MANAGEMENT SUPPORT AND TECHNICAL ANALYSIS SERVICES (MSTAS) PROJECT

Evaluation of the Arrangement Between USAID and the African Development Bank Relating to Private Sector Activities

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Table of Contents

I. Introduction, Summary and Conclusions

This evaluation reviews two credit guarantees completed under the "Arrangement" between USAID and the African Development Bank. The Scope of Work for this analysis requests an assessment of credit guarantee programs in Tanzania and Zambia, with a particular focus on the degree of collaboration between USAID and its partner for this activity, the African Development Bank (AfDB). In order to carry out this assignment various USAID documents were reviewed, in particular the five documents listed at the end of this report, two covering Tanzania, two covering Zambia, and one a "Power Point" presentation on Tanzania. In addition, there was close interaction with various USAID officials in its Washington office who had been involved in different aspects of these loan guarantee programs. Although it was initially planned to have telephone conversations with AfDB officials involved in these loan guarantee programs, these officials indicated their preference for written communications, so a brief list of topics for discussion was sent to these officials, whose responses are included in this report at the end of the sections on Zambia and Tanzania, respectively.

The choice of Tanzania as one of the countries to benefit from this program reflected an opportunity to generate growth and employment by increasing access to finance for local SMEs in line with the Bank's private sector development agenda. An AfDB official, Juliet Byaruhanga, indicated that choice of Tanzania was made jointly with USAID.

The main findings from this analysis were that the loan guarantees were quite popular in that the amounts available for guarantees were quite quickly utilized in both countries. However, in one of these countries, Tanzania, an apparently very good and innovative beginning (with warehouse receipts allowed to be used as collateral for loans) was followed by substantial loan defaults, with the amounts to be covered seen as very large by USAID officials (and it is not clear if the amounts due from the AfDB to cover these defaults have yet been received). As described below in greater detail in this report, the main blame for these defaults was placed on policies of the Government of Tanzania to garner support from certain politically important groups, primarily by intervening in pricing of certain agricultural products. Two aspects of this deserve further investigation: (1) whether these policies should have been a "surprise" or might have been foreseen and taken into account; and (2) whether the key participants, the AMCOS cooperatives, whose operations combined credit and marketing, could overcome the challenges found in many developing countries with such arrangements.

Another significant open question is the extent of the impact or "additionality" resulting from the loan guarantees. A basic challenge in answering this question is that no specific targets or goals were set against which the uses of these loan guarantees could be measured. However, the extent to which the borrowers who used guarantees were in fact existing rather than new borrowers and/or were borrowers who had provided collateral that exceeded the amount of the loan suggests that it would be difficult to demonstrate additionality. Furthermore, in the case of Zambia, which did not have default problems, particular mention was made of the fact that lending decisions were made at the bank's headquarters and not at the field offices. While this can be a way to help to control risk, it is also an approach that is likely to exclude new and relatively small borrowers. Indeed, while technical assistance to farmers is mentioned in the reports, there is no mention of the potential usefulness of providing training to rural loan officers (or, of equal importance, having effective units for external audit and control purposes), which combined have been shown to yield remarkable results in some countries (e.g., Mongolia).

The degree of collaboration between USAID and the AfDB is another focus of the present analysis. While the written statements provided by the AfDB officials speak highly of the collaboration with USAID, the AfDB officials also requested copies of the USAID reports cited in this analysis as they had never seen any of these. Furthermore, a "search" of all these USAID reports for the word "AfDB" found at most two or three examples in all the reports but one, the "Joint Guarantee Progress Report [on Tanzania]," from August 2010, which did discuss activities that involved the AfDB at several points. However, perhaps the most telling statement about collaboration with the AfDB comes from the final slide in the recent "Power Point" presentation, which states:

> AfDB Partnership
>
> - Little awareness or engagement on the ground.
> - Communication did not flow from headquarters to the field.
> - Internal bureaucratic challenges (claim payment delays, additional reporting requirements, etc.).

