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JBIC ODA Loan Projects: Mid-Term Review

Time of Mid-Term Review Field Survey: May 2006

Project Title: Sri Lanka "Small and Micro Industries Leader and Entrepreneur Promotion Project II" (L/A No. SL - P68)

[Loan Outline]

Loan Amount/Contract Approved Amount/Disbursed Amount: 4,838 million yen/N.A./4,492 million yen (Loan Completion March 2006)
Loan Agreement: Agreement entered January 2001
Loan Completion : March 2006 (the fifth year following conclusion of L/A)
Executing Agency: National Development Bank (NDB)

[Project Objective]

By providing low-interest loans to small and micro businesses, this project aims to improve and expand Sri Lanka's production base. By providing technical transfer loans, the project also seeks to finance technical and financial training as well as the hiring of consultants and the administration of quality control. In this way, the project aims to foster economic growth and reduce poverty.

Consultants: None Contractors: None

Item	Ex-ante evaluation (at time of appraisal)	Ex-post evaluation results as estimated at time of mid-term review
[Relevance] (1)National policy level	(1) In its medium-term development plan entitled "Vision for the 21st Century" promulgated in 1999, the Sri Lankan government hoped to build a prosperous and modern nation by the year 2010 by achieving annual economic growth of 7-8%. Small- and medium-sized companies have played a significant role in the national economy, accounting for 90% of all enterprises in the private sector, 70% of all employment, and 55% of industrial production value added. On the other hand, unemployment in Sri Lanka was at a relatively high level of 10%. Therefore, in terms of job creation and strengthening of the industrial base, expectations of small- and medium sized-sized businesses are high, and in the medium-term development plan, the government has been focusing on improving technology needed for future economic growth.	(1) The development policies promulgated by the Mahinda Rajapakse administration, which came to power in 2005, are indicated in "Mahinda Chintana" (Mahinda Vision) and the policy framework outlined under the title "Creating Our Future. Building Our Nation: The Economic Framework of the Government of Sri Lanka." Those policy manifestos place micro, small- and medium-sized business at the nerve center of the national economy, and aim to promote backward and forward linkage, provide infrastructure and organizations, introduce competitive technologies, spread experience in management and marketing knowhow, expand access to credit, and strengthen incentives.
(2)Policy level	(2) The new industrial policy (1995) stressed the importance of promoting transactions between major enterprises and micro, small- and medium-sized businesses through the encouragement of the system of subcontracting, supporting the provision of an environment that facilitates the expansion of small- and medium-sized businesses, supporting the procurement of funds, improving technological prowess and productivity, and strengthening marketing tactics including export.	(2) In 2000, JICA completed "Master Plan study on Industrialization and Investment Promotion in Sri Lanka." In 2002, the Sri Lankan government's small and medium-sized business task force published its "White Papers on Promotion Strategies for Small and Mid-sized Businesses." These publications surveyed and analyzed the problems that small- and medium-sized businesses face. In terms of finance, it has been frequently pointed out that there are problems such as the fact that it is difficult for small- and medium-sized businesses to receive loans from banks, and that the interest rates applied are high. Structural problems surrounding the provision of funding in the medium and long term have been identified. The Sri Lankan government has been striving to solve such problems, for example by establishing SME Bank in 2004, loans from which are wholly financed by the government and which target small- and medium-sized businesses.
(3)Project level	(3) The medium- to long-term loans targeting micro, small- and medium-sized businesses were limited (see note below). As this project aimed to provide technical transfer loans as well as low-interest loans for micro, small- and medium-sized businesses, it was of high priority. Note: At the time of the appraisal, when micro, small- and medium-sized businesses requested loans from a commercial bank, not only were they expected to meet stringent security requirements, but they were subjected to interest rates that exceeded market rates by a large margin. Thus, their access to funding was limited.	(3) Following the "Small and Micro Industries Leader and Entrepreneur Promotion Project," which was funded by Japanese ODA loans, this project bore the role of supporting technological advancements and improving small and micro businesses' access to funds. A number of programs have targeted small- to medium-sized businesses to date, including the SMI Projects I-IV supported by the World Bank, the SMAP and SMESDP projects suported by the Asian Development Bank (ADB), and the Small and Micro Industries Leader and Entrepreneur Promotion Project funded by Japanese ODA loans. However, these projects have all come to an end. Among projects currently underway or under consideration, besides the Small and Micro Industries Leader and Entrepreneur Promotion Project III, some support is coming from the ADB and from the German Kreditanstalt Für Wiederaufbau (KfW) (see table below). However, ADB's SMESDB Project II does not include a subloan financing role for private businesses, and KfW is supporting programs that target the industrial sector, and as such the opportunity for use by small and micro businesses is limited. Projects undertaken under the auspices of the Sri Lankan government-sponsored SME Bank have just started, and are not yet up to speed. As the only genuine financing system still available to small and micro businesses, the present project's importance is clear.

