FMO EX-POST EFFECTIVENESS STUDY: (M)SME FINANCING IN A FRAGILE AFRICAN STATE - Evaluation executed by A2F Consulting

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Anonymised EXECUTIVE SUMMARY

CONTEXT AND OBJECTIVES

MASSIF is a fund of the Dutch Government managed by FMO, which supports the establishment and development of financial infrastructure in developing countries. MASSIF strives to be additional to other sources of finance, and as a result, is active in many high-risk countries, including post conflict and fragile states. In these countries, financial sectors are typically weaker and financial needs of SMEs tend to be underserved. MASSIF has a relatively high exposure in the fragile African State selected for this evaluation. MASSIF has invested in a local commercial bank, a leasing facility, a private equity fund, and a microfinance institution (MFI); all of which target micro-, small and medium sized enterprises ((M)SMEs) as their core clientele.

A2F Consulting was contracted by FMO to conduct this effectiveness study on MASSIF investments. The study aims to explore whether and how investment policies and client and instrument selection contribute to reaching optimal development results. Despite recent improvements, the country concerned remains in a precarious economic position. After a decade of negative growth, GDP growth picked up from 2009 to 2012, before slowing again in 2013 and 2014. The country's mining and manufacturing sectors are expected to continue to underperform and political instability has persisted. Political corruption is a significant concern as the country ranks very low on the Corruption Perception Index. Although quality of life indicators have improved, the country's human development is still categorized as "low" and progress towards Millennium Development Goals remains sluggish.

METHODOLOGY AND SCOPE

The evaluation took a theory-based approach to assess four key evaluation dimensions: relevance, effectiveness, additionality and attribution. A mixed methods technique was applied combining quantitative and qualitative analysis. The assessment at the (M)SME level was carried out primarily through a questionnaire-based survey of 67 MSME clients of the financial intermediaries. These SME clients consisted of all investees of the private equity fund, and 20 randomly selected clients of the leasing company, the bank and the MFI, respectively. A local consulting firm executed the survey. This firm is an experienced provider of marketing strategies in the country and ensured a fully randomized selection of (M)SMEs.

RESULTS

Overall, the evaluation concludes that MASSIF interventions in this fragile state are highly relevant and overall satisfactory. There is ample academic evidence that financial deepening helps create jobs and this partly happens through expanding SME finance, which is the essence of MASSIF's interventions. At the time of the investments by MASSIF, the country was emerging from a prolonged period of economic and political instability, with a deep recession and hyper-inflation. MASSIF provided its partner financial institutions (PFI) with scarce capital, while catalyzing investments from other institutions. As such, there was clear additionality for all investments except for the leasing company, where shareholders could also have provided more funding. MASSIF investments were found to be moderately effective, because two of the institutions faced a significant increase in non-performing loans (NPL) while growing their operations, one had its license revoked, and no conclusive judgment can be made yet for the fourth investment. The technical assistance was, therefore, also moderately effective in strengthening management capacity and, especially, in implementing Environmental, Social and Governance (ESG) improvements and systems.

The client survey results suggest that MASSIF investments may have been very effective in generating job growth and increasing revenue at SME level. 55% of SMEs surveyed stated that employment increased as a result of financial services received, and 79% agreed that revenues increased. The survey data shows that total employment increased by 54% after financial services were received (excluding clients of the private equity fund, whose investments were all still very recent). While 80% of clients of the MFI felt that they could not have received a similar financial service from another provider, the corresponding figures for the bank and the leasing company were 25% and 0%, respectively. While SME survey responses were largely positive, it is important to note that the overall investment by MASSIF was too small to make a significant MSME impact at the country's systemic level.

However, the attribution of the development outcomes observed to solely MASSIF's intervention is rather difficult. Currently, the evaluated bank stands out mostly because of its higher level of capital adequacy than its peers, but is underperforming its peers in terms of cost-income ratio and profitability. Similarly, only 5 of its 20 SMEs clients surveyed felt the financial product received from the bank was unique in the market. All of MASSIF's investments also benefitted from critical contributions of other stakeholders. This includes management teams with an established track record in all four institutions, as well other established investors. Except for the private equity fund, the technical assistance provided, which is a key distinguishing feature of MASSIF, has also not always been in areas of key importance for development outcomes.

MASSIF's interventions in this particular country are rated as satisfactory overall. In terms of comparative performance, the leasing company has been successful in meeting the needs of its SME clients by helping them to acquire productive equipment (machinery) and movable assets (commercial vehicles). In terms of outreach, the bank shows the best results. Due to its longer presence in the market, a stable source funding, and the robustness of its business, the bank serves a significantly larger number of clients compared with the leasing company or the MFI. In the case of the MFI, its current problematic situation is certainly the result of events beyond MASSIF's control. Based on client surveys, the MFI's operations, however, were most valued by its (M)SME clients. While the private equity fund is adequately performing, its outreach in terms of number of SMEs assisted is limited compared to other MASSIF investees. Having been created just a few years ago, the private equity fund's operational history is rather short but preliminary indicators point to sustainability in the long run.

LESSONS / RECOMMENDATIONS

In terms of lessons learned, the evaluation shows that MASSIF's intervention in difficult country settings can lead to double bottom line payoffs. However, MASSIF should seek to strengthen its quality at entry. Rigorous due diligence is even more important in such challenging business environments, given the existence of macro-prudential "contagion risks". Effectiveness would also be enhanced by adjusting the SME definition to the local context, and to have firmer agreements with investees on SMEs to be reached. Defining what is an SME, while taking into consideration the characteristics of the economic context in which they operate, is the first step towards being able to effectively measure the impact of any type of financial support to SMEs. Linking TA and ESG to investment is an effective way to raise awareness to promote more ethical and responsible finance, as well as to attract funds from other international and domestic sources. However, the assessment of TA needs should take place more systematically, and TA in (M)SME lending should receive a greater focus from the onset.