II. DCA Loan Guarantees in Zambia

The following discussion of DCA Loan Guarantees draws on material in "Zambia's DCA Portfolio Report," March 2014. Zambia's National Commercial Bank, ZANACO, has already fully utilized the $5 million loan guarantee fund provided jointly with the African Development Bank (AfDB), which provides a 40% guarantee on principal defaults, while USAID provides a 10% guarantee on principal defaults. As of the date of the report, March 2014, ZANACO is described as having a "large footprint" with 63 branches and a larger number of other types of outlets and over 600,000 customers, including depositors and users of money transfer services as well as borrowers. It is one of the five largest banks in Zambia with a 30% share of the agricultural market and with $167 million of its $500 million loan portfolio set aside for agriculture as of 2012. However, while the 2014 "DCA Portfolio Report" stresses that "the bank regularly engages with its clients," all loan approvals are centralized at the head office, which can impede outreach into rural areas, judging from worldwide best practice experience.[1] Nonetheless, almost half of the 66 guaranteed loans are for agriculture – 29 – but only four of these are to first time borrowers. Also, the average size of agricultural loans, just under $77,000, is somewhat lower than the overall loan average of just under $110,000. The portfolio at risk is 0%, but collateral requirements nonetheless remain very high (one knowledgeable bank official, but not from ZANACO, indicated that collateral requirements were at least 120% even with DCA guarantees).[2]

While the program with ZANACO described above is currently USAID's largest loan guarantee involvement in Zambia, there are two other programs, one of which is with ZANACO but also involves Sida in addition to USAID, where Sida provides 30% and USAID 20% of the funding for the 50% loan guarantees. The total amount authorized is just over $9 million, almost twice the size of the other programs. The program with Sida targets the agricultural sector, small farmers in particular, who are dealt with on a group basis and are required to provide up-front cash collateral for loans. ZANACO is also facilitating technical assistance for these farmer groups and, perhaps even more importantly, the head of the agri-business sits on the credit committee to ensure that agricultural loans are considered on their own merits.

The third loan guarantee program supported by USAID in Zambia was with Bank ABC, again for $5 million, with USAID providing a 50% guarantee to encourage on-lending to SMEs. However, after generating a mere 10% utilization rate, with the majority of the few loans that were booked looking rather large for SMEs (ranging from $274,000 to $450,000), the arrangement was terminated. Among the stated reasons for the termination were that such guarantees were not needed, given the collateral requirements of a minimum of 120% of the loan (again underscoring that the program had not succeeded in altering the risk assessment policies of the bank); while another constraining factor was a Central Bank mandate that interest rates on loans needed to be decreased. In addition, the arrival of an advisor from another international organization to assist Bank ABC with SME lending revealed additional constraints that impeded use of these guarantees.

An earlier report, "DCA Portfolio Management, Zambia TDY, June 2013," had already recognized many of the issues that are detailed in the "DCA Portfolio Report" discussed above, and underscoring that Bank ABC SME decided to move into SME finance sans utilization of the

[1] Having well-trained loan officers in rural areas allows them, potentially, to have primary responsibility for loan approvals because of their intimate knowledge of agricultural conditions and borrower performance in their areas, but this opens the danger of loan approvals depending on personal relationships, or worse, and thus requires a strong internal audit and controls staff to maintain adequate controls with actual visits to rural areas.

[2] The combination of zero default rates and over-collateralization policies seem to indicate that the partial guarantees have not necessarily induced a shift towards more flexible, best practice focused risk assessment/management practices.

DCA guarantees, which it saw as constraining its flexibility. On the other hand, ZANACO had already fully utilized the amounts available under DCA funding by the time of the "Portfolio Management" report. The main issues raised in the "Portfolio Management" report were concerns about ZANACO's arrearages in certain significant loans, together with an overall portfolio at risk (91 days or more in arrears) of 19%.[3] In addition, the "Portfolio Management" report noted some shortcomings in ZANACO's record-keeping for loan files, but on the other hand thought that the bank was collecting data that could be useful for future impact assessments. In fact, USAID found the description of the success of one of ZANACO's clients, a dairy cooperative, sufficiently significant that it occupies a full page of the report. There is also a brief discussion of the recent initiation of a DCA loan guarantee program in Zambia that is being done jointly with Sida, emphasizing the importance of aiming from the very beginning at effective coordination between the two agencies, suggesting that this is perhaps somewhat lacking in relations with the African Development Bank (AfDB). In fact, in this "DCA Portfolio Management" report, only two mentions of the AfDB can be found, while in "Zambia's DCA Portfolio Report" for 2014 there are three references to the AfDB, and both reports underscore the need for better coordination with the AfDB.

