PD-AAS-129 42129

Comparative Analysis of Mid-Term Evaluations

Term Lending Projects in Kenya and Thailand

June 1985

Bureau For Private Enterprise
U.S. Agency for International Development
Washington, D.C. 20523

In October 1984, the Bureau for Private Enterprise formallly initiated its evaluation program when we conducted mid-term reviews of our first projects. Loans and accompanying grants to the Siam Commercial Bank in Bangkok and to the Kenya Commercial Finance Company/Kenya Commercial Bank located in Nairobi were designed principally to test the hypothesis that AID could develop projects with commercial banks under which commercially priced term credit and other services would be provided to small and medium-sized businesses located in rural areas.

The following is a comparative analysis of the evaluations.

I. MAJOR SIMILARITIES BETWEEN THE TWO PROJECTS

A. The tested hypothesis proved that term lending can be made available through the commercial banking system to small and medium-sized enterprises in rural areas of developing countries.

B. The development impact of the subloan activity is evident.

C. The subloans reached the target group of small and medium scale enterprises.

D. This type of project is of low cost to the U.S.

E. Both projects suffered from implementation problems due to understaffing of the PRE Office of Investment, resulting in slow draw-down of grant and/or loan funds.

F. The anticipated institutional development through the operations of the Business Advisory Services to assist subborrowers was delayed or unrealized.

II. MAJOR DIFFPERENCES BETWEEN THE TWO PROJECTS

KENYA	THAILAND
A. INTEREST RATE	
Kenya charged a high rate of interest to subborrowers, giving the U.S. the stigma of being a high-cost lender. The 19% interest rate was at the ceiling for term loans in Kenya.	Thailand provided below local market rate loans to sub-borrowers.
B. TARGET GROUP	
Kenya targeted very small businesses, reaching a large proportion of first time entrepreneurs and women.	Thailand tended to choose both small and medium sized companies. One was large-scale (over $10 million), as defined by PRE.
C. MARKETING OF LOANS	
Kenya drew down only one third of the credit line ($1.8 million out of $5 million) during the first two years. The availability period had to be extended.	Thailand drew down fully its available credit line of $4 million within the two year availablility period.
Kenya made 38 loans with an average dollar value of $43,000.	Thailand identified a few specific borrowers and worked with them individually to make 15 loans with an average dollar value of $266,747.
Kenya advertised through the media and screened the responses.	Thailand worked with borrowers who were well-established in their industries. (See Evaluation Report No.2, pp.IV-3 and 4 for detail). The Siam Commercial Bank directed a sharply focused program to well-established prospects.

D. FOREIGN EXCHANGE RISK

KCFC arranged with the Government of Kenya to insure the subborrowers against foreign exchange risk and charged the borrowers 1% for this insurance.

Thailand passed the exchange risk on to the subborrower and tied it to the devaluation of the Thai Bhat.

E. CREDIT MANAGEMENT

In the majority of cases, the Kenya Commercial Finance Co. was unable to make a reliable judgement of the creditworthiness of its clients because of lack of analysis.

Although there were gaps in record keeping, the SCB was confident that it had full and timely understanding of its borrowers' affairs. The team found that the portfolio had been managed in a totally professional manner.

III. CONCLUSIONS AND RECOMMENDATIONS

Both Kenya and Thailand have focused traditionally on short term lending (overdraft facilities) patterned after the British merchant banking system. Britain would probably point out that the U.K. has succeeded in achieving industrialization without term lending facilities.

It is, therefore, significant that this project was successful in using commercial banks to apply term lending to small and medium scale agribusinesses in rural areas. Since part of PRE's role is to serve as a catalyst for private enterprise in development, it is noteworthy that the Mission in Kenya developed a large follow-on effort and that the Mission in Thailand has recently developed a major rural industrial strategy to provide rural credit to small and medium sized entreprises.

However, there is one general conclusion which was tantamount to all others in the evaluation commentary. **WHEN DEALING WITH COMMERCIAL INSTITUTIONS, IT IS CRITICAL TO HAVE A GOOD PRELIMINARY UNDERSTANDING OF THE OBJECTIVES OF THE INSTITUTION AND THE LIMITATIONS OF ITS OPERATIVE POLICIES. SUCH UNDERSTANDING SHOULD HELP TO ENSURE REALISTIC DESIGN OF FUTURE PROJECTS BY A.I.D.**

For example, commercial banks are not high risk takers. They tend to lend to established businesses with substantial collateral in place. A.I.D. has to recognize this limitation when trying to encourage such institutions to address a different target business with a broader range of services.

