonstrate its financial strength and its strong commitment to private-sector and agricultural development in Africa.

Despite a poor-quality portfolio, at project start, the bank had clear competitive advantages in the SME market: (i) it was the third-largest bank in Zambia, with an extensive branch network, (ii) it had built links with agricultural organizations; and (iii) it had implemented dedicated capacity, professional processes and tools starting from 2008, with the main objective of improving the SME portfolio quality.

Was the environment favorable?

An improving environment for SME sector development.

Macro-economic trends, as well as an improving business environment, sustained development of the SME sector, while increasing competition between banks encouraged portfolio diversification as well as SME lending. The introduction of a credit bureau also supported the development of SME lending, since it significantly helped banks assess and manage SME credit risk.

Has the FI increased capacity to provide financial services and specifically credit in forms accessible and attractive to SMEs?

Strong capacities built…

Driven by Rabobank's vision, Zanaco implemented dedicated strategies to serve SMEs and the agricultural sector. The new management therefore set up dedicated departments to focus on each of these two segments. Processes, methodologies and tools were introduced and periodically improved, with the main objective of improving risk management and building a sound portfolio.

Has the FI increased the number and/or volume of its transactions with SMEs?

… which translated into improved quality of the SME portfolio more than its growth.

As far as the SME line is concerned, Zanaco's strategy was to focus on deposit and banking services, rather than credit facilities, due to a high level of risk. This resulted in strong growth of the SME deposit base (+141% between 2008 and 2012). In terms of credit, the bank focused on improving portfolio quality - which was achieved -, and primarily targeted larger SME customers. This led to 85% growth of the portfolio but a stagnating number of facilities. Overall, the share of SMEs in the bank's total portfolio remained below 5%. EDFI funding was provided at a time where Zanaco was focusing on improving SME portfolio quality rather than on its growth and hence could not significantly contribute to strong development of the SME loan portfolio.

Although EDFI funding has been modest in comparison to the bank's assets, the development of Zanaco's total long-term loan portfolio is closely related to the funding received from its European partners: it enabled the bank to grant medium and long-term loans, including to SMEs. With an SME portfolio that remained much smaller than EDFI funding, this contribution has been only partial.

Is access to finance for SMEs sustainable?

EDFI funding helped consolidate the bank's financial structure and hence the sustainability of SME business outcomes.

In 2012, Zanaco reported a very good financial performance and a sound financial structure. EDFI funding directly contributed to reducing maturity gaps, and to increasing capacity to provide long-term USD loans: (i) EDFI provided Zanaco with long-term resources that significantly helped reduce maturity gaps; (ii) by providing USD funding, EDFI directly helped sustain growth of USD lending operations; and (ii) indirectly, one can reasonably assume (as mentioned by management) that EDFI funding helped the bank secure additional borrowings from international lenders (AfDB and IFC loans secured in 2010 and 2011).

As at end December 2012, Zanaco had a sound financial structure and a good profitability, which had both improved over the project period. With a limited weight in the bank's total resources, EDFI could only have a limited impact on the bank's overall financial strength. As per management accounts, the SME business line's contribution to the bank's overall profit has been positive. However, since a limit on interest margins has now been imposed by the authorities, the profitability of the bank's SME credit business may be affected.

What was the impact on SMEs?

Detailed data on SME clients were not available. Nevertheless, the share of labor-intensive business sectors, agriculture in particular, in the bank's total portfolio significantly increased over the project period, indicating a positive impact on employment. Interviewed SMEs were overall satisfied and reported a positive impact of medium and long-term loans received from Zanaco on their businesses.

Conclusion

EDFI has effectively supported Zanaco's evolution into a strong commercial bank serving all segments of the population, with a dedicated but cautious approach for SMEs.

EDFI funding contributed to Zanaco's successful implementation of its strategy after privatization and after Rabobank came in: it helped consolidate the overall financial structure and reduce maturity gaps, although its weight in the bank's total resources remains limited.

In terms of SME finance, the funding had a direct impact on medium-sized agricultural corporates that borrowed in USD. However, these agricultural corporates do not fall into the bank's definition of SMEs (they are a step larger). Nevertheless, it can also be reasonably considered that it has had an indirect impact on SMEs, insofar as it contributed to the overall situation of the bank, allowing it to allocate funds to the SME segment. The choice of the FI, especially considering Rabobank's role, was probably the key element that led to the creation of capacity to serve the SME segment with a positive impact.

4.7 CAL Bank in Ghana

Name	Size	Total assets (USD m) as at 31/12/2012	EDFI shareholder(s) as at 31/12/2012
CAL Bank	Medium	611	PROPARCO
Active EDFI loans (1)	**SME promotion (2)**	**TA provided**	**SME promotion (3)**
USD 15m / 8yrs / USD USD 7.6m / 7yrs / USD USD 10m / 7yrs / USD	Yes Yes Yes	Yes	No
Bank's SME definition		**No. and vol. SME loans end of 2010 and Q1-/2013 (4)**	**Share of SME loans in total loans end of 2008 and 2012 (4)**
Turnover/y: USD 25,000 – 1.25m Loan sizes: USD 5,000 – 250,000		Nr.: 270 → 330 Vol.: USD 4.8m → 8.8m	3% → 1.5%

All figures as of end of 2012 if not indicated otherwise

(1) Face value of the loans which were still active as of end of 2012/loan tenor/loan currency

(2) SME promotion is defined as an objective as per project documents

(3) Contribution to capacity-building in SME banking

(4) Outstanding loans

The bank and its strategy toward SMEs

CAL Bank: a long-standing and fast-growing EDFI partner, with the ambition to maintain its position as one of Ghana's leading banks in the corporate and SME business space.

CAL Bank started operating as a Merchant Bank in 1990. In 2004, it obtained the Universal Banking License from the Bank of Ghana (BoG) and became a retail commercial bank providing financial services to a broad range of clients: large corporates, SMEs, and public sector institutions, as well as retail customers. SMEs are defined by CAL as enterprises whose yearly turnover is comprised between USD 25,000 and USD 1.25 m and to which the bank grants credit facilities from USD 5,000 to USD 250,000[30]. CAL Bank's interest in the SME market is primarily motivated by the goal of collecting deposits. CAL Bank now has a network of 19 branches and 50 offsite ATMs across Ghana.

One of the leading banks in the corporate business space, CAL Bank increased its assets fivefold during the period 2007-2012. Its strategy is to retain a position as one of the leading banks in the

[30] Conversion in USD with exchange rate as of 31/12/2012

corporate and SME business space. It focuses its commercial efforts on high-growth sectors, such as the oil sector, real estate and the food industry.

CAL Bank's partnership with an EDFI member dates back to 1994, when PROPARCO provided its first loan.

Were the inputs relevant?

EDFI inputs were partly relevant but not designed to directly influence, or solve specific constraints in the bank's SME business.

In 2008, CAL Bank obtained a joint eight-year USD 15m loan from PROPARCO and DEG, followed by an additional seven-year loan of USD 10 m from PROPARCO in 2011. In 2012, PROPARCO became a shareholder of CAL Bank via a private placing of shares and currently holds 6.9% of the bank's share capital.

PROPARCO also supports CAL Bank in the implementation of an environmental and social management system.

The fact that PROPARCO provided equity by participating in an oversubscribed private placement casts doubts on the additionality of this investment. As to the loans in USD extended to CAL Bank by PROPARCO and DEG, they were relevant in 2008 to address the liquidity mismatch in the short term bracket, much less in 2011 when they were relatively small compared to the bank's size. EDFI loans were primarily relevant to enable CAL Bank to respond to growing demand from its corporate customers for FCY loans.

Even though their objective is to promote the SME sector, none of the EDFI inputs can be seen as having been designed to directly influence, or solve specific constraints in, the bank's SME business.

What was the type of financial institution?

A medium-sized bank with no specific strategy for the SME market …

At the beginning of the project period considered in this study, CAL Bank had defined what it understood as an SME client but had no strategy specifically designed for the SME market; SME customers were dealt with by its Retail and Business Banking department.

Was the environment favorable?

… operating in a moderately favorable environment, …

In 2007, there were positive perspectives in the Ghanaian economy, despite double-digit inflation. But Government domestic borrowing discouraged banks from lending to the private sector. Nonetheless, competition was getting stronger in the banking sector, yet not enough to provide strong incentives for banks to go down market to the SME sector. The business environment was improving, especially conditions for enterprises to access finance, including the legal conditions to establish credit bureaus.

Has the FI increased capacity to provide financial services and specifically credit in forms accessible and attractive to SMEs?

… CAL Bank hasn't become an SME-oriented bank yet, but it has implemented an interesting approach to SME finance …

CAL Bank cannot yet be designated as a SME-oriented bank; its interest in the SME market is primarily motivated by the goal of collecting deposits. Nonetheless, without having an elaborate strategy for the SME market, or structures dedicated to SME customers, CAL Bank has implemented a clear "arms' length" approach to SME finance: it lends its credit to enterprises able to pledge tangible assets amounting to 1.5 times the loan's value in case of new borrowers and are transparent enough, or to SMEs that are suppliers to its corporate clients, so as to not have to incur the cost of analyzing their creditworthiness and financial situation in details.

Has the FI increased the number and/or volume of its transactions with SMEs?

… but with a limited outreach so far.