Donor	Project Name	Year of Agreement	Target	Disbursed Amount	Beneficiary interest rate
ADB	SMESDP Project	2001 (completed)	Subloan financing, policy financing, technological support, and credit guarantee targeting small and medium-sized businesses	Subloan financing portion: US$60 million	Market based interest rate
	SMESDP Project II	Project Preparatory Technical Assistance conducted (2005)	Exact contents are pending, but in the planning documents from the appraisal, it states that there is no plan to provide subloans targeting private enterprises.	N/A	N/A
KfW (Germany)	KfW-NDB Loan Project	2005	Subloan financing targeting the entire industrial sector. No preferantial treatment of small and medium-sized businesses	20 million euros	Market based interest rate
	KfW-DFCC Bank Loan Project	2005	Same as above	20 million euros	Market based interest rate
JBIC	Small and Micro Industries Leader and Entrepreneur Promotion Project II	2001 (completed)	Subloan financing targeting small and micro businesses	4.838 billion yen	Approx. 12.3%
	Small and Micro Industries Leader and Entrepreneur Promotion Project III	2004	Same as above	9.619 billion yen	9.0%

[Effectiveness]

(1) Operation and Effect Indicators
Quantitative effects

General Loan Scheme (see note)	No. of loans: 5,400	
	No. of jobs created: 13,600 people	

Note: To be eligible for a general loan, 1) the borrower must be registered, 2) the borrower's fixed assets investment expenditure must be not exceeding 14 million rupees, and 3) at least 25% of the investment must be financed by the borrower. Technical transfer loans were limited to beneficiaries involved in the Small and Micro Industries Leader and Entrepreneur Promotion Project or the Small and Micro Industries Leader and Entrepreneur Promotion Project II.

(1) Operation and Effect Indicators
Quantitative effects

General Loan Scheme	No. of loans: 3,728	(achievement rate: 69.0%)
	No. of jobs created: 19,864 people	(achievement rate: 146.1%)

If one compares the actual results with initial targets, whereas the number of loans disbursed reached only 69% of their target figure, the project managed to exceed targets for job creation, with actual jobs created reaching 146.1% of their target figure. Among the reasons that the number of loans disbursed fell below their target is the fact that in "Small and Micro Industries Leader and Entrepreneur Promotion Project II" the upper limit for loan amounts was higher than that of the "Small and Micro Industries Leader and Entrepreneur Promotion Project", and so there was a greater number of relatively large loans in the overall subloan portfolio.

