

Ex-ante Evaluation

1. Name of the Project

Country: Mongolia

Project: Two-Step Loan Project for Small and Medium-Scale Enterprises Development and Environmental Protection

(Loan Agreement: March 28, 2006; Loan Amount: 2,981 million yen; Borrower: The Government of Mongolia)

2. Necessity and Relevance of JBIC's Assistance

Since the early 1990s, Mongolia has promoted the development of a market economy, with assistance from international institutions and bilateral official assistance. Advances have been made in economic deregulation with regard to production, prices, exchange rates, and trade, etc., and also in sales of national assets and stabilization of the macro-economy. Beginning in the early 1990s, the government promoted development of financial legislation such as central bank law and banking law, introduction of prudential regulation, and introduction of a modern financial system, including the strengthening of the banking supervision by the Bank of Mongolia (the central bank). In the late 1990s, temporary financial distress caused by bad debt was experienced, but with the support of international institutions such as the ADB, the Mongolian government disposed of the bad debt and sold the government-operated banks, leading to the current generally stable financial sector with a total of 17 commercial banks (of which a government-operated bank is only one). In addition, as a result of the promotion of a market economy, many private companies have rapidly appeared, and the number of registered companies increased from 10,900 companies in 1995 (including 9,700 were private companies) to 23,900 companies in 2003 (including 23,500 were private companies). Of these, SMEs with 50 employees or less account for 98% of all companies, and thus SMEs are playing an important role in Mongolia's economy in employment and production.

Given the stability of the financial sector and the expansion of the private corporate sector, credit for the private sector in particular has expanded in recent years. However, interest rates on savings accounts remain high due to the high credit risk and competition among banks for savings deposits, so the nominal lending rate remains high and most bank loans are for short-term funds of less than one year, although inflation has subsided. Thus, there is an insufficient amount of long-term funds being invested exceptionally in SMEs, which are considered to be poor credit, despite their strong demand for funds. Moreover, 80% of the registered companies are in the service sector, and there are few companies in the agricultural and industrial sectors.

Meanwhile, a framework of environmental legislation has been established in Mongolia, but at the current stage, environmental measures and recycling efforts by companies are just beginning. In addition, during the winter season, air pollution in Ulaanbaatar is worsening due to the burning of raw coal by ordinary households. Despite the fact that, given such conditions, there is a strong need for environmental measures such as the introduction of coal briquettes to improve the air quality, it is difficult to procure long-term funds for investment in plant and equipment that would contribute to the improvement of the environment.

Since its switch to a market economy, the Mongolian government, with its stated goal of nurturing private companies, has produced significant effects by supplying long-term funds to private

companies by means of two-step loans (TSL) from the World Bank and KfW, etc. However, it is unable to satisfy the vigorous demand, and a state of insufficient long-term funds persists. In the Economic Growth Support and Poverty Reduction Strategy (EGSPRS) prepared in 2003, five priority areas are mentioned for the achievement of the goal of poverty reduction through growth particularly in the private sector, namely (1) stabilization of the macro-economy and increased efficiency in the public sector, (2) shift to a market economy and construction of a system and environment for growth led by the private sector, (3) promotion of environmentally balanced and sustainable regional development, (4) fair allocation through ongoing human resources development and improvement of education, health, and social welfare services, and (5) promotion of good governance and gender equality. The policy of EGSPRS is to promote environmentally-friendly, sustainable development, together with supporting the private sector by providing long-term funds to SMEs.

In Japan's "Assistance Plan for Mongolia" prepared in November 2004, four priority areas are stated for the achievement of the goal of assisting self-help efforts for poverty reduction through sustainable economic growth, namely (1) support for the shift to a market economy, (2) support for regional development, (3) support for environmental conservation, and (4) support for infrastructure development. Moreover, in JBIC's current Medium-Term Strategy for Overseas Economic Cooperation Operations, promotion of industry and resolution of global-scale problems are stated as priorities in assistance to Mongolia. Therefore, JBIC's assistance for this project is highly necessary and relevant.

3. Project Objectives

The Project aims at private sector development and environmental protection (i) through provision of market-based long-term finance to small and medium-scaled enterprises (SMEs) mainly in agricultural and industrial sectors and to the projects for environmental protection and (ii) through provision of technical assistance to commercial banks and small and medium-scaled enterprises, thereby contributing to the development of long-term finance market and the employment creation, growth, and poverty reduction on a sustainable basis in Mongolia.

4. Project Description

(1) Target Area

The entire area of Mongolia

(2) Project Outline

- (a) SME development two-step loan (TSL): Long-term funds are to be provided to small- and medium-size private companies as follows.

Eligible sectors: primarily the agricultural and industrial sectors (excluding real estate, military, and consumer finance sectors)

Eligible companies: private companies with 50 employees or less that qualify for the preferential corporate tax rate (15%) (companies with less than one hundred million tugrik in pre-tax profit; there were 13,500 eligible companies in 2004)

Loan period: 3 to 10 years (grace period: 0 to 3 years)

Sub-loan size: 10,000 to 600,000 dollars

Sub-loan interest rate (government to PFIs): LIBOR + 1% (dollar-denominated), average

interest rate on savings (tugrik-denominated)

Second sub-loan interest rate (PFIs to companies): to be set by PFIs (dollar denominated and tugrik-denominated)

- (b) Environmental conservation TSL: supply of long-term funds to small- and medium-size private companies engaged in environmental conservation businesses. Details are the same as (a) above, aside from the fact that eligible companies will be limited to those in environmental conservation businesses.
- (c) Consultant services: project monitoring, provision of assistance for boosting the capacities of the executing agencies, PFIs, and SMEs, and implementation of a survey on development of the domestic long-term funds market, etc.

