

Ex-ante Evaluation (for Japanese ODA Loan)

1. Name of the Project

Country:	The People's Republic of Bangladesh
Project:	Financial Sector Project for the Development of Small and Medium-sized Enterprises (SMEs)
Loan Agreement:	May 18, 2011
Loan Amount:	5 billion yen
Borrower:	The Government of the People's Republic of Bangladesh

2. Background and Necessity of the Project

(1) Current State and Issues regarding the Development of SMEs and the Financial Sector in Bangladesh

In recent years, Bangladesh has been maintaining a high rate of economic growth at 6% annually and is expected to show steady growth in the future. After the economic crisis in 2008, on the other hand, some decline and stagnation were seen in garment exports and remittances from overseas Bangladeshi workers that have been supporting the past economic growth. In order to aim at steady growth, productivity improvements and the expansion of incomes in the future, it will be necessary to diversify industries led by further enhancement of the manufacturing sector and expand domestic private investment.

The small and medium-sized enterprises (SMEs) in Bangladesh are said to generate 25% of the GDP on the basis of their added value and provide about 31 million jobs. They also account for about 60% of the total output of the manufacturing industry, and their sound development is expected to play a greater role in economic growth and poverty reduction in Bangladesh. On the other hand, such factors as the insufficient power supply, corruption, accessibility to land and finance, etc., are constraining investments in Bangladesh. In particular, the access to land and financial services have been considered the most serious constraints on SMEs.

In Bangladesh, financial services, in particular bank lending, has concentrated on large enterprises over a certain scale, whereas financial services to micro and cottage enterprises owned by the poor in many cases have been provided by microfinancing institutions, which have lately tended to increase in number and volume. However, SMEs that are positioned in between those two (they are referred to as the "missing middle") are subordinate in terms of access to finance. The amount of funds allocated to them is low compared to their contribution to the Bangladesh economy on a value added basis and, in particular, the medium- and long-term funds they require for facility investments have not been sufficiently provided. The factors inhibiting SMEs from borrowing from banks and financial institutions include stringent collateral requirements that rely excessively on land, high levels of interest rates, short lending periods, complicated loan procedures, etc.

In recognition of these issues, the Government of Bangladesh have taken a number of measures, including the establishment of the Small and Medium-sized Enterprise Foundation (SMEF) in 2006, the expansion of financing scheme to promote fund supply (Refinance Scheme) via the central bank, the Bangladesh Bank (BB), by receiving donor support from the World Bank (WB) and the Asian Development Bank (ADB).

(2) Development Policies for the Development of SMEs and the Financial Sector in Bangladesh and the Priority of the Project

The development of SMEs has been raised as a primary issue for economic growth in the Poverty Reduction Strategy Paper (PRSP), which is positioned as a top priority in the national development strategy, the National Strategy for Accelerated Poverty Reduction II, which was recently revised, and the Outline Perspective Plan (OPP) of Bangladesh 2010-2021: Making Vision 2021 a Reality. Furthermore, a cabinet decision was made in September 2010 on the revised version of the Industrial Policy originally established in 2005, in which the need for a Refinance Scheme and other policy support for SMEs were pointed out. In addition to the expansion of the Refinance Scheme as mentioned above, the BB, which had been assuming the role of a supplier of funds, also created a department exclusively in charge of SMEs in December 2009 and announced a financing policy and program for SMEs in March 2010.

(3) Japan and JICA's Policy and Operations for the Development of SMEs and the Financial Sector.

In the light of Japan's Country Assistance Program for Bangladesh (May 2006), JICA has positioned the development of SMEs and the financial sector in Bangladesh as a priority area for the "private sector development" among development issues pertaining to "economic growth," which is one of the priority sectors for aid.

JICA has not so far provided specialized support for the development of SMEs and the financial sector in Bangladesh. In the area of private sector development, however, studies on growth for export diversification, the dispatch of experts to the Board of Investment in Bangladesh, and the Rural Development Credit Program for the Grameen Bank, etc., have been supported.

(4) Other Donors' Activities

The following donors have mainly provided support for the development of SMEs in Bangladesh and many other donors have participated in this support:

- ADB and WB (IDA): Providing support credit rationing for local SMEs and female entrepreneurs through the Refinance Scheme via the BB.
- International Finance Corporation (IFC) and UK Department for International Development (DFID): Providing support to build credit information systems for SMEs within the BB.
- In addition to the above, European donors and the United States Agency for International Development (USAID) have provided support to build a value chain for SMEs.

(5) Necessity of the Project

The Government of Bangladesh has positioned the development of SMEs as a priority sector for the development of its industries. The role of SMEs is considered likely to expand further in the future in order for the promotion of industrialization and exports led by the manufacturing sector of the country. On the other hand, the financial sector, mainly banks, is currently concentrated on lending for large enterprises and the short-term lending for working capital needed for the commercial sector. In consequence, they have failed to meet the demand for funds for the medium- and long-term facility investments of SMEs. Therefore, the supply of medium- and long-term funds for SMEs has a significant role in terms of economic growth and poverty reduction in Bangladesh. The Project is aimed at the improved access to finance for SMEs in Bangladesh through financial support via a Two-Step Loan, and it is also in line with the priority area specified in foreign aid policy of Japan and JICA. Thus, the necessity and relevance of JICA's assistance to this project are high.

