ADB

Validation Report

Reference Number: PVR–210
Project Number: 34113
Loan Number: 1978
December 2012

Indonesia: Small and Medium Enterprise Export Development Project

Independent Evaluation Department
Asian Development Bank

ABBREVIATIONS

ADB	–	Asían Development Bank
BEI	–	Bank Ekspor Indonesia
DMF	–	design and monitoring framework
MOF	–	Ministry of Finance
PCR	–	project completion report
SEIF	–	Small and Medium Exporters' Investment Facility
SME	–	small and medium-sized enterprise
TA	–	technical assistance
TAMU	–	technical assistance management unit

NOTE

In this report, "$" refers to US dollars.

Key Words

adb, asian development bank, export development, participating bank, small and medium-sized enterprises, sme, ta, technical assistance

The guidelines formally adopted by the Independent Evaluation Department (IED) on avoiding conflict of interest in its independent evaluations were observed in the preparation of this report. To the knowledge of IED management, there were no conflicts of interest of the persons preparing, reviewing, or approving this report.

PROJECT BASIC DATA

Project Number:	34113	**PCR Circulation Date:**	Sep 2009	
Loan Number:	1978	**PCR Validation Date:**	Dec 2012	
Project Name:	Small and Medium Enterprise Export Development Project			
Country:	Indonesia		**Approved** ($ million)	**Actual** ($ million)
Sector:	Industry and Trade	**Total Project Costs:**	113.00	
ADB Financing: ($ million)	**ADF:** 0.00	**Loan**:	85.00	6.44[a]
	OCR: 85.00	**Subborrower's Equity**:	14.00	
		Others: Participating banks	14.00	
Approval Date:	17 Dec 2002	**Effectiveness Date:**	17 Feb 2004	18 May 2004
Signing Date:	20 Nov 2003	**Closing Date:**	19 May 2009	2 Sep 2008
Project Officers:	E. R. Rodriguez M. Ryan R. Budiman, Sr.	**Location:**	ADB headquarters Indonesia Resident Mission Indonesia Resident Mission	
Validator:	C. Dingcong, Consultant	**Peer Reviewer:**	F. De Guzman, Evaluation Officer, IED2	
Quality Reviewer:	C. Kim, Principal Evaluation Specialist, IED2	**Director:**	H. Hettige, IED2	

… = not available, ADB = Asian Development Bank, ADF = Asian Development Fund, IED2 = Independent Evaluation Department (Division 2), OCR = ordinary capital resources, PCR = project completion report.

[a] $72.8 million cancelled on 25 January 2007 and $5.7 million cancelled on 24 September 2007

I. PROJECT DESCRIPTION

A. Rationale

1. The Asian financial crisis of 1997−1998 pushed a large number of people below the poverty line. However, during the period of economic recovery, small and medium-sized enterprises (SMEs), particularly export-oriented firms, proved resilient in weathering the crisis. SMEs benefited from the rupiah's depreciation and provided substantial job opportunities, which contributed to reducing poverty. In view of these, the Government of Indonesia recognized the importance of SME development in spurring economic growth. As such, the Poverty Partnership Agreement between the Government of Indonesia and Asian Development Bank (ADB) noted SME development as a key area for future ADB support in Indonesia.[1]

2. While the need to explore the full potential of the SME sector was clearly recognized, the government failed to take full advantage of the SME sector because of some impediments, including the following: (i) regulatory framework biased against SMEs; (ii) lack of sustainable business development services for SMEs; and (iii) difficulty of SMEs to obtain financing, particularly for meeting investment requirements. Earlier ADB assistance addressed the issues of regulatory framework and business development services. However, the issue of SME financing needed to be resolved. Thus, follow-up support was deemed necessary to the earlier approved Industrial Competitiveness and SME Development Program, which focused on

[1] ADB. 2001. *Poverty Reduction Partnership Agreement between the Government of Indonesia and the Asian Development Bank (2001–2004).* Manila.

regulatory framework and policies,[2] and the technical assistance (TA) for the development of business development services.[3]

3. Given the market conditions then, SMEs faced difficulties in obtaining financing. Indonesian banks often looked only at collateral and offered only short-term funds. To meet investment needs, firms had to secure funds in the same currency as their revenue stream. It was envisaged that ADB would help banks channel funds to SMEs with foreign exchange term financing, while providing technical assistance for improving communication between banks and SMEs.

B. Expected Impact

4. At appraisal, the project framework of the Small and Medium Enterprise Export Development Project[4] indicated the following target impacts: (i) poverty reduction in Indonesia; (ii) balanced and sustainable economic growth; and (iii) commercially, financially viable, and sustainable private sector SMEs. The envisaged performance target for the first impact was reduction in absolute poverty by 50%, from 20% in 2002 to 10% in 2015. For the second targeted impact, the performance indicator was an increase in total non-oil-and-gas exports from $50 billion (2002 baseline) to at least $75 billion by 2015. For the last impact, the indicator was an increased share of SME exports, from 10% (2002 baseline) to at least 15% by 2015.

5. The project was expected to provide long-term job prospects for unskilled and semiskilled workers, thus absorbing the 2.5 million entrants to the labor market each year. It was also envisaged to provide more productive work prospects for a large segment of the labor force, including the 10% seeking work and better opportunities and the 60% that were already engaged in the informal sector. The first round impact of the loan was expected to be about 1.5 million job-years. The majority of workers, who were expected to find productive work in SMEs under the project, were to be drawn from among the poor or near poor.