The Kenya Commercial Finance Co. tried to focus on the lower end of the target group, but had difficulty drawing down the loan. The Siam Commercial Bank made larger loans which had more immediate impact, but tended to reach medium sized enterprises. it is unlikely that commercial banks will move down scale from their traditional customer group unless they perceive they have excess resources with which to expand.

Therefore, A.I.D. **CANNOT SIMPLY ASSUME THAT AN INSTITUTION HAS ALL OF THE CAPABLILITIES IT NEEDS TO IMPLEMENT A LOAN OR GRANT AGREEMENT.** This assumption is directly related to the following CONCLUSIONS:

1. Both projects suffered from significant implementation problems resulting, in part, from understaffing of the PRE Office of Investment, resulting in slow draw down of loan funds by KCFC, late use of the grant funds by KCB and limited use of the grant funds by SCB.

2. In addition, institutional development through the operations of Business Advisory Services (BAS) was either delayed (in Thailand) or unrealized (in Kenya) at the time of the evaluations. In Thailand the delay of disbursement of $75,000 in grant funds was due in part to the Bank's uncertainty of the BAS function and the proper financing of activities under the grant. In Kenya the non-use of the grant funds was due in part to organizational problems at both the KCB and the KCFC and in part to unrealistic expectations by PRE which in turn could not give sufficient management attention.

MAJOR RECOMMENDATIONS

1. To attain the desired improvements in the grant to the Kenya Commmercial Bank for the Business Advisory Services, PRE should work with the Mission Director in Nairobi and encourage use of a local Project Manager similar to the one USAID Nairobi will use for its rural enterprise project.

2. In Kenya, PRE should design as quickly as possible an implementation plan to improve the BAS. This should be a joint effort with the KCB/KCFC. In Thailand, PRE should place a high priority on the use of the remaining grant funds. This will also require a precise plan to define the BAS and its objectives.

3. SCB will be reluctant to establish any new procedures or practices for the BAS unless PRE or A.I.D. indicates its intentions to add new resources to the program. Therefore, PRE should continue the grant funding of this project to complete the necessary institution building. Such a commitment is warranted not only because of the success of the program but also because of the enthusiasm of Senior Bank officials and Branch Managers.

<u>Other recommendations</u> related to correcting the locally high interest rate in Kenya, the constraints to the draw-down of funds, the assumption of the foreign exchange risk by the borrower in Thailand and the encouragement of bilateral cooperation by other term lending donors were:

1. KCB should try to reduce the interest rate, perhaps by matching the U.S. funds with lower cost money available at their branches with a combined rate of 16.5% (which is within the established range of market rates for such loans). In Thailand the blended rate was 14.75%.

2. The prohibition for use of loan funds to finance integrated agribusiness operations should be eliminated because it has been a constraint to the draw-down of funds in Kenya. Specifically, PRE should establish a clearer definition of the distinction between agricultural and agribusiness activities; it should also establish a limit on the proportion of funding devoted to farming.

3. The subborrower should not have to assume the foreign exchange risk. PRE and SCB should consider an insurance system like the one in Kenya, allowing subborrowers to pay a small annual premium in return for coverage.

4. In Kenya there should be more coordination and consultation among the bilateral donors sponsoring term lending which could eliminate the variety of competitive credit alternatives presented.

IV. LESSONS LEARNED FOR FUTURE PROJECTS

There were three general lessons which the evaluators emphasized in both reports. They summarize the salient points which came out of the mid-term studies.

LESSON #1

DESPITE LIMITATIONS, A.I.D. CAN AND SHOULD ENCOURAGE MORE LDC COMMERCIAL LENDING INSTITUTIONS TO UNDERTAKE THE RISK OF PROVIDING TERM LOANS TO SMALL AND MEDIUM-SIZED ENTERPRISES.

LESSON #2

PRE SHOULD UNDERTAKE ITS OWN INSTITUTIONAL ANALYSIS AT THE TIME OF PROJECT DESIGN TO PROVIDE A CLEAR UNDERSTANDING OF THE BANK'S CAPABILITIES AND ACTUAL SERVICES.

LESSON #3

BECAUSE OF THE EXPERIMENTAL NATURE OF THE PROJECTS FOR BOTH A.I.D. AND THE BANKS, THERE MUST BE FREQUENT MONITORING AND CONTINUOUS MANAGEMENT ATTENTION.