CAL Bank's approach to SME finance does not allow for a large outreach; with about 330 loans outstanding as of the end of the first quarter of 2013 and the SME portfolio amounting to less than 2% of the bank's loan book at the end of 2012, CAL Bank's outreach to the SME sector is marginal in terms of funding. But the bank had a 10-times higher number of SME depositors, which indicates that it is capable of offering services other than loans that are appreciated by SMEs.

Is access to finance for SMEs sustainable?

CAL Bank has experienced strong growth and is a profitable bank, very likely to sustain its present approach to SME banking.

EDFI equity investments helped maintain CAL Bank's capital adequacy ratio above the level required by law. EDFI debt funding contributed to easing CAL Bank's short-term liquidity situation in 2008; although EDFIs remained important providers of external funds to the bank, later investments were small relative to the bank's fast-growing size, and must have had a marginal effect on its liquidity and profitability.

As domestic deposits went from representing 59% of total liabilities in 2007 to 74% in 2012, CAL Bank was able to diversify away from borrowed funds. Nonetheless, a large portion of the deposits is collected from institutional customers in the form of time deposits, which are less stable and more expensive than smaller retail deposits.

CAL Bank became more profitable during the time period considered, as it benefited from increasing economies of scale. The contribution of its SME customers to its overall result is unknown and must be rather small. Nonetheless, since its management regards SME customers primarily as a source of deposits, the bank is very likely to sustain its operations with these customers in their present forms.

What was the impact on SMEs?

CAL Bank has made a relevant contribution to increasing access for SMEs to formal financial institutions.

CAL Bank must be seen as an attractive player in the SME finance market for its interesting approach to SME finance via linkages with corporate clients. Although its outreach is limited in absolute numbers and compared to its size, the bank has developed a relevant method to increase access for SMEs to formal financial institutions. Moreover, CAL Bank contributed to the provision of longer-term funding for SMEs, thereby enabling the implementation of investment projects.

Conclusion

EDFI inputs might have indirectly contributed to the development of the SME sector through CAL Bank.

As EDFI inputs cannot be seen to have significantly contributed to CAL Bank's approach to SME finance, their impact on the SME sector must be regarded as indirect; they probably contributed to the development of the SME sector via the loans extended by CAL Bank to corporate customers that are clients of SME suppliers, and also by enabling CAL Bank to allocate long-term resources in Ghanaian Cedi to SMEs as these resources were freed up by the funds in USD it received from its foreign partners. Only a very small portion of CAL Bank's SME borrowers received loans in hard currencies.

5. Findings

5.1 Preliminary remarks

(1) Although the projects included in the sample can be considered as representative of FIs commonly supported by EDFIs, the small number of cases studied limits the possibilities to generalize on the basis of the findings.

The following findings were obtained by qualifying observations made along the contribution chain, linking determinant factors to observable project results and, when these observations suggested a causal link between determinant factors and results, applying a reasoned plausibility check on such possible relations (see section 3.1). Hence, these findings are to be seen as the result of a methodical attempt to explore the research questions. While they provide useful indications as to which factors have influenced the effectiveness of the projects studied here, they cannot be extrapolated to all similar projects carried out by EDFI members.

(2) The heterogeneous quantity and quality of data collected from client FIs also limits the empirical content of the present findings.

For the purposes of the present study, we requested a set of data from client FIs that they were not used to producing. It was thus quite a difficult exercise for most of them.

Client FIs' ability to provide the requested data primarily depended on the data entered in their information systems:

- In most cases, the banks had defined what they understood as "SMEs" but did not mark out these clients in their databases. FIs were thus not able to report on their SME clientele base or portfolio. In such cases, we had to use other segmentation criteria to analyze portfolio data. (e.g. enterprise portfolio trends, loan sizes and amounts, etc.)
- Detailed client data (turnover, profit, etc.), as well as historic data, were in most cases not available in the banks' information systems, limiting possible analyses on clients and trends.

Lastly, management or staff had often changed at both bank and EDFI level, limiting historic memory on funded projects.

(3) The findings were derived from more detailed analyses of the six banks in the sample (see appendix 3). These analyses were carried out on the basis of a wide range of sources, such as project documents provided by the EDFI members, interviews with the financial institutions and data provided by these institutions (see also section 3.5).

The project assessments as summarized in section 4 are based on a more extensive analysis not included in this main report, but in a separate appendix; the summaries presented are not the sole basis for all of the findings presented hereafter.

5.2 Summary of evaluations of elements in the contribution chain

The following schedule displays the evaluation results obtained by using the method described in section 3.3.2 for the six banks in the sample. Dark blue fields indicate that the scores obtained for the determinant factors and the projects' results (outputs, outcomes and impacts) were high (2.5 and above); average scores are presented in light blue, and low scores (below 1.5) in white.

		BOA-U	DFCU	Eximbank Tanzania	I&M	Zanaco	CAL
Factors							
1. Were the inputs relevant?	Relevance with respect to the FI's specific needs and constraints for the development of its SME business						
	Relevance with respect to the FI's overall financial, institutional and managerial needs and constraints						
	Input combination	C	C	C	D	C	C
2. What was the type of financial institution?	Size of client FI	SM	SM	SL	SM	SL	SM
	Existence and implementation of SME banking strategy						
	History of co-operation with EDFI members						
3. Was the environment favorable?	Macroeconomic						
	Financial sector						
	Business						
	SME sector						
Outputs							
4. Has the FI increased capacity to provide financial services and specifically credit in forms accessible and attractive to SMEs?	Capacity increase in SME banking						
	Accessibility of credit products for SMEs						
	Attractiveness of credit products for SMEs						
Outcomes							
Outcome 1: 5. Has the FI increased the number and/or volume of its transactions with SMEs?	Volume SME Portfolio (nr and volume)						
	Quality of SME loan portfolio						
Outcome 2: 6. Is access to finance for SMEs sustainable?	Client FI's financial strength						
	Client FI's ability to secure domestic resources						
	Contribution of SME business line to FI's profitability						
Impact							
7. What was the impact on SMEs?	Employment generation	not scored					
	Growth and financial situation of FI's SME clients						

Input combination:
A = Projects without EDFI TA inputs
B = Project with EDFI TA inputs geared to SME banking
C = Projects with TA inputs geared to institution strengthening
D = Project with EDFI TA inputs geared to SME banking <u>and</u> to institution strengthening

Size of institution:
SL = Large bank (over 5% of total banking assets as of T0)
SM = Medium-sized bank (from 2% to 5 % of total banking assets as of T0)
SS = Small bank (under 2% of total banking assets as of T0)

High scores for determinant factors indicate, for instance, that at the beginning of the projects studied here, the project inputs were, in the consultants' opinion, highly relevant for the purpose of increasing access to finance for SME. High scores obtained for project outputs and outcomes indicate a high degree of achievement of these results, again reflecting the consultants' judgment. Due to the scarcity and the heterogeneity of the data obtained, no reliable scores could be obtained for the projects' impacts.

The above schedule highlights possible links between determinant factors and project results, namely when similar scores were obtained for these elements in the contribution chain. For instance, Bank of Africa and Zanaco obtained high scores for the existence and implementation of SME banking strategies at the beginning of the project and also for the increase in their capacity to serve SME clients during the project, indicating a possible causal link between a determinant factor and a project output.

In the following two sections, the assessments of the determinant factors and of the project results will be discussed separately. In section 5.5, possible links between these elements will be discussed.

5.3 Evaluation of determinant factors

5.3.1 Were the inputs relevant?

(1) EDFI project inputs were highly relevant with regard to the overall needs of Client FIs.

The due diligence work in preparing project approvals places considerable emphasis on analysis of the financial situations, thus providing a good understanding of each FI's financial constraints and needs. Overall, the client FIs' financial situations were sound – hence had limited financial risk from EDFI's perspective, with weaknesses identified in areas such as maturity mismatches, currency risks, and capital adequacy. In such cases, (i) the type of financial inputs were designed to help improve the situation and (ii) specific covenants and related reporting requirements were included, providing incentives for the FIs to improve on their financial stability.

Managerial capacities were also properly analyzed in EDFI project documents, leading to identification of specific training or capacity-building needs. In most cases, the technical assistance provided addressed such needs. EDFI provided training support mainly in the field of environmental and social management, as well as in financial risk management.

(2) Overall, project inputs were not specifically geared to addressing specific constraints with regard to SME finance or banking. Nor were they designed to incentivize banks to develop SME lending.

The factor "Relevance of the project's inputs with respect to the Client FI's needs for development of its SME business line" was considered as weak in all cases: this assessment resulted from the consultants' understanding of this indicator, i.e. whether the provided inputs were specifically aimed at removing particular constraints for the development of the Client FI's SME business line, as defined by the Client FI.

Most EDFI funding that was provided to the banks studied here targeted SME development. However, typically, the EDFIs' approach to development finance is to provide funding to financial institutions in view of strengthening them, thereby increasing their ability to serve a variety of customers, including SMEs. EDFI support is normally not made available to develop a particular line of business, except those that require long-term funding and/or funding in foreign currencies.