	(Qualitative effects) (1) Expansion of income through job creation (2) Alleviation of poverty (3) Fostering of micro and small businesses (4) Strengthening of the production capacity (5) Strengthening of the institutional capacity of financial institutions	Qualitative effects 1) Expansion of income through job creation Based on the beneficiary survey, 30% of beneficiary enterprises showed no increase in hiring, 20% showed a 0%-20% increase, 31% of enterprises showed a 20%-50% increase, and 15% experienced an increase in hiring of greater than 80%. 2) Alleviation of poverty It was presumed that increased hiring would help reduce poverty by expanding income, but this has not been verified by data. An impact study will be needed. With regard to regional decentralization, which is desirable from the standpoint of eliminating regional discrepancies, if one looks at the extent to which subloans were disbursed in Southern Province, Uva Province, and Sabaragamuwa Province, where poverty is said to be relatively high, Southern Province accounted for 12.4% of all loans, which is higher than the distribution rate of small businesses(11.1%) indicated in the White Paper on Small and Medium-Sized Business Promotion Strategies. On the other hand, Uva Province accounted for only 4.7% of loans, and Sabaragamuwa Province accounted for 6.7%, which is lower than the corresponding white paper figures for the distribution rate of small businesses (7.3% and 12.8%, respectively). In both Uva and Sabaragamuwa, the present project had a limited effect in reducing poverty in those regions. 3) Fostering of micro and small businesses According to the beneficiary survey, the project made a major contribution in improving a number of areas, as 72% of businesses reported improved productivity, 74% reported increased sales, and 50% reported the achievement of better product quality. On the other hand, in other areas the project did not show significant effect, as 69% of businesses denied having a reduction in shortening the product delivery times, 67% denied having introduced new products, 57% reported no reduction in manufacturing costs, and 50% experienced no increase in competitiveness. In addition, 31% of respondents pointed to market constraints and 22% pointed to production capacity as constraints facing micro and small businesses. In response to the question of whether these constraints were resolved or alleviated by obtaining financing, 19% responded affirmatively that financing helped, and a large majority of 72% responded that it had no effect. 4) Strengthening of the production capacity The tendency for the provision of subloans to concentrate in the top five areas (namely, Colombo, Gampaha, Kurunegala, Kandy, and Ratnapura) continued as before. If one compares the distribution of small and medium-sized businesses compared to that in the White Papers on Small and Mid-Sized Business Promotion Strategies, under the current project, the number of loans disbursed exceeds that in the white papers in Colombo, Kurunegala, but in Kandy and Ratnapura, the number of loans fell below white paper figures. 5) Strengthening of the institutional capacity of financial institutions In order to complement financing programs supported by donors, the majority of Participating Credit Institutions (PCI) have established and are managing independent financing programs that target small and medium-sized businesses. A survey of PCIs confirmed that the majority of banks have adopted a more positive attitude toward financing or have at least set up a designated section responsible for small and medium-sized businesses. It is evident that participation in donor programs, including this project, has helped strengthen the institutional capabilities of the credit institutions. (2) Analysis of factors that influence project impact and effectiveness 1) A policy coordinating committee was established in order to manage the progress of the overall project (see Note 1) as there was a perceived need to coordinate among the parties concerned and to measure the progress of the project. However, the committee convened only three times in its first year, and from the second year onward, it did not convene. Therefore, during the project period the ongoing problems were not grasped. 2) It was recognized that the synergy with JICA's "The Master Plan Study on Industrialization and Investment Promotion" were needed to flow funds to critical subsectors (see Note 2). However, the notion of promoting priority subsectors was not reflected in the Operating Instructions, and so the realization of expected effect was limited. 3) The need to clear environmental regulations (see Note 3) was reflected in the operating instructions, and fulfillment of this by PCIs was confirmed. Note 1: The participating members were the Finance Ministry's Foreign Affairs Department, the Finance Ministry's National Planning Department, the Industrial Development Committee, the Export Promotion Committee, the Central Environment Authority, the National Development Bank, representatives from PCIs, and Small Business Chamber of Commerce and Industry. Note 2: The study entitled "Master Plan Study on Industrialization and Investment Promotion" conducted by JICA from 1999 to 2000 established a promotion plan that emphasized the information service industry in addition to six critical sectors—sewing, tanning, rubber, machinery, plastic, electrical and electronic industries.

Note 3: This corresponds to cases where permission is needed based on environmental standards established by the government for such things as waste water.

Information for reference

[Efficiency]
(1) Outputs

(1) Outputs

(1) Amount of General Loan Scheme (see Note 1)	4,608 million yen
(2) Amount of Technical Transfer Loan Scheme (see Note 2)	230 million yen

Note 1: General Loan Scheme that can be used by eligible micro and small businesses. The financing was used for long-term funds needed for such things as the installation or renovation of manufacturing equipment or the augmentation of existing facilities.

Note 2: Low-interest loans (25% of which is granted by the Sri Lankan government) that can be used for technical advancements by eligible micro and small-business loans. The financing was used for funds needed to conduct management, financial, or technical training, to hire consultants, and to purchase quality control equipment.

(1) Outputs

(1) Amount of General Loan Scheme (see Note 6)	4,226 million yen (91.7% of committed amount)
(2) Amount of Technical Transfer Loan Scheme (see Note 7)	41 million yen (18.0% of committed amount)

1) Provision of general loans
Regarding general loans, within 12 months of the project start, loans for the total amount had already been agreed to, but thereafter some of them were revoked. The project therefore concluded with a portion being unutilized. The circumstances leading to the lack of loan provision were as follows.