6. The expected main benefits for the government and SME exporters were as follows: (i) investments in new technologies for export growth during economic recovery; (ii) sustainable direct and indirect employment generation through labor-intensive exports; (iii) increased direct exports from SMEs; (iv) enhanced market-oriented business advisory services to SMEs through existing business networks to complement investments and increased labor productivity, and (v) improved mechanism for the delivery of credit to SMEs through adequate and transparent financial intermediation and project management.

C. Objectives or Expected Outcomes

7. The intended outcomes of the project were: (i) increased exports by SMEs, and (ii) increased SME job opportunities. For outcome (i), the performance target was an increase in value of SMEs' direct exports from $4 billion (2002 baseline) to at least $6 billion by 2005. For

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[2] ADB. 2000. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Republic of Indonesia for the Industrial Competitiveness and Small and Medium Enterprise Development Program.* Manila.

[3] ADB. 2002. *Technical Assistance to the Republic of Indonesia for Strengthening Business Development Services for Small and Medium Enterprises.* Manila.

[4] ADB. 2002. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Technical Assistance Grant to the Republic of Indonesia for the Small and Medium Enterprise Export Development Project*. Manila.

outcome (ii), the target was increased employment of 1.5 million job-years attributable to SMEs by 2015. The project aimed to support economic growth, reduce poverty through job creation, and promote labor-intensive exports. As part of a larger support strategy, the project supported the SME export sector directly through investment capital, a niche market within the entire SME sector lending. In addition, the project was envisaged to improve the appraisal capacity of banks to undertake investment lending and the exporters' capacity to apply for bank credit with sound financial advisory services. It was to present integrated support to export-oriented SMEs nationwide, with priority given to subprojects from selected provinces with export potential, such as East and Central Java (part of ADB's geographical focus), Sulawesi (part of the East ASEAN Growth Area), and Bali.

D. Components and Outputs

8. The project had two components:

(i) Small and Medium Exporters' Investment Facility (SEIF) for small exporters to meet investment requirements for capacity expansion and modernization. These investment funds were to be channeled to public and private banks through Bank Ekspor Indonesia (BEI), which was to manage the banks' risks, while the participating banks were to manage the exporters' risk (exporters were to assume the foreign exchange risk of the subloans); and

(ii) a TA grant of $500,000 to strengthen credit and project appraisal capacity for all participating banks through the technical assistance management unit (TAMU),[5] including training for bankers on SME credit scoring, basic trade finance instruments, and financial advisory services for SME exporters to have access to the SEIF.

E. Provision of Inputs

9. At appraisal, the project was estimated to cost $113 million equivalent, consisting of $85 million in foreign exchange financing from the SEIF and local currency cost of $28 million financed by subborrowers' equity and/or participating banks. At cancellation, $6.44 million was disbursed, which included a $5.59 million subloan disbursement and a front-end fee of $850,000.

10. The loan became effective on 18 May 2004, after a delay of about 4 months. Implementation was difficult due to the change in economic environment, which caused participating banks to use their own funds rather than utilize the ADB loan. Upon the request of the government, ADB in December 2005 allowed the financing of subloans up to 100% of working capital requirements and increased the maximum subloan size to $2 million. However, these changes were made too late in project implementation and did not result in a significant increase in approved subloans. In January 2007, ADB canceled the unused loan balance of $78.56 million. The loan was officially closed in September 2008. The data on the actual total project costs, subborrower's portion, and participating banks' cost are not available.

11. The TA, financed through the Asian Currency Crisis Support Facility, was designed to support project implementation. In parallel, the Government of Japan financed an SME

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[5] ADB. 2002. *Technical Assistance to Republic of Indonesia for Small and Medium Enterprise Export Development*. Manila (TA 4041-INO for $500,000).

promotion program for $5 million to complement this TA. The TA component developed an implementation system for the project. It also helped the staff of participating banks, and to some extent the staff of BEI, develop and improve their skills in subproject appraisal and management of credit lines financed by external financial institutions. The TA completion report rated the TA *successful*.[6] However, for reasons not provided, the BEI disbanded the TAMU during its internal reorganization. Hence, the TAMU ceased to provide support to the Ministry of Finance (MOF) and ADB in terms of data collection, analysis, and dissemination.

F. Implementation Arrangements

12. The executing agency was the Directorate General of the Financial Institutions in the MOF. BEI was the implementing and loan administration agency for the SEIF that was to be made available to SME exporters through Indonesian state-owned and private banks. Of the six pre-selected banks to participate in the project, only two actually participated. The four banks did not participate due mainly to excess liquidity and the availability of cheaper funds from their own resources.

13. The related TA provided 18 person-months of international consulting services and 22 person-months of domestic consulting inputs over a contract period of 18 months. The performance of consultants was *satisfactory*. The quality of their inputs met the expectations of their terms of reference.

II. EVALUATION OF PERFORMANCE AND RATINGS

A. Relevance of Design and Formulation

14. The appraisal design took into account lessons from international experience and ADB's experience in Indonesia. The project anticipated its interest rates to be competitive with alternative sources of funding. The availability of foreign currency credit for SME exporters sought to address the squeeze on foreign currency availability arising from the financial crisis and reduced availability of credit lines to Indonesian banks.

15. The project completion report (PCR)[7] considered the project *relevant* at the