Given interest in assessing coordination between USAID and the African Development Bank (AfDB) under this assignment, we tried to arrange telephone conferences involving the primary author of this report, USAID officials and official of the AfDB. However, AfDB officials preferred written communications, so that a list of relevant questions was developed. Answers received from Mr. Willy Bubibunene, the AfDB official primarily involved in the loan guarantee project in Zambia are given below:

"…The ZANACO project involves a partial Credit Guarantee Facility (PCGF) with a tenor of 10 years. The maximum cumulative disbursement amount that can be covered by the PCGF is 50% of US$5million, i.e., US$2.5million. The bank's share of the coverage is 80%, i.e., US$2million, and USAID the remaining 20%, i.e., US$500,000.

"As of September 2013, ZANACO had disbursed 100% of the facility to 66 SMEs. No arrears among those SMEs and no claims pending or paid. The demand for this type of product is very high. I can say this experience is rather successful and that further initiatives of this kind are to be encouraged between USAID and the bank.

"Unfortunately I cannot comment on Tanzania since this project with ZANACO is the only one under my umbrella.

[3] By March 2014, the time of the later report on Zambia, these arrearages had been taken care of.

"Could you send me studies of the impact of the loan guarantee program on access to credit? I haven't read it yet. However, I think that our 2 institutions should continue to collaborate and be bolder and come up with new initiatives to help SMEs in the African continent."

While the reactions of the AfDB official responsible for Zambia invite further collaboration, emphasis is placed not on more loan guarantees but rather bolder new initiatives to help African SMEs. In addition, it is interesting to note that USAID's reports on the loan guarantees in Zambia had reportedly not been previously reviewed by this key AfDB official.[4]

USAID reported a total of $81,634 in fees collected for the Zambia program. All fees were collected by the AfDB, who took 40% of the risk vs. USAID's 10%. The USAID subsidy amounted to $56,010.

III. DCA Loan Guarantees in Tanzania

The "Joint Guarantee Progress Report," prepared in August 2010, less than two years after the program was initiated, shows significant progress, with many successes and few problems. In fact, these loan guarantees benefit small farmers in the poorest (and most isolated) region in Tanzania; based most importantly on the efforts of the implementing bank, CRDB, along with the enactment of a law enabling warehouse receipts as collateral. CRDB's guaranteed loans were also enabled by the major role of AMCOS (Agricultural Marketing and Cooperative Society) that brought farmers together and provided various key services (e.g., record-keeping and financial management, pre-harvest financing of inputs, overseeing delivery to CRDB approved warehouses). In addition financial transactions largely pass through CRDB, thereby helping to reduce risks.

An important issue at the time was that lending under the guarantee was programmed to be primarily longer term (36 months or longer) for investment purposes, but the demand was primarily for short-term loans to facilitate production and marketing during the year. In fact, as of the date of the report, there had been 82 working capital loans approved for $4.22 million, with $1.6 million disbursed, the vast majority in the poorest region of Tanzania. This contrasts with only 5 investment loans for totaling well under $1 million. Consequently, CRDB requested a change in the allocation and, because of the excellent progress being made with the warehouse receipts models, acceptance of such a change was recommended.

There were, however, several recommendations for changes, such as having CRDB report on an AMCOS by AMCOS basis (rather than just the total) and including data on performance (e.g., profits and distributions to members, total crop yields and total membership). On the positive side, there were no loan arrearages and, based on the initial success in Tanzania's poorest region, CRDB was planning to expand into other regions and to include even more

[4] As mentioned above, It is interesting to note that there are only two or three references to the AfDB in each of USAID's two documents on loan guarantees in Zambia that were reviewed.

remote parts of the poorest region. A demonstration affect impact on other banks was also noted, but of particular importance were the week-long training sessions for AMCOS focused on understanding cash-flow management and other relevant skills. For the future, it was recommended that CRDB expand into other regions and diversify the crops supported, and to focus on a major challenge: support training of farmers in outlying areas.