Hence, EDFIs did not specifically assess the Client FIs' needs and constraints (financial, technical, etc.) with regard to SME finance prior to investing. Inputs could thus not be specifically designed to address such constraints nor to support SME business development. Specifically:

- The type of funding did not fully match SME funding needs: whereas long-term funding was necessary to address SMEs' demand (SMEs' access to MLT loans is considered as one of the key obstacles to their development in most African countries), the fact that most EDFI loans were granted in foreign currencies (in USD in most cases) was a limiting factor according to the banks' management, (i) because most small and medium-sized enterprises do not earn income in foreign currencies, a condition for receiving FCY loans under regulations or banks' internal rules, and (ii) because Client FIs had opportunities to employ funds in foreign currencies to grant loans to corporate clients and were not prepared to bear the cost of hedging for the currency risk that they would have incurred, had they used EDFI funding to finance loans to SME in local currencies. Banks' management explained that, in most cases, EDFI loans were used predominantly in the corporate segment, and mentioned that they would rather need LCY resources in order to grow their SME loan portfolio.
- Technical inputs were, in most cases, not specifically oriented towards the development of structured SME lending or banking. In the case of one bank in Uganda, at least, we believe that this would have been needed to strengthen its credit appraisal methods prior to the economic and financial crisis which hit the country in 2011 and caused its SME loan portfolio to deteriorate.
- Funding agreements did not include specific SME-oriented incentives. In only a few cases were SME designated as eligible sub-borrowers and only in one case (BOA) were quantified objectives in terms of SME business development specified. Accordingly, there were no specific reporting requirements with regard to the development of the Client FIs' SME business line. No targeted incentives were thus provided with respect to SME finance.

Although this aspect was not taken into consideration in forming an opinion on the relevance of inputs with regard to the development of the FIs' SME business line, we noted that there was no analysis in the project documents guided by the objective of enhancing a given financial sector with financial products that were missing or insufficiently offered, such as leasing, factoring, guarantees, etc..

5.3.2 What were the types of financial institutions?

(1) In most cases EDFIs have been cooperating with medium-sized banks with significant growth prospects.

Most of the banks belong to the mid-sized banking segment in their respective countries, where the financial sector is characterized by the dominance of a few large banks controlling a large portion of the sector's assets, and many small banks operating in niches. Since the larger banks may have access to financial resources at better conditions than those offered by EDFIs, and the small banks are considered too risky or opaque, mid-sized banks are “natural” partners for EDFI members.

(2) All FIs had defined “SME” segments, which they considered as “strategic”. But rarely had they invested in creating dedicated capacity to serve this segment.

EDFI conducted due diligence on the overall FI’s situation and thus chose well-managed FIs with overall sound financial situations. The banks’ businesses and strategies are described in EDFIs’ finance proposals, though not analyzed in detail with regard to the SME segment, as defined by the banks themselves.

Whereas all FIs had definitions for “SME customers”, and stated that this business segment was “strategic”, only two had invested in specific organisational structures for their SME business lines. These two banks had also defined specific strategies for the SME segment. The other banks had grown their SME business “organically” and had it managed either by their “retail” departments (two banks), their “corporate” department (one bank), or scattered in two business units (one bank).

Most banks had not defined any operational reporting system to monitor their business with SMEs, and had thus difficulty providing data on SME clients and loan portfolios.

5.3.3 Were the environments favorable?

Although macro-economic environments were rather bad, conditions in the financial sector were favorable in most cases.

The macro-economic environments were rather bad with uncertain economic prospects, except in Tanzania and Zambia, where most indicators showed positive trends. The business environment was nonetheless found to be rather good and in most cases improving, according to World Bank’s “Doing Business” assessments. Conditions and prospects in the SME sector were found to be rather bad in Eastern Africa, due to the uncertain environments affecting SMEs particularly, but more promising in Zambia and in Ghana.

However, the financial sector environment was favorable in most cases: increasing competition, favorable interest rate trends, as well as improvements in the financial infrastructure (credit bureaus), could encourage banks to target new market niches, SMEs in particular.

5.4 Evaluation of outputs, outcomes and impacts

5.4.1 Have the FIs increased capacity to provide financial services and specifically credit in forms accessible and attractive to SMEs?

(1) Capacity in SME banking did not increase much in most cases: no dedicated strategies, structures, and management tools were implemented.

Whereas attractive products are generally offered, with product and service ranges that were broadened over the projects' periods, no dedicated structures (distribution channels, business units, dedicated staff) were set up or strengthened in most cases. Traditional distribution networks (branches) nonetheless expanded, enabling client FIs to reach out to more SME clients. Nonetheless, except for BOA-U and Zanaco, the FIs had no dedicated strategy for the SME market, and none had action plans for the implementation of an SME strategy.

(2) Client FIs had in most cases conservative approaches to SME banking, which led to rather low improvement in terms of credit accessibility.

Most of the visited banks had implemented "relationship banking" approaches, relying on good knowledge of the client. Such approaches could have enabled them to offer accessible lending services, but, with the exceptions of BOA-U and DFCU, which were particularly open to small enterprises, the FIs had conservative credit policies, making their credit not easy to access, particularly for small enterprises. Due to high risks perceived in the SME segment (especially following the economic crises in the past years), the FIs preferred to focus on high-quality clients, and therefore defined restrictive eligibility criteria and collateral requirements. They also did not invest in active marketing to attract large numbers of new clients.

Only CAL Bank (Ghana) implemented an interesting "arm's length" approach, targeting SME within the supply chains of its larger corporate clients.

(3) Products and services offered to SMEs were nonetheless considered as quite attractive by the banks' existing SME clients, especially with the provision of medium and long-term facilities.

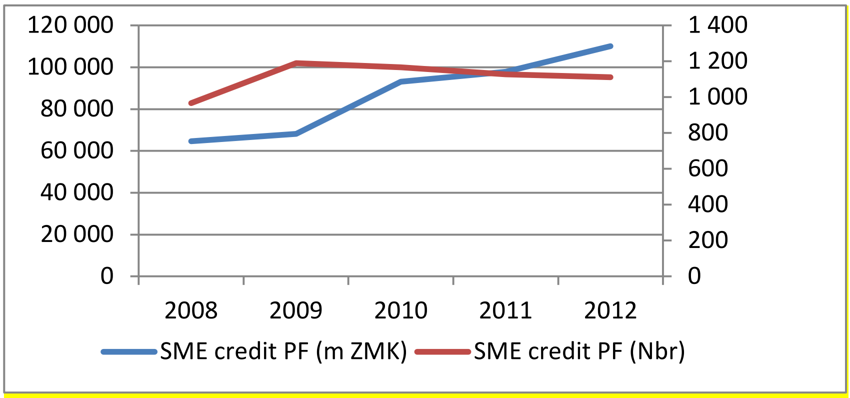
In most cases, existing SME clients met with during the banks' visits were satisfied with the banks' services. It is to be noted, though, that these clients were chosen by the banks. The banks were rarely able to provide data to calculate reliable client retention rates that would confirm that they have been able to keep their SME clients satisfied over a longer period of time. Nevertheless, the increased provision of medium and long-term loans to SME matches one of SMEs' critical needs in African countries.

5.4.2 Have the FIs increased the number and/or volume of their transactions with SMEs?

(1) Most of the FIs under review focused on the quality of their SME portfolios and therefore did not greatly increase their SME credit portfolios.

The increase in the number and the volume of transactions, specifically credit, with SME customers, was assessed as better than for the creation of capacity for SME banking but was still viewed as quite disappointing, mainly due to a majority of cases where the client FIs did not pursue a strategy of attracting a large number of SME customers, preferring to focus on a few high-quality clients.

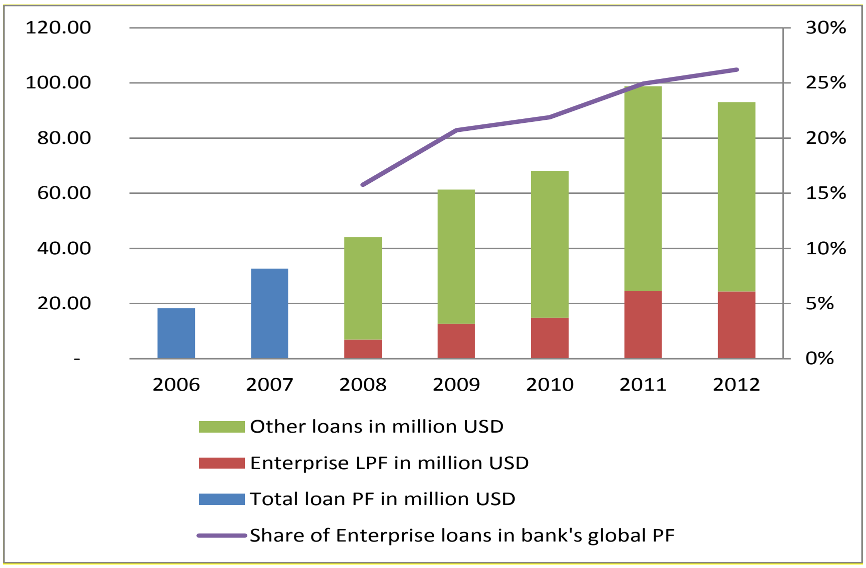
The trend in Zanaco's portfolio, as shown in the graph below, illustrates this bank's strategic focus on high-quality clients – in most cases larger enterprises -, resulting in a significant increase of the SME portfolio amount, but also in a stagnating number of SME loans.



Graph 1: Zanaco's SME portfolio- No. and volume. Source: Zanaco

(2) I&M and BOA-U significantly increased their SME portfolios over the projects' periods.