- It is natural for a portion of certain approved loans to be revoked, but in administration of the program, past experience was not taken into account.
- Although there was a room for the flexible management of interest rates, the interest rates were fixed.The reason for this was that the executing agency and the policy coordinating committee did not take suitable measures to utilize interest rate flexibility clauses in the loan agreements.
- From 2003 to 2004 market interest rates dropped by a wide margin, the medium- to -long term loan interest rates from commercial banks fell below those offered through the present project, and so applications were withdrawn for some approved sub-loans.
- The Small and Micro Industries Leader and Entrepreneur Promotion Project III started at the end of 2004, but subloan interest rates were set at 9%, which was lower than that of the present project, and the interest rate terms for the present project were not re-examined.
- Revolving funds were not utilized (see note), and once all of the general loan amount had been approved, new loan requests were admitted only after there was requests for withdrawal of previously accepted loans. From the standpoint of small businesses, this did not serve the function of providing a stable source of funds. The reason for this was that the executing agency and the policy coordination committee didn’t take measures to utilize revolving funds stated in the loan agreements. It should have been possible to reutilize funds by applying revolving funds without delay.

2) Provision of technical transfer loans
Only 18% of available technology transfer loans were utilized, and the project was completed with the remaining portion unused. The following reasons are given to explain this lackluster performance.

- Information on the technical transfer loans was not sufficiently disseminated, and so people simply did not know that such loans could be used or what the eligibility requirements might be.
- Most of the training courses that micro and small businesses participated in had low attendance fees in the order of 25,000 rupees, and that amount was generally too small for bank financing. As the profit margin observed by participating PCIs was a low 2%, the scheme held little attraction from their standpoint.
- On the other hand, foreign consultants were expensive, making it hard for micro and small businesses to hire them. Even with 25% being donated by the government, business owners did not see this financing system as an attractive arrangement.
- People recognized that to promote the technical transfer loans more effectively, a tie-up with the Ministry of Industrial Development would be needed, however, the ministry’s participation in the support of the technical transfer loans was not obtained. To promote technical transfer loans, the NDB chose to approach the Sri Lanka Standards Institute, the Industrial Technology Institute, and the National Engineering & Research Development Center.

For both of the above types of loans, the NDB misunderstood the mistake of recognizing that the project completed when the approved loan amount reached the initially planned total loan amount, and as a result, follow-up activities were not sufficiently implemented.

Note: The funds which repayment from the beneficiaries are pooled together and which could be reutilized by the borrowers and executing agency before the repayment to JBIC.

(2) Project period	(2) January 2001-March 2006 (63 months)	(2) January 2001-March 2006 (63 months) In March 2006, the last loan was disbursed, and so the project duration ended as planned.
Lessons Learned and Recommendations	(Lessons learned) When committing to loans in the next phase of the current project, it is critical that Project Memorandum and Minutes of Discussion stipulate how the previous phase is to be handled, completed, and continued. In addition to providing clarification, sufficient consideration and adjustments will also be needed during the execution stage to prevent confusion over discrepancies from the executing conditions. (Recommendations) (1) In order to utilize revolving funds in accordance with the loan agreements, we recommend to promote / expedite procedures for decision-making and execution, including the adjustment of loan conditions by the policy coordinating committee. (2) Discussions to supervise the project were conducted among JBIC, the borrowers, and executing agency. However, there remains a room for improvement in grasping the issues, considering countermeasures, or executing. It is important that those concerned parties hold closer and more detailed discussions on loan supervision, root out problematic issues, discuss the best course of action, and finally execute their plan.	
Indicators set for the ex-post evaluation		(Investment indices) (See note) (1) No. of general loans (2) Job creation through general loans (Effect indices) (1) Expansion of income through job creation (2) Alleviation of poverty (3) Promotion of micro and small businesses (4) Strengthening of the production base (5) Strengthening of the organizational capacity of credit institutions Note: It is difficult to compare target figures and actual results through indicators alone. It is agreed by the Borrower and NDB that the extent of achievement should be obtained and confirmed through the impact assessment study to be conducted as provided in the Loan Agreement.