The "DCA Portfolio Report: Tanzania," February 2014, begins by noting that guarantee utilization is on-track and has focused mainly on the warehouse receipts lending program, but then abruptly shifts to the fact in September 2013, the CRBD reported that 86 loans along the cashew and sunflower value-chains had defaulted for a total of US$1.9 million, apparently a record amount. The basic explanation given in the report for the cashew producer defaults is politics, as the government had set farm-gate prices high to please rural voters, while international buyers and processors operated on a market-based pricing basis, so that the AMCOS cooperatives could not cover the high prices they had paid and were driven into bankruptcy and default.[5,6] In regard to sunflower processing, defaults occurred when unchecked edible oil imports flooded the market, pricing out small-scale processors, many of whom eventually defaulted.

The report then provides a series of recommendations for future activities, beginning with work on impact evaluations. Also recommended is a greater focus on technical assistance and an up-dated monitoring plan, as well as a number of actions to improve coordination. As in the earlier report, emphasis is given to the introduction of the innovative warehouse-receipts based lending approach, and to the outreach of CRBD with its numerous branches and presence in remote and poor areas. Also emphasized are the importance of AMCOS and the assistance provided to the AMCOS by CRBD.[7] One element not mentioned in the earlier report are the guarantee-backed loans to agricultural students (13 graduates at the time of the report) who

[5] There is an Appendix 6 that provides details of the CRDB Claim Submission.

[6] The report then discusses three other projects (PRIDE Tanzania, National Bank of Commerce and EA Power), but these are not related to the current discussion (and there is also an Appendix with a survey of PRIDE borrowers).

[7] While the problems with the AMCOS cooperatives are attributed mainly to bad government interventions, more investigation of this is important. The innovation of formalizing the use of warehouse receipts as collateral is likely to be very beneficial but does not eliminate all the potential risks of multi-purpose cooperatives, even though the point is made that they were given technical assistance. Multi-purpose cooperatives combining credit and marketing were once very popular in the agricultural sectors of developing countries, but their frequent failures has led to a different view, with NCUA outlawing them in the US and WOCCU taking a very strong position against them worldwide. It is simply too easy for the credit side to be pressured into providing "temporary" liquidity to the marketing side, thereby covering up whatever problems there are to be resolved. So, what happened in Tanzania needs to be more thoroughly investigated, and very specific technical training needs to be provided (and legal restrictions imposed as well).

are expected to become involved in agribusinesses. This has become a well-received program locally, focused on creating employment and fostering entrepreneurship among recent graduates from the Sokoine University of Agriculture.

Two other aspects of the report are of potential interest, first the distribution of borrowers. Three regions (Dar es Salaam, Dodoma and Morogoro) account for virtually all of the first-time borrowers, and in the first two of these regions collateral is 50% or less of the loan amount. Also of note is the very low interest rate (12%) charged to borrowers in Singida, while in other regions borrowers paid from 16% to 20%. The report also mentions briefly the need to improve communication with the African Development Bank (AfDB). Clearly the dramatic portfolio quality problems experienced by CRBD by 2013 underscore the importance of more effectively reviewing and assessing the risks associated with portfolio pricing policies/parameters, as well as the coop-based lending model/approach, at the program design stage.

Again in the case of Tanzania the relevant AfDB officials preferred written communications for purposes of communicating on DCA program outcomes. As a result a list of relevant questions was developed, and the answers received from the AfDB official primarily involved in the loan guarantee project in Tanzania are given below:

"1. On the 23rd of September 2008, AfDB/USAID signed a guarantee agreement with CRBD Bank. Ultimately, the composite facility was aimed at achieving broader socio-economic development, social protection and poverty reduction in and around Tanzania, with principal goals including but not limited to (i) women entrepreneurial empowerment and uplift, (ii) private sector development through agriculture and eco-tourism.