I&M's results were quite strong on this criterion, but the bank had only started its SME lending operations quite recently. BOA-U also performed well on this criterion, with a sharp increase in the share of enterprise loans in the bank's total portfolio, as illustrated by the graph below. This high growth, however, may have contributed to the deteriorated quality of the portfolio in 2012 in the context of an economic and financial crisis.



Graph 2: BOA-U: share of "Enterprise" (SME) loans in the total portfolio. Source: BOA-U

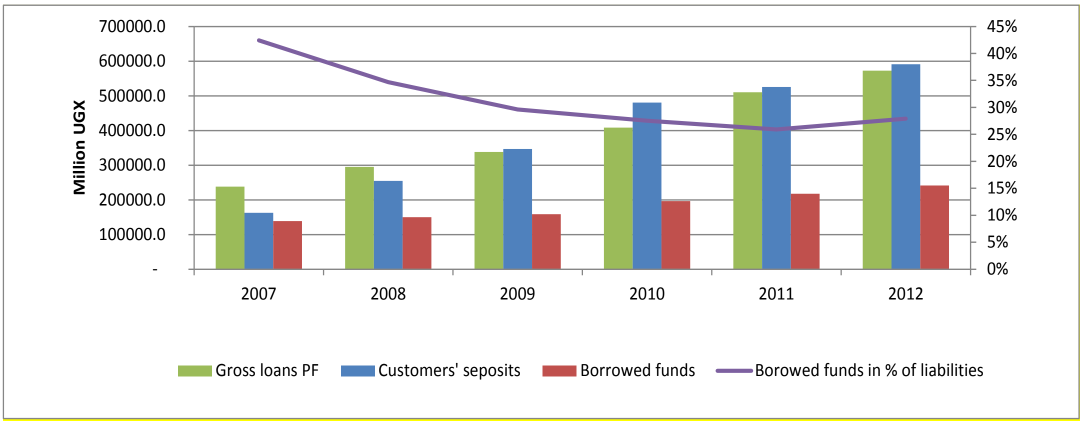
5.4.3 Is access to finance for SMEs sustainable?

(1) With increased financial strengths, as well as a high ability to collect domestic deposits, the sustainability of the provision of financial services by the studied FIs has also improved.

In all cases, significant improvement in the bank's financial situations was observed over the project periods. In particular, reduced liquidity and foreign exchange mismatches were noticeable, as was an increase in capital adequacy ratios.

Profitability trends, as measured by cost-to-income ratio, ROE and ROA, also improved significantly in many cases, showing the banks' ability to efficiently manage their businesses and to offer their services on a sustainable basis. The overall quality of the banks' portfolios was in several cases mitigated or deteriorating, mainly due to economic downturns occurred during the past two years.

As shown for DFCU in the following graph, most banks were able to secure domestic resources, with increasing domestic deposit portfolios.



Graph 3: DFCU: Share of domestic deposits in total liabilities. Source: DFCU

(2) Nonetheless, the contribution of SME business lines to the FIs' profitability could not be assessed, nor could it be considered as positive for half of the FIs in the sample.

Except for Zanaco, which had recently introduced management accounts with segmental income statements, no bank was able to measure the contribution of their SME business lines to the bank's overall result.

Nonetheless, our assessments led us to consider that the project performance was quite weak in terms of financial sustainability when looking at the "Contribution of the Client FI's SME business line to its overall net result" in three of the six cases analyzed. In the case of the two Client FIs in Uganda, this was due to doubts expressed by their management about their business with small enterprises as a contributor to the bank's overall results, while in the case of the Zambian bank, it was due to the very small size of this business line relative to the bank's size, as well as to the high level of non-performing SME loans.

With no proven positive and significant contribution to their profitability, and the frequent absence of a dedicated strategy for this market, the durability of the banks' SME focus can be questioned, as these banks could quickly decide to pull back from this market, or at least renounce lending to small enterprises, as was the case for some of them, thus not contributing to closing the frequently observed gap between microfinance and bank finance ("missing middle").

5.4.4 What was the impact on SME customers?

Due to limited availability of data, the impact criteria could not be rated. Nonetheless:

- The increased provision of MLT loans certainly had a positive impact on these enterprises' financial situations and growth potential. Access to MLT funding was often cited as very positive by SME clients interviewed during field visits.
- The contribution to employment generation - as per the analysis of breakdowns by sector of the banks' total loan portfolio - appeared quite positive, with increasing shares of the labor-intensive agriculture, manufacturing and construction sectors observed in most cases.

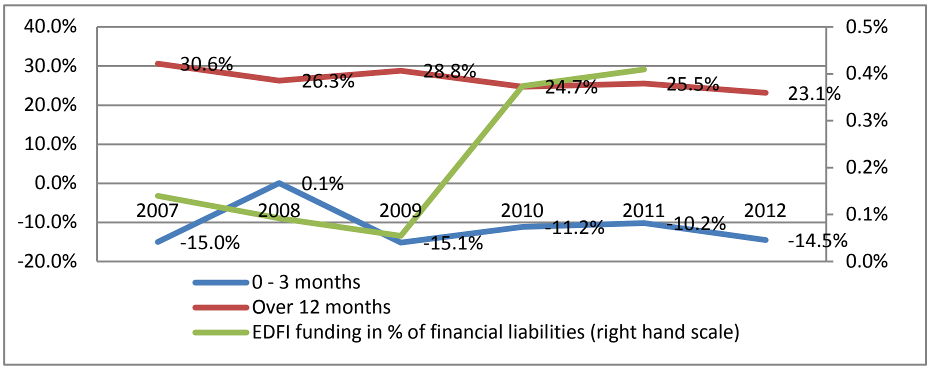
5.5. Identification and analysis of determinant factors

5.5.1. How did the types of inputs influence projects' outcomes?

(1) The fact that EDFI projects focus on the Client FIs' overall needs – financial and technical - clearly contributed to very good project outcomes in terms of sustainability and thus to increased sustainability of the supply of financial services to the Client FIs' various clienteles, including SMEs.

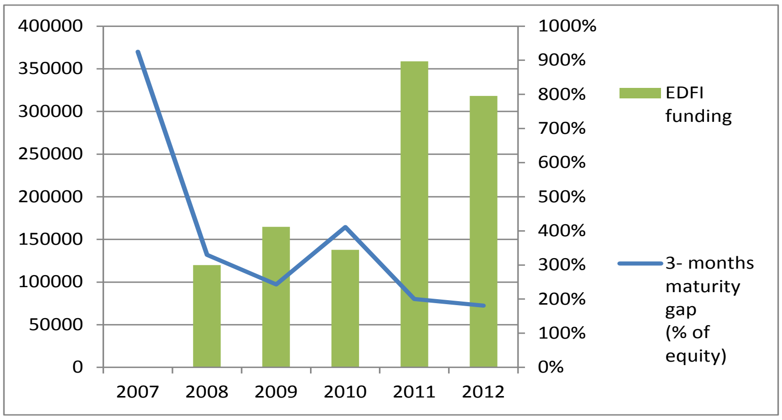
The match between inputs and the Client FI's overall needs led to very good project performances in terms of sustainability: inputs contributed to improving Client FIs' strength, both in terms of managerial skills and financial strength (financial structure, profitability), as illustrated by the following three cases, where there is a clear correlation between EDFI funding and the trend in the Client FI's financial strength:

- I&M: contribution to reducing liquidity gaps:



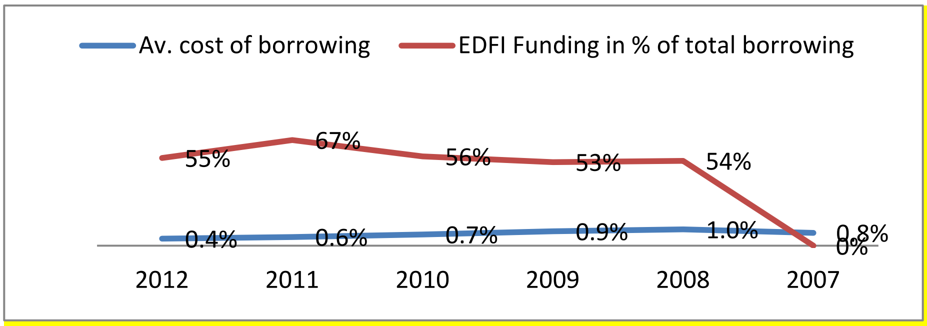
Graph 4: I&M – Liquidity gaps as a % of equity vs. EDFI funding as a % of financial liabilities. Source: I&M

- Zanaco: reduction of maturity mismatches:



Graph 5: Zanaco: EDFI funding vs liquidity gap. Source Zanaco.

- BOA: EDFI funding appears to have had a positive effect on the overall cost of borrowed funds, which fell as EDFI funding increased:



Graph 6: BOA-U: EDFI funding vs cost of borrowings. Source: BOA-U

Although the increased strength and profitability of the client FIs is not an SME specific outcome, it is a key factor influencing the expected durability of the banks' ability to provide their clients, including

SME, with attractive products and services; sustainable serving of SME clients further requires that banks' SME business contributes positively to their net result.

(2) EDFI funding did not discourage the Client FIs' from searching out domestic resources.