3. Project Description

(1) Project Objectives

The objective of the Project is to improve the financial intermediation for, and the increase in the production and investments of, SMEs in Bangladesh, by providing the medium- and long-term funds through the participating financial institutions (PFIs) and strengthening the capacity of PFIs, thereby contributing to sound development of the country's industry and economy as well as employment generation.

(2) Project Site/Target Area: Throughout Bangladesh

(3) Project Components

- 1) Loans for the development of SMEs: provision of medium- and long-term funds for SMEs through PFIs.
- 2) Consulting services (support for the Project management and support for strengthening the capacity of PFIs, etc.)

(4) Estimated Project Cost (Loan Amount)

7,097 million yen (the amount of the yen loan is 5 billion yen)

(5) Schedule

It is scheduled to take place between May 2011 and March 2016 (59 months in total). The Project will be completed at the time of the final disbursement of the Two-Step Loan (expected to be in March 2016)

(6) Project Implementation Structure

- 1) Borrower: The Government of the People's Republic of Bangladesh
- 2) Executing Agency: Ministry of Finance. However, the BB will carry out the actual implementation of the Project on commission from the Ministry of Finance.

(7) Environmental and Social Consideration / Poverty Reduction / Social Development

- 1) Environmental and Social Consideration:
 - a) Categorization: FI
 - b) Reasons for Categorization: The Project is classified as Category FI under the "JBIC Guidelines for Environmental and Social Considerations (established in April 2002)" since funding for the Project is provided through financial intermediaries, the sub-projects cannot be specified prior to JICA's approval of the funding, and these sub-projects are expected to have a potential impact on the environment.
 - c) Others / Monitoring: In the Project, the BB, which will actually implement the Project, and PFIs will confirm the environmental and social considerations in accordance with the relevant domestic laws of Bangladesh and the above Guidelines, and actions required according to the relevant category will be taken for each sub-project. No Category A sub-projects are expected to be implemented.
- 2) Promotion of Poverty Reduction: None.
- 3) Promotion of Social Development: Consulting services of the Project provide support for training and promotional activities, etc., to promote financing to women entrepreneurs.

(8) Other Schemes and Collaboration with Other Donors: The need for technical knowledge by the end users will be confirmed through the monitoring of the Two-Step Loan and the possibility of technical assistance will be considered.

(9) Other Important Issues: None

4. Targeted Outcomes

(1) Quantitative effects

1) Performance Indicators (Operation and Effect Indicators)

Indicator	Baseline (Before sub-loan finance)	Target (2018) [Expected level 2 years after project completion]
Sales turnover of the benefited SMEs (million Tk.)	Data collected upon the application of sub-loans	Expansion from the baseline figure
Profit of the benefited SMEs (million Tk.)	Same as above	Same as above
Total loan outstanding of the PFIs to the SMEs (million Tk.)	Date collected upon the PFI accreditation	Expansion from the baseline figure
Ratio of SME lending in total loan outstanding of the PFIs (%)	Same as above	Same as above

2) Internal Rate of Return: Not calculated

(2) Qualitative Effects

Improvements in the capabilities of financial institutions to lend to SMEs, improvements in access to funds for SMEs, job creation and the development of the private sector

5. External Factors and Risk Control

None

6. Lessons Learned from Past Project

Ex-post evaluations of past similar projects have noted that consideration should be given to the definition of the eligible SMEs. In relation with this Project, the definition of SMEs has been changed under the Industrial Policy approved by the Cabinet in September 2010, and it has been confirmed that the Ministry of Finance, Ministry of Industries and the BB will uniformly apply the definition adopted in the Industrial Policy (2010) in future government policies and the BB plans to issue a circular in line with the definition.

Furthermore, the lesson has been learned from the ex-post evaluation of past similar projects that, in cases where a plural number of intermediary agencies (financial institutions) are involved in parallel in financial intermediary loans, it is effective to design the financing so that each institution can handle the implementation flexibly in accordance with the demand for funds and the scale of operations of each target end user, not restricting uniformly its eligibility and loan conditions. Based on such lessons, flexibility in the terms and conditions for lending, etc., will be assured in the Project.

7. Plan for Future Evaluation

(1) Indicators to be used

- 1) Sales turnover of the benefited SMEs (million Tk.)
- 2) Profit of the benefited SMEs (million Tk.)
- 3) Total loans outstanding of the PFIs to SMEs
- 4) Ratio of SME lending in total loan outstanding of the PFIs (%)

(2) Timing: 2 years after project completion