"2. There is evidence of an increased appetite for SME Lending, especially in the agricultural sector and less in the eco-tourism sector, which was also a target sector. CRBD has deepened the reach of its financial services and has grown its SME portfolio over the project period. As of August 31, 2013, the project had facilitated access to finance to 253 beneficiary borrowers, more than 52% of its targeted 450 beneficiaries. Women empowerment has also seen a boost under the project, as more than 30% of the beneficiaries have been women and, according to CRDB's management, have been very good in repayment of the facilities granted them. It is sufficient to note that this outreach has been able to cover remote and poor rural areas like Lindi and Mtwala, which were not originally attractive for lending.

"Although not tangibly quantified, the project has made major far-reaching direct and indirect developmental strides, having, among other accomplishments (i) deepened financial inclusion by making financial services accessible to residents of remote villages, towns and communities, (ii) reduced unemployment and attendant poverty and other social inequalities, (iii) increased social and entrepreneurial empowerment of women, (iv) improved standards of living in rural areas,

(v) stimulated key stakeholder interest (including Government) in SME development, and (vi) generally enhanced private sector development, especially in expanding rural entrepreneurship and business management.

“3. Based on the above, I believe that the collaboration between USAID and AfDB should continue for the increased betterment of SMEs in Africa. There should be particular emphasis on assisting the participating organizations to monitor and evaluate in order to tangibly quantify outcomes.

“4. Lastly, I will be happy to receive the studies of the impact of the loan guarantee program on access to credit undertaken by USAID, since I did not actively participate in the exercise.”

USAID reported fees of $192,961 for the Tanzania program, all of which were collected by the AfDB. The Bank took 40% of the risk compared to USAID’s 10%. The USAID subsidy for this program totaled $248,000.

This extremely positive overall assessment of the program by the AfDB representative is somewhat surprising, in light of the ambiguous portfolio performance and sustainability parameters for CRBD outlined earlier.

Documents Reviewed

"Zambia DCA Portfolio Report: 2014 Portfolio Management Report and Recommendations for USAID/Zambia," March 14, 2014

"DCA Portfolio Management Zambia TDY, June 17 – 19, 2013" from Joseph Obi

"Tanzania DCA Portfolio Report: 2014 Portfolio Management Report and Recommendations for USAID/Tanzania," February 2, 2014

"Joint Guarantee Progress Report [on Tanzania]," from Kofi Owusu-Boakye, August 5, 2010

"Development Credit Authority: Lessons Learned from CRDB Tanzania" Power-Point presentation, June 2014

Questions Sent to AfDB Officials

Were there important differences in the results in the two countries (Tanzania and Zambia)? If so, what were the most important differences and what could be learned from these differences? To what extent do you think that the goals of this loan guarantee program were achieved?

Were you satisfied with the studies of the impact of the loan guarantee program on access to credit? If yes, what do you think were the most important findings? If no, how do you think these impact studies fell short and could be improved?

Based on these studies and other factors in the relationship between USAID and the AfDB, do you think that the current relationship should be continued? Should be modified (if so, in what ways?). Should be terminated (if so, why?).

Two major reviews of each of the loan guarantees in the two countries were carried out by USAID (Tanzania, "Joint Guarantee Progress Report," August 2010, and "DCA Portfolio Report," February 2014; and Zambia, "DCA Portfolio Management Zambia TDY," June 2013, and "DCA Portfolio Report," March 2014). Where you involved in these reviews? If so, in what ways? Did you receive copies of these documents? Did you comment on them?

AfDB Officials Contacted

Josselyn Ahogny, Division Manager, FFCO 4, j.ahogny@afdb.org

Leon N'Din Attoh, Loan Administration Division, n.attoh@afdb.org Tel. +225 20 26 3132

Juliet Byaruhanga,Private Sector Operations, Uganda Field Office, j.byaruhanga@afdb.org
Tel. +256 772 420991

Samuel Ekue Mivedor, s.mivedor@afdb.org Tel.: +225 0105 4040

Willy Bubibunene Ngandu, w.bubibunene@afdb.org Tel. +216 7110 2682

Hervé ZouZou, Portfolio Management Division, Private Sector Department, h.zouzou@afdb.org
Tel.: +225 2026 3518, Cel: +225 0157 2222