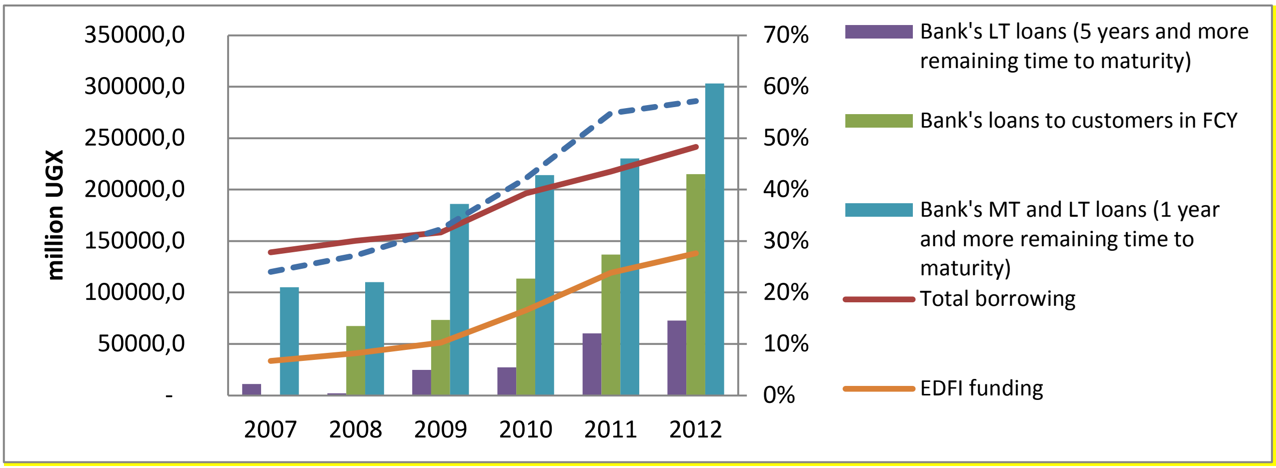
All banks showed a high level of capacity to secure domestic resources. This indicates that receiving EDFI funding did not discourage them from designing and implementing plans to attract more domestic resources. This is due to several factors:

- As mentioned by the Client FIs' management (e.g. DFCU), the pricing of EDFI funding was progressively increased, in line with market conditions, thus encouraging the FIs to search out low-cost local resources.
- In some cases (e.g. Zanaco) with large networks, the bank had already built a solid deposit base, and focused on its development in order to also sell related fee-generating banking services.
- Local currency resources were required for banks to extend their micro and small-loan portfolios, as the latter mostly consisted of LCY-denominated loans.

(3) In all six cases, the provision of long-term funding led directly to increased medium and long-term loan portfolios.

The provision of long-term funding, which was not available locally at project inception, was one of the key constraints for banks to grant their clients (including SMEs) attractive loan products.

EDFI inputs hence enabled client FIs to address SME clients' needs for medium and long-term funding. The graph below shows a clear link between EDFI funding and DFCU's LT loan portfolio.



Graph 7: DFCU- MLT loans vs EDFI funding. Source: DFCU

(4) As EDFI input combinations have typically not been designed to incentivize banks to grow their SME business, nor specifically geared to addressing the Client FI's constraints with regard to SME finance/banking, a link between the type of inputs provided and outcomes in terms of capacity created and SME portfolio growth cannot be seen.

As mentioned above, most SMEs require longer-term finance in local currency to finance their development. Due to the high costs of hedging the currency risk, EDFI finance is provided in hard currencies in most cases. Since the client FIs preferred to lend the foreign currency loans they received to enterprises qualifying for foreign currency loans, in most cases corporate customers, EDFI foreign currency funding's contribution to SME portfolio growth was indirect, to the extent that financial resources that the FIs would have otherwise allocated to other customers were freed up to contribute to their SME business lines. But this indirect contribution is difficult to ascertain in the absence of a baseline "stock-taking" of the FI's performances in its SME business line, and the measurement of progress made during the lifespan of the projects thereafter.

Expected developments in terms of SME finance were not clearly specified (except for one loan to BOA-U), neither in project assessment documents nor in funding agreements. This clearly limited the banks' incentive to develop their SME business.

As no specific SME banking-related inputs were provided by the EDFIs, changes in the parameters on the supply side were up to the banks and dependent on other factors.

5.5.2. How did the type of financial institution influence projects' outcomes?

(1) Projects carried out with FIs having a clear strategy for SME banking appear more successful insofar as the increase in capacity to serve these clients over the project period is concerned. However, this does not appear to be a sufficient condition for a strong increase in outreach.

Banks that had made investments in their SME business line appear to have performed better in terms of capacity increase in SME banking during the lifespan of the projects studied. A causal link can be assumed because existing investments indicate a bank's genuine interest in the SME market. Aside from the two banks that had just started to open up to SMEs at the moment when the projects started (CAL bank and I&M), a direct link also seems to exist between existing capacities for SME banking at the project outset and outreach (indicated by an increase in the size of the SME loan portfolio). However, increased outreach (which was typically not strong) did not necessarily go hand in hand with an increase in capacities for SME banking. These findings indicate the possibility that project inputs that are directed more towards increasing capacities for SME banking may lead to better results in terms of outreach, at least in cases when the projects are implemented at financial institutions that have demonstrated a genuine interest in SME banking.

On the other hand, there are reasons to believe that external funding and technical support will not be the only incentives for a bank to decide to invest in the development of SME banking; probably more important are factors in the environment and how such a business line fits in with the bank's overall strategy. In any case, these findings are strong enough to recommend that a bank's interest in the

SME sector is substantiated by tangible actions (i.e. investments in strategy, products, structures, staff, etc.) to develop an SME banking business line.

(2) The hypothesis that smaller banks would be more likely to serve SMEs could not be credited with empirical evidence based on the data on capacity-building and outreach collected from the small number of cases studied. However, discussions with the banks' management indicate that medium-sized banks have a higher strategic interest in serving SMEs than large banks.

Most banks visited were medium-sized. And most of them, including the large banks, had implemented "relationship banking" approaches, whilst one medium-sized bank (CAL bank) had implemented an "arms' length" approach. Nevertheless, discussions with the banks' management provided reasons to assume that:

- Medium-sized banks tend to have a higher interest in developing SME business line, probably due to their earning structure: the weight of interest income in their total revenues is higher than for large banks; as SME portfolios generate higher interest margins, they can make a greater contribution to banks' profits.
- Conversely, large banks have more diversified income structures, due to more diversified fee-generating banking services provided through larger distribution networks and a broader range of clientele. For that reason, their interest in developing SME lending operations is probably lower.

(3) From the point of view of sustainability, the EDFIs' approach to supporting Client FIs in their regional expansion plans, which also helps facilitate regional exchanges and mitigate risks, is promising.

In the case of BOA and Zanaco, EDFIs were financing banks that were part of a pan-African group in which they have acquired stakes. In the case of I&M and EXIMBANK, EDFIs are accompanying these banks in their regional investment strategies, thereby helping foster regional exchanges, knowledge sharing (including strategies and approaches for the SME and the agriculture sectors), and reducing the risk taken on these banking institutions by their shareholders and lenders.

5.5.3. How did the environment influence projects' outcomes?

(1) The quality of the business environment appears to have had a positive influence on the creation of capacities for SME banking at the client FIs. Another causal link seems to exist between the quality of the financial sector and outreach.

A link can be observed between the "business environment" factor and the "increased capacity in SME banking" output. Causality can be supposed due to the fact that banks are more inclined to make such investments when they see opportunities in the SME sector, which, in turn, are positively influenced by the quality of the business environment. But no link can be seen between the quality of the business environment and the increase in the banks' SME loan portfolio (outreach).

Another causal link between the quality of the banking sector and outreach ("increase in the banks' SME loan portfolio" outcome) is suggested by the data collected. This may be explained by reasoning that competition between banks and the existence of important elements in the financial infrastructure (credit bureau, registry for collateral securities) lead banks to allocate more resources to SME.

(2) Other links between outcomes and environment variables cannot be recognized from the data collected for the cases used in this study. Nonetheless, the influence of environment factors on SME outreach can be observed through banks' behavior.

Because SMEs are considered more vulnerable to factors in the environment, one would expect banks would tend to increase their business with them when the environment looks favorable. This does not seem to have been the case for the projects studied here. Notably, where the business environment had shown the greatest improvement before the beginning of the projects studied, the banks operating in these environments were not those that increased their volume of transactions with SME customers the most.

The absence of a recognizable link may of course be related to particular cases included in the small sample. The situation for the banks that performed well in terms of capacity building (BOA-U and DFCU in Uganda) and outreach (I&M in Kenya), despite an unfavorable macroeconomic and business environment, suggests that the environment is an important factor nonetheless: in the cases of the Ugandan banks, increasing their market share in the SME segment was clearly defined as a strategic objective. But both banks were, in the end, disappointed by the effects of the economic and financial crisis in 2011/12, which affected the quality of their SME loan portfolios, and their management decided to review their strategies for the SME market segment. They particularly developed a stronger preference for medium-sized enterprises that were viewed as more solid and better endowed with assets. With regard to I&M in Kenya, this bank has a very specific approach to SME lending, which consists of doing what the Ugandan banks are planning to do now, i.e. focusing on solid SME business clients first of all, while the larger number of SMEs in Kenya enables it to build up a portfolio with such prime clients that is almost comparable to what the Ugandan banks achieved.

