On 25 June 2018, the Director General, Independent Evaluation Department, received the following response from the Special Senior Advisor to the President on behalf of Management:

1. Management thanks the Independent Evaluation Department for this important thematic evaluation study. ADB’s support for Small and Medium-Sized Enterprises (SMEs) is a key part of sovereign and nonsovereign operations to promote inclusive growth in our developing member countries (DMCs). ADB has invested substantial resources in SME support activities over a considerable period of time. Experience has shown that the contribution of the SME sector towards employment generation and consequent economic development is significant. We continue to learn and improve financing and technical assistance operations in the SME space.

A. General Comments

2. Management acknowledges intensive engagement between IED and departments during the interdepartmental review of draft reports. We appreciate IED’s efforts to incorporate our comments. However, there are still important concerns that were not fully reflected in the final report. The study focuses on identifying less successful experiences. It could have contributed to knowledge sharing if types of operations that had worked well were identified and lessons drawn for design and implementation of successful projects. In addition, a full evaluation of SME support work would have adequately recognized the complexity of SME development in DMCs. The issues that impede SME growth vary widely among DMCs and are complex in nature. Policy regimes, infrastructure, natural endowments, competitiveness, financial sector development, human development, natural hazards, geographic location, and a range of other issues affect SME development. It is also important to note that ADB works with other development partners so that SME-related support is customized to country needs and duplication is avoided. Interplay of these contextual and partnership issues makes attribution of project level outcomes and impact difficult. For these reasons, a truncated evaluation such as reflected in this report gives an incomplete understanding of how ADB operations contribute to SME development in DMCs.

3. Scope of evaluation. The study focuses on business environment, access to finance, value chains, and women in business, but mostly excludes support to microfinance and trade finance. Contrary to the claim that “ADB operations did not serve the core underserved SMEs (smaller enterprises, new businesses, and enterprises that. . . were not able to borrow”, ADB has supported more than 7.6 million microfinance borrowers since 2010 by providing access to finance. In addition, since 2017, the Trade Finance Program has supported over 3,600 SME transactions, and the Supply Chain Finance Program over 400 SME transactions. These exclusions weaken the evaluation as the boundary between microenterprises and SMEs is defined specifically by country, subsector, or business focus of financial institutions. A more systematic and updated analysis of operations that include microfinance and trade finance would have encompassed
all of ADB’s support to SMEs and enriched the study. Entrepreneurship development is about growth along the continuum of micro-small-medium enterprises and addresses constraints on a full range of financing and capacity needs.

4. **Rationale for ADB support to SMEs.** The rationale is clearly established for sovereign and nonsovereign operations in ADB’s Charter, operational policies, and business plans. Support for entrepreneurship development and creation of decent jobs remain high priority in all DMCs. ADB is advancing SME operations in frontier markets, and continues to focus on middle-income countries and transition economies. Country partnership strategies represent the broad thrust of SME operation priorities responding to demand from DMCs to address constraints, including access to finance by SMEs. The entry point varies by country context, economic cycle, and the available support products.

5. ADB supports countries in improving the business environment for entrepreneurs and companies—including SMEs and inclusive businesses—and will continue to enhance business development services and strengthen the financial sector. Business enabling conditions will most likely require national level interventions, including the development and strengthening of legal and regulatory frameworks, as well as implementation and enforcement capacity at national and local levels. Sovereign and nonsovereign operations to financial institutions are closely coordinated to ensure that market pricing is not distorted. Sovereign operations will continue to play an important role in creating the enabling framework for nonsovereign operations and for capacity development when country needs and demand arise.

6. The evaluation’s criticism of the selection of financing partners is misplaced. ADB policies require a rigorous selection process to identify qualified financial intermediaries to service SME clients. It is against ADB policy to select weak intermediaries that put a project at risk. It is also to be noted that as part of financial intermediary operations, ADB often works closely with financial institutions to integrate environmental and social safeguards into their operations, develop new financing products, and improve risk management.

7. **Performance of operations.** Finance sector operations as a whole, not just support to SMEs, have historically lower success rate than other sectors. To address this, significant efforts have been made to improve the success of ADB finance operations. The results are noted in the recent Development Effectiveness Review, which notes that the overall success rate of finance sector operations has improved from 50% to 67%. Given that the success rate of all ADB operations is 72%, this is not a very significant difference. The study misleadingly states that performance is under the ADB average without giving proper acknowledgment that the SME sector is linked to wider economic, financial sector, political, and legal issues that may have been addressed in other “non-SME” defined projects. Furthermore, the aggregated analysis masks important differences between sovereign and nonsovereign portfolios and interventions.
B. Recommendations

8. Management concurs with the principles of the four recommendations to which we provide our responses below. However, we would like to point out that the evaluation’s overall findings are weak due to lack of strong analytical underpinnings, no external benchmarking, inadequate consideration of implementation constraints in SME interventions, and a nonrepresentative sample. These underlying shortcomings of the evaluation render the conclusions not robust.

9. **Recommendation 1**: Specify the parameters of ADB’s support for SMEs covering its rationale, strategic areas of focus, including the mix of sovereign and nonsovereign operations, corporate-level objectives and performance indicators, and clear requirements for preparing and implementing SME operations as part of the new financial sector framework to be prepared under Strategy 2030.

Management agrees. ADB’s support for SMEs is clearly set out in the Financial Sector Operational Framework and in the country strategies and business plans. Interventions are planned and implemented according to ADB policies as set out in the Operations Manual and other guidelines that specify the requirements for preparation and due diligence. The need to develop more diverse financing instruments is not limited to support to SMEs. Financial sector support could include more diverse financing instruments for SME operations, including those that can be deployed in higher risk environments. ADB will consider how SME operations will be improved when the financial sector operational framework is updated.

10. **Recommendation 2**: Improve the implementation and monitoring of results of SME operations.

Management agrees. Monitoring and evaluation are a key feature of any ADB operation. More recent and pipeline projects have more rigorous design and monitoring frameworks. Operations departments ensure that baselines and clear targets are established, supplemented by appropriate reporting requirements that allow ADB to monitor the growth and performance of the portfolio and its impacts on target SMEs.

11. **Recommendation 3**: Improve the SME knowledge base in ADB and increase advisory services to better serve clients.

Management agrees. It is important to build on current knowledge that supports SME operations. Knowledge products and services need to be relevant, up-to-date, and focused on new trends and developments. Financial markets and SMEs are transforming rapidly and are at different stages of development in ADB’s DMCs. Knowledge work will need to be well targeted to meet the specific needs of individual countries. Impact evaluations, as recommended above, and innovative research can also advance the knowledge base on SME operations.

12. **Recommendation 4**: Improve staff skills and interdepartmental coordination, particularly between the Private Sector Operations Department (PSOD) and the regional departments, to maximize the One-ADB impact.
Management agrees. Improving staff and counterpart capacity and deepening coordination is a process of continuous improvement throughout ADB operations. There are also many relevant technical assistance (TA) initiatives for capacity development in which staff and counterparts participate. For example, the Office of Risk Management runs with PSOD an average of three workshops a year on risk management, through which nearly 500 participants from 32 DMCs have been trained since 2013. PSOD’s Trade Finance Program conducts six training sessions for banks per year. Additionally, both sovereign and nonsovereign operations use TA in many of projects to help banks digitize and develop new products to better reach micro, small- and medium-sized enterprises.