(3) Total Project Cost/Loan Amount

3,141 million yen (Yen Loan Amount: 2,981 million yen)

(4) Schedule

April 2006-December 2009 (45 months)

(5) Implementation Structure

- (a) Borrower: The Government of Mongolia
- (b) Executing Agency: Counterpart Steering Committee (CSC) composed of members from the Ministry of Finance, Ministry of Trade and Industry, Ministry of Foodstuff and Agriculture, Ministry of Nature and the Environment, and the central bank (the external liaison is the Ministry of Finance)
- (c) Operation and Maintenance System: Sub-loans will be extended from the government to PFIs, and PFIs will provide financing to eligible companies based on PFIs' loan screening. PFIs are five private banks selected for their soundness, management abilities, growth potential, and lending experience, and they are scheduled to be regularly reviewed.

(6) Environmental and Social Consideration

(a) Environmental Effects/Land Acquisition and Resident Relocation

(i) Category: FI

(ii) Reason for Categorization

This project is classified as Category FI under the "Japan Bank for International Cooperation Guidelines for Confirmation of Environmental and Social Considerations" (established April 2002) because the loan is being extended to financial intermediaries, etc., and JBIC is unable to specify the sub-projects prior to loan approval; moreover, it is likely that the sub-projects will impact on the environment.

(iii) Other

Given the scale and the assumed contents of the sub-projects in the project, no significant impact is foreseen on the environmental due to the sub-projects. Moreover, CSC, which is the executing agency, will check the socioeconomic considerations in accordance with JBIC guidelines in the sub-projects with the assistance of the consultants hired by the project.

Socioeconomic considerations will be taken into account appropriately in this project because CSC and PFI have checked the same socioeconomic considerations in other two-step loan projects funded by other donors.

(iii) Promotion of Poverty Reduction

It is expected that the project will contribute to poverty reduction by providing a loan facility and employment creation to low-income and poor persons because only SMEs are eligible as loan recipients in the project.

(b) Promotion of Social Development (e.g. Gender Perspective)

None

(7) Other Important Issues

The project will reduce the air pollution in Ulaanbaatar by providing assistance for coal briquette production using environmental conservation TSLs and will assist with upgrading the capacities of SMEs and the banking sector through consultant services and by collaborating with JICA's technical cooperation (Mongolia-Japan Center).

5. Outcome Targets

Evaluation Indicators (Operation and Effect Indicator)

Indicator	Baseline (2004)	Target (2011, 2 years after completion)
Percentage of number of non-performing sub-loans in the project (%)	-	10% or less
Percentage of monetary amount of non-performing sub-loans in the project (%)	-	10% or less
Number of training sessions for PFIs and SMEs in the project (number of times)	-	50 times or more
Sales of private SMEs in the project (% of increase)	-	20% or more
Operating profit of private SMEs in the project (% of increase)	-	10% or more
Employment figures of private SMEs in the project (% of increase)	-	10% or more
Credit for private SMEs (% of increase)	-	10% or more
Percentage of credit that is long-term credit (%)	27.9%	40% or more
Emission of CO ₂ (tons/year)	To be decided at time of	Reduced compared to

	sub-loan approval	time of sub-loan approval
Emission of NOx (tons/year)	To be decided at time of sub-loan approval	Reduced compared to time of sub-loan approval
Emission of SOx (tons/year)	To be decided at time of sub-loan approval	Reduced compared to time of sub-loan approval
Emission of dust (ppm)	To be decided at time of sub-loan approval	Reduced compared to time of sub-loan approval
Recycled wastes (tons/year)	To be decided at time of sub-loan approval	Reduced compared to time of sub-loan approval
BOD emission (tons/year)	To be decided at time of sub-loan approval	Reduced compared to time of sub-loan approval
COD emission (tons/year)	To be decided at time of sub-loan approval	Reduced compared to time of sub-loan approval

6. External Risk Factors

Overall recession of Mongolia's economy

7. Lessons Learned from Findings of Similar Projects Undertaken in the Past

From ex-post evaluations of similar projects in the past, it has been learned that, when multiple executing agencies (financial institutions) act as intermediaries in development finance loans, it is effective to design the project so that loans can be extended flexibly depending on the fund demand and scale of the end users targeted by each financial institution, and not to enforce a single set of terms and conditions for loan eligibility on all companies and sub-projects. Based on the lesson learned, in this project, no nominal level will be fixed as a market base for the sub-loan or second sub-loan interest rate. Also, PFIs will set a wide range for eligibility of industries and companies and the sub-loan size, in addition to allowing the interest rates for sub-loans to be set freely.

8. Plans for Future Evaluation

(1) Indicators for Future Evaluation

Percentage of number of non-performing sub-loans in the project (%), Percentage of monetary amount of non-performing sub-loans in the project (%), Number of training sessions for PFIs and SMEs in the project (number of times), Sales of private SMEs in the project (% of increase), Operating profit of private SMEs in the project (% of increase), Employment figures of private SMEs in the project (% of increase), Credit for private SMEs (% of increase), Percentage of credit that is long-term credit (%), Emission of CO² (tons/year), Emission of NOx (tons/year), Emission of SOx (tons/year), Emission of dust (ppm), Recycled wastes (tons/year), BOD emission (tons/year), COD emission (tons/year)

(2) Timing of Next Evaluation

After project completion