The generally unfavorable macroeconomic environment in most countries visited can be considered a factor explaining why, on average, the Client FIs have not been willing to strongly increase their exposure towards SME customers. We found that Client FIs' managers generally thought that interest margins for loans to SME clients are (obviously) higher than for corporate clients, and sometimes also higher than for loans to individuals. But these managers were also well aware of the fact that these clients are fragile and affected the most by economic downturns. An insecure environment can explain the strategy of banks to: a) focus on medium-sized enterprises, which are more resilient than small ones; b) grant longer tenor loans to SMEs on a very selective basis; and c) prefer to focus on a smaller number of well-selected clients rather than to aim at a mass business, using tools such as scoring. In fact, the construction of statistically-tested scorecards requires using data on loans to the targeted clients that has been collected over a longer period of time during which factors in the environment must have been sufficiently stable.

In insecure business environments, small businesses are not incentivized to increase their transparency by adopting entirely formalized business practices, notably the production of trustworthy financial accounts. Opaque enterprises lead to increased intermediation costs, which is why banks are not very inclined to deal with them. Microfinance institutions are better prepared to assess the credit risk with informal businesses, but are constrained in their up-market strategies by limited resources.

This invariably leaves a “missing middle” which finds it particularly difficult to get access to credit from the formal financial sector.

Nonetheless, as explained in section 5.5.1, banks could achieve better results in terms of accessibility of their credit and of outreach if they were to develop more specific strategies for their SME business segment, thereby making good use of approaches aimed at reducing the cost of collecting information on “semi-formal” businesses. An interesting example is offered by CAL bank which has developed support for a supply chain of Ghanaian companies that provide goods and services for their corporate clients.

5.6. Conclusions

EDFIs typically implemented projects with medium-sized banks with significant growth prospects. These banks were operating in rather unfavorable macro-economic environments, while improvements in the respective financial sectors were observed.

All FIs under review had defined “SME” segments, which they considered as “strategic”. But rarely had they defined specific strategies to approach these clients or invested in creating dedicated capacities to serve SMEs. Most FIs could not provide data on the development of their operations with their SME clients or demonstrate how this business line had contributed to their overall results.

Most of the banks studied had not significantly increased their capacity to serve SMEs since the start of the projects studied and the increases in their SME loan portfolios were generally modest. The majority of the Client FIs had conservative approaches to SME banking, which led to rather small improvements in terms of credit accessibility. Nonetheless, evidence was found that the banks had increased the portion of MT and LT loans in their SME portfolios, thereby helping these clients to implement investments.

EDFI project inputs were highly relevant with regard to the overall needs of Client FIs and therefore clearly contributed to very good project outcomes in terms of sustainability of the supply of financial services to the FIs’ various clienteles, including SMEs. Nonetheless, as already mentioned, the contribution of their SME business lines to the Client FIs’ profitability could not be assessed, nor is it likely to even have been positive for half of the FIs in the sample.

With respect to sustainability, it is worth mentioning that EDFI funding did not discourage the Client FIs’ from mobilizing domestic deposits and that the approach of several EDFI members to supporting the Client FIs in their regional expansion plans helps facilitate regional exchanges and mitigate risks.

Overall, project inputs were designed to support the partner banks’ overall strategies, rather than being specifically geared to addressing specific constraints with regard to SME finance or banking. Nor were they designed to incentivize banks to develop SME lending, for instance by requesting reports on the development of SME credit or banking operations in the framework of the funding agreements. As a result, a link between the type of inputs provided and outcomes in terms of capacity created and SME portfolio growth could not be confirmed.

On the other hand, the data collected indicates that projects carried out with FIs with a clear strategy for SME banking are more successful as far as the increase in capacity to serve these clients is concerned. But as no clear link between increased capacity in SME banking and increased outreach becomes apparent from the data collected, other factors must have a strong influence on the banks' decisions, notably factors in the environment in which they operate: the data analyzed suggests that the quality of the business environment has a positive influence on the creation of capacities for SME banking at the client FIs. Another causal link seems to exist between the quality of the financial sector and outreach, i.e. the development of SME loan portfolios. It was observed that banks notably display a preference for the relatively larger, medium-sized enterprises when the economic environment deteriorates, as they consider these enterprises as more solid and better endowed with assets.

The study's results furthermore suggest that, all other factors being equal, projects with banks that have demonstrated their interest in the SME sector by investing in dedicated strategies and structures will probably yield better results than banks that have not taken such an approach.

The hypothesis that smaller banks would be more likely to serve SMEs could not be credited with empirical evidence based on the data on capacity-building and outreach collected from the small number of cases studied. However, discussions with management of the banks visited suggests that medium-sized banks have a higher strategic interest in serving SMEs than large banks, which have more possibilities to increase their earnings with fee-based services offered to a broader range of clients.

Due to limited availability of data, the projects' impact on the Client FIs' SME customers could not be properly assessed. Nonetheless, although a causal link with the projects' inputs could not be established, it can be considered that the increased provision of MLT loans had a positive impact on these enterprises' financial situations and growth potential. It was also found that most of the banks studied had augmented their credit to labor-intensive businesses, including SMEs.

6. Recommendations

The following recommendations are proposed, based on the findings of this exploratory study. These recommendations intend to be practical, and mostly concern the design and management of EDFI projects aimed at increasing access to credit and other financial services for SMEs in African countries. As they are derived from findings based on a small number of case studies, often using heterogeneous sets of data, these recommendations are meant to serve as a basis for discussions among – and within the organizations of - the EDFI members.

6.1 Recommendations for the design of projects

(1) For projects intended to augment access to credit for SMEs, small and medium-sized banks having invested in dedicated strategies and capacity for their SME business lines should be considered as the most favorable type of partners.

As also shown by the literature, this study suggests that small and medium-sized banks are more inclined to develop their business with SMEs. The study's results also indicate that banks that have a structured approach to the SME market (strategy) and have invested in dedicated capacities to serve these enterprises are more likely to continue doing so.

(2) Working with large banks should not be ruled out, as they may use original approaches with promising results.

As shown by the case for CAL Bank in Ghana, there are large banks implementing original approaches to SME banking that consist of offering a large range of financial services, not only credit, and using "arm's length" approaches, such as the provision of credit to SMEs that are suppliers of their corporate clients. However, such approaches require certain conditions in the legal and regulatory framework and also specific institutions. Hence, EDFIs should critically assess whether the business and financial sector environment allows such projects to be effective.

(3) When needed, client financial institutions should be offered support to invest in development of their SME business / SME banking capacity.

This support should be focused on strategy and marketing for the SME sector, with a view to helping management define objectives, client segments, products and, as the case may be, dedicated distribution channels and staff. Other important areas for technical support involve reducing operating costs and improving credit risk management for the banks' SME banking operations..

(4) Most of the banks studied found it difficult to provide operational and financial reports on their SME business. To overcome this hindrance, they need to implement adequate management information systems. Support in terms of MIS project management would respond to their needs.

Equally important is to help banks implement management accounting systems and other business reporting tools. With these tools, management is able to get operational and financial reports by client segment, which in turn will enable the bank refine its strategy for these business segments. In that way, a good MIS can be a driver for a financial institution's willingness to invest in particular client segments.

It is worth noting here that a number of the banks visited for this study are implementing elements of management information systems. We found they faced problems when dealing directly with providers of software solutions, often because these projects are large and complex and thus overburden their management and IT units. We believe that the banks should be assisted in the field of MIS project management.

(5) Whenever projects are specifically aimed at increasing access to credit and financial services for SMEs, Client FIs should demonstrate that they are making progress in these fields, i.e., to show results in return for the funding they receive.

Projects aimed at increasing SME access to financial services, including credit, should clearly specify what is expected from the supported financial institutions in terms of actual progress in the development of their SME business lines. Expected progress in SME banking or finance should be: (i) clearly specified at the project outset; (ii) baseline measured and monitored, using agreed indicators and (iii) rewarded if achieved.

Ideally, a baseline study should be the starting point. This study should (a) demonstrate that the financial institutions have realistic plans and strategies for the development of their SME business line and (b) propose a set of targets and indicators to measure progress.

Progress should be defined in terms of:

- increased capacity to serve SMEs (products, organization, staffing, distribution channels, etc.); and
- positive SME portfolio trends (number of customers, volume of operations, quality indicators). Indicators should be relatively easy to measure with the data available in the bank's MIS. If needed, specific MIS support could be considered to enable the client FI to issue operational reports on its SME business (see above).

The present study can be a starting point for the development of such indicators. Agreed progress in the Client FIs' SME banking operations should be defined based on specific business development plans/projections prepared by the Client FIs themselves, so as to fit well in their overall strategies and to be in tune with their capacities, corporate culture, risk appetite, and definitions of SMEs. These plans should also be critically assessed with regard to how realistic they are in a particular environment and for a particular financial institution (financial and technical constraints).

For the purpose of rewarding progress in SME banking or finance, funding could be granted to the financial institution by way of sub-agreements to a framework agreement. The framework agreement would commit a maximum amount of funding that the financial institution will be able to draw, starting from an initial drawdown granted with the usual conditions set on the basis of a due diligence. Further drawdowns will be subject to progress in the development of the financial institution's SME banking or finance, whereby the expected progress and the indicators used will be specified in the framework agreement, together with the usual financial covenants. The incentive for a financial institution will consist of the possibility of securing a larger amount of funding with one single agreement, provided that it complies with the financial covenants and meets the conditions pertaining to agreed progress in its SME business line. A time limit should be defined for the drawing of each tranche and of the totality of the committed funding after which the EDFI member, or members, will reduce or cancel their commitment.

(6) When SME access to finance is the objective, EDFI funding can, but does not need to be directly channeled to SME finance. What matters is that the client financial institutions will respond by increasing their outreach to the SME sector, using either the resources provided by EDFI members or other resources.

As was the case for most of the projects analyzed in the framework of this study, funding can be granted with the prime objective of contributing to the client financial institution's overall strategy and needs. Therefore, funding can be extended in hard currencies if the client financial institution has opportunities to lend these funds to its corporate customers or to other client segments. What matters is that EDFI inputs will contribute to the growth and sustainability of the client financial institution by providing resources it cannot raise in the local credit or capital market, and – if provision of financial services to SME is aimed for - that the client financial institution will respond to this by increasing its outreach to the SME sector, using either the resources provided by EDFI members or other resources, such as domestic deposits.

EDFIs are additional to the market and provide funding in markets and to clients that cannot easily obtain such funding from commercial parties on workable terms. This should give EDFIs sufficient leverage to impose conditions on their client financial institution, asking them to either expand credit to SMEs with their domestic resources, or to bear the cost of a currency swap/hedge so that EDFI-supplied funding can be used to finance non-exporting SMEs.

6.2 Recommendations for cooperation and further research

(1) EDFIs should work together on improving project effectiveness by analysing results using common tools.

Lack of data (historic and SME portfolio data) is a constraint on evaluating and hence improving the effectiveness of EDFI SME finance projects. Data collection and evaluation tools should therefore be developed and shared between EDFI members, and serve as a basis for continuous improvements of EDFI approaches:

- A common framework for SME project baseline studies could be developed, and shared between EDFIs.

- A common set of indicators to be reported by client FIs and to measure their progress in the field of SME banking and finance could be defined. It should include indicators aimed at measuring (a) capacity created, (b) outcomes in terms of SME business volumes and (c) SME business sustainability. Business indicators should be limited to simple, easy-to-produce ones that are included in, and add value to, FI clients' MIS, and impose acceptable reporting burdens.
- Share evaluation results and lessons learnt.

Harmonization – along the lines of the IFI harmonization initiative – will help the development of shared methods (e.g. baseline studies) and the communication of results achieved.

(2) Further research on a broader sample of EDFI clients would make it possible to draw stronger conclusions with regard to hypotheses that could not be sufficiently tested within this study, in particular concerning the type and size of client financial institutions and the importance of the environment as determinants of effectiveness.

Testing some of the hypotheses derived from the literature review would require further investigation on a larger sample. In particular, the hypotheses that:

- *"The type of financial institution is likely to be a factor explaining differences in project achievements".* While the study's results seem to indicate that small and medium-sized banks are more inclined to develop their SME clientele, this should be further researched with a broader sample including:
  - A larger number of small, medium, and large-sized financial institutions,
  - Not only banks, but also microfinance institutions (moving up-market) and/or other types of Non-Bank Financial Institutions (SME specialized financial institutions, leasing companies, etc.)
- "*The environment in which financial institutions operate is not only likely to set absolute boundaries on their efforts to develop SME finance, but it may also determine their choice of strategies*". This hypothesis gained some strength with the results of this study. Nonetheless, its validation would require a much broader sample covering more diverse environments, and hence different regions of the world.

HORUS
DEVELOPMENT FINANCE

A report prepared for the association of bilateral European Development Finance Institutions, EDFI

Evaluation of the Effectiveness of EDFI Support to SME Development through Financial Institutions in Africa

Final Report

Appendices 1: Sample

Appendix 2: Detailed evaluation indicators

Mai 2014

1. Sample

1.1. Preliminary sample

EDFI's Steering Committee defined the preliminary sample composed of nineteen financial institutions, including a large majority of commercial banks, several non-bank financial institutions and a development finance institution.

#	Region	Country	Financial Institution (FI)
1	East	Kenya	Alios Kenya
2	East	Kenya	Bank of Africa Kenya
3	East	Kenya	I and M Bank Limited
4	East	Uganda	Bank of Africa Uganda Limited
5	East	Uganda	DFCU Bank Limited
6	East	Tanzania	Alios Tanzania
7	East	Tanzania	Bank of Africa Tanzania
8	East	Tanzania	Exim Bank Limited
9	East	Madagascar	Bank of Africa Madagascar
10	South	South Africa	First Rand Bank Limited
11	South	South Africa	Real People Investment Holdings Limited
12	South	South Africa	Sasfin Bank Limited
13	South	Zambia	Norsad
14	South	Zambia	Zambia National Commercial Bank
15	South	Zimbabwe	NMB Bank Limited
16	West	Ghana	CAL Bank Limited
17	West	Ghana	Fidelity Bank Limited
18	West	Nigeria	Access Bank PLC
19	West	Nigeria	Stanbic IBTC Bank PLC

1.2. Sample of selected FIs

The following table includes key data on the seven FIs selected as part of the sampling exercise.

Financial institution	BOA	CAL Bank Ltd	DFCU Bank	Eximbank Ltd	Fidelity Bank Ltd	I and M Bank Ltd	Zambia National Commercial Bank
Country	Uganda	Ghana	Uganda	Tanzania	Ghana	Kenya	Zambia
Region	East	West	East	East	West	East	South
DEG							
Proparco							
FMO							
Norfund							
EDFI members' earliest investment	1996	2006	2005	2006	2010	2004	2008
SME specific funding by EDFI members	yes	yes	yes	yes	yes	yes	yes (agriculture)
Extend of non-EDFI support	Substantial but recent	Does not seem to be dominant	Substantial, but does not seem to be dominant	Does not seem to be dominant	Does not seem to be dominant	Does not seem to be dominant	Does not seem to be dominant
Data availability	yes	yes	yes	yes	yes	yes	yes
# of EDFI members involved	2	2	4	3	3	3	2
Multi-instruments (EDFI)	yes	yes	yes	no	no	yes	no
SME-lending related TA (EDFI)	yes (before 2007)	no	partly	no	no	indirectly	no
Comments	* IFC, Feb 2011: 5 year senior loan of up to $5 million, with a 2 year grace period to Bank of Africa Uganda. The IFC Loan will be combined with an advisory services program to the Bank under the Africa Micro Small Medium Enterprise Finance Program * EIB loan for SME finance (2011, 5 Ugandan banks) * But EDFI member (FMO) support started sooner and is substantial	* Small bank (total assets end 2011 = 311 million EUR); EDFI funding can make a difference * IFC used to hold 16.45% shares of CAL BANK; was largest shareholder * Very specific SME funding products	* IFC invested equity (25% shares bought in 1984, key shareholder for over 20 years) and debt; * Substantial KfW/GoU funding * SME lending related TA was provided by FMO * The bank used to be an MFI, interesting case	* IFC 2005: "Since its inception in 1997, Exim has been targeting the credit market for Small and Medium Enterprises" * Good case story * TA: Proparco/IFC: "Capacity building by way of intensive training for the Bank's staff and management and by transferring result-oriented, premier practices in SME banking skills through a twinning arrangement with a topranking financial institution."	* "SME" mentioned in the bank's annual report; no other evidence that the bank has a dedicated business line * middle sized bank (EUR 408 million total assets end of 2011)	* Large bank (954 million total assets end of 2011); EDFI members equity holding: 21% * SMEs only mentioned in annual reports in reference to DEG financing; nothing particularly SME-specific on website * Support seems to be geared towards export finance incl. SME sector	*FMO: "FMO has not financed this institution (in any of the three loans outstanding) with a specific use of fund. Zanaco does finance SME's although is not typically considered an SME bank. Therefore Zanaco should not be part of this EDFI evaluation." *Nonetheless, Zanaco has a dedicated SME banking unit according to its website

2. Detailed evaluation indicators

The following section presents the indicators and sub-questions used to attribute a score to each of the research questions.

2.1 Were inputs relevant?

Relevance of project inputs can be attributed a score (using a scale from 0 to 3, whereby 3 will be the best score) based on the consultant's expert judgment and the opinions of the Client FIs' management on the inputs' consistency with (a) the overall priorities and needs of the recipients (Client FIs) and (b) the specific objectives of increasing the Client FIs' capacities and actual transaction volumes with SMEs. A score can be attributed because it makes sense to consider that the more relevant project inputs are, the more likely is the achievement of these objectives.

Two types of indicators were used:

- Indicators to which nominal values can be attributed (for example: A, B, C); these values allow the computation of frequencies; they cannot be used to calculate medians, averages or correlations;
- Indicators to which ordinal values can be attributed (for example: 1, 2, 3), these values allow for the computation of frequencies and also of median and correlations. However, for practical reasons, the attributed values were deemed to have equal intervals, thereby qualifying as cardinal values with which arithmetic averages can be computed.

Indicators	Values
Relevance of Project's inputs with respect to the Client FI's needs for the development of its SME business line: Consultant's expert opinion formed on the basis of the following questions: ▸ Have the financial instruments and terms been solving the FI's constraints with regard to SME finance? ▸ Have the conditions (covenants, reporting requirements, etc.) incentivized the FI to develop its SME business? ▸ Have technical inputs been in line with the FI's constraints with regard to SME finance? ▸ Have other inputs been in line with the FI's constraints with regard to SME finance?	Quasi-interval values attributed to each question (max.: 3; min.: 0); arithmetic average of scores obtained for each question
Relevance of Project's inputs with regards to the Client FI's overall financial, technical and managerial sustainability:	Quasi-interval values attributed to each question

Consultant's expert opinion formed on the basis of the following questions: ▸ Have the financial instruments and terms contributed to solving the FI's financial constraints? ▸ Have the other inputs contributed to solving the FI's technical and/or managerial constraints?	(max.: 3; min.: 0); arithmetic average of scores obtained for each question

The combination of inputs cannot easily be attributed a score, because there is no theory which would sustain that a particular combination of equity, debt instruments and/or technical support has *generally* a stronger effect on a FI's performances in its SME business line than another.

Therefore, in order to make measurement possible, Projects can be categorized with the following nominal values:

A = Projects without EDFI TA inputs
B = Project with EDFI TA inputs geared to SME banking
C = Projects with TA inputs geared to institution strengthening
D = Project with EDFI TA inputs geared to SME banking and to institution strengthening

2.2 What was the type of financial institution?

The literature suggests that there is no one type of FI with which SME finance projects are more successful. On the contrary, previous studies seem to indicate that different types of FIs (small, medium-sized and large banks, NBFIs and MFIs) can all positively contribute to augmenting access of SMEs to financial services in their own way. Nonetheless, the size of the Client FI should be taken into account in the frame of this study to explore if differences in objective achievements could be appearing to be related to this factor. Also, there is obviously a case for differentiating between such Client FIs which had a previous experience in SME banking and those who had not. Finally, the length in time of the cooperation of the Client FI with EDFIs is another criteria which can be considered to have an influence on the achievement of objectives, not only because time matters to achieve objectives but also because a longer history of cooperation contributes to creating confidence and mutual understanding of each other's rules and objectives.

The following indicators were used:

Indicators	**Values**
Size of Client FI ▸ Large bank (over 5% of total banking assets as of T0) ▸ Medium-sized bank(from 2% to 5 % of total banking assets as of T0) ▸ Small bank(under 2% of total banking assets as of T0)	Nominal values: SL SM SS
Amount and relevance of actions and investments undertaken by the Client FI towards SME banking as of T0: Consultant's expert opinion formed on the basis of the following questions: ▸ Had the Client FI implemented dedicated products and services for the SME clientele? ▸ Had the Client FI implemented dedicated distribution channels for the SME clientele? ▸ Had the Client FI implemented dedicated organizational structures and/or staff for the SME clientele? ▸ Had the Client FI implemented a dedicated strategy for SME banking?	Quasi-interval values attributed to each question (max.: 3; min.: 0); arithmetic average of scores obtained for each question
Duration and nature of history of cooperation with EDFI members as of T0: ▸ Duration of the cooperation ▸ One or several EDFI members have been a shareholder before T0	Interval values: less than 3 y: 0 3-5 y = 1 over 5 y = 2 If yes, add 1 point

2.3 Was the environment favorable ?

The environment in which a Project takes place can have a strong influence on the Client FI's decision to invest in SME lending capacities and assets. A series of indicators were used to measure:

- the macro-economic environment,
- the sector environment, and
- the business environment.

Indicators	Values
Macroeconomic environment: Consultant's expert opinion formed on the basis of the following indicators: ▸ Growth perspectives as of T0 (GDP) ▸ Inflationary trend as of T0 ▸ Interest rates structure and trends as of T0 ▸ State's borrowing as of T0	Quasi-interval values attributed to each aspect (max.: 3; min.: 0); arithmetic average of scores obtained for each indicator
Sector environment: Consultant's expert opinion formed on the basis of the following indicators: ▸ Level of competition in the banking sector as of T0 ▸ Regulatory obstacles to SME lending as of T0 ▸ Financial infrastructure (credit bureaus, guarantee funds) as of T0	Quasi-interval values attributed to each indicator (max.: 3; min.: 0); arithmetic average of scores obtained for each indicator
Business environment: Consultant's expert opinion formed on the basis of the following indicators: ▸ Indicators reported by the World Bank in its "Doing Business" reports as of T0	Quasi-interval values (max.: 3; min.: 0)
SME sector: Consultant's expert opinion formed on the basis of the following indicators: ▸ Growth trends and perspectives in the SME sector as of T0 ▸ Existence of favorable sector policies and programs as of T0	Quasi-interval values attributed to each indictor (max.: 3; min.: 0); arithmetic average of scores obtained for each indicator

2.4 Has the client FIs increased capacity to provide financial services and specifically credit in forms accessible and attractive to SMEs?

Indicators	Values
Scaled up capacity to respond to SME demand for financial services: Consultant's expert opinion formed on the basis of the following questions: ▸ Has the Client FI implemented dedicated products and services for the SME clientele? ▸ Has the Client FI implemented dedicated distribution channels for the SME clientele? ▸ Has the Client FI implemented dedicated organizational structures and/or staff for the SME clientele? ▸ Has the Client FI implemented a dedicated strategy for SME banking?	Quasi-interval values attributed to each question (max.: 3; min.: 0); arithmetic average of scores obtained for each question
Accessibility of Client FI's credit for SMEs: Consultant's expert opinion formed on the basis of the following questions: ▸ Are the formal eligibility criteria defined by the Client FI allowing a large portion of the SMEs to get access to its credit? ▸ Are the bank's procedures and its actual practice allowing a large portion of the SMEs to get access to its credit?	Quasi-interval values attributed to each question (max.: 3; min.: 0); arithmetic average of scores obtained for each question
Attractiveness of loans and other financial services for SMEs: Consultant's expert opinion formed on the basis of: ▸ Interviews with SME clients ▸ Client retention	Quasi-interval values attributed to each indictor (max.: 3; min.: 0); arithmetic average of scores obtained for each indicator

2.5 Has the FI increased the number and/or the volume of its transactions with SMEs?

Indicators	Values
Evolutions in Client FI's SME customer portfolio: Consultant's expert opinion formed on the basis of the following indicators: ▸ Growth in the number of SME clients since T0 ▸ Growth in the volume of the Client FI's portfolio of loan to SME clients since T0 ▸ Evolution in the share of SME loans in the Client FI's global loan portfolio since T0 ▸ Achievement of the Client FI's targets for its SME business line (when available)	Quasi-interval values attributed to each indictor (max.: 3; min.: 0); arithmetic average of scores obtained for each indicator
Quality of the Client FI's SME loan portfolio: Consultant's expert opinion formed on the basis of the following indicator: ▸ Evolution and level of NPLs in the Client FI's SME loan portfolio	Quasi-interval values (max.: 3; min.: 0)

2.6 Is access to finance for SMEs sustainable?

Indicators	Values
Evolutions in Client FI's financial strength: Consultant's expert opinion formed on the basis of the following indicators: ▸ Capital adequacy ▸ Asset quality ▸ Liquidity risk ▸ Profitability ▸ Risk management framework	Quasi-interval values attributed to each indictor (max.: 3; min.: 0); arithmetic average of scores obtained for each indicator

Ability of Client FI to secure domestic resources: Consultant's expert opinion formed on the basis of the following indicators: ▸ Evolutions in the share of domestic financial resources in the Client FI's liabilities ▸ Plans developed by the Client FI to secure relatively cheap and stable domestic resources	Quasi-interval values attributed to each indictor (max.: 3; min.: 0); arithmetic average of scores obtained for each indicator
Contribution of the SME business line to the Client FIs' overall strategy and results: Consultant's expert opinion formed on the basis of the data and information collected at the Client FI.	Quasi-interval values (max.: 3; min: 0)

2.7 What was the impact on SMEs?

Measuring impacts, in terms of growth, financial situation and employment would require a set of corresponding data for sufficiently large samples of SMEs, which are not available at the Client FI's, at least not in standardized electronic formats. Moreover, establishing that the Projects have had an impact on growth, financial situation and employment of the SMEs served by the Client FIs would require undertaking measures on a sample of enterprises which have not benefitted from the loans granted by the Client FIs, to establish counterfactual evidence. Doing this is notoriously difficult, due to various methodological problems, such as, to mention only one, the difficulty of choosing comparable SMEs in the samples of beneficiaries and non-beneficiaries, owing to the fact that Client FIs can be expected to have extended their credit to the best performing SMEs and left aside the weaker enterprises.

Hence, in the framework of this study, impacts will be indirectly measured using the following indicators:

- For the impact on employment, the evolution in the share of labor-intensive business enterprises in the Client FIs' loan portfolio. These sectors are:
  - Agriculture,
  - Manufacturing,
  - Construction.
- For the impact on the growth and the financial situation of the Client FIs' SME customers, the evolution in the share of middle and long term loans in the Client FIs' enterprises loan portfolio. The underlying assumption is that middle and long term loans are
  - contributing to redress the enterprises' balance sheets in which, due to the scarce availability of long term external financial resources, longer term assets are frequently financed with short term loans, and
  - contributing to finance new investments which in turn are pre-conditions for the implementation of growth strategies.

Indicators	Values
Employment : ▸ Evolution in the share of labor-intensive business enterprises in the Client FIs' loan portfolio	Quasi-interval values (max.: 3; min.: 0)
Growth and financial situation: ▸ Evolution in the share of middle and long term loans in the Client FIs' enterprises loan portfolio	Quasi-interval values (max.: 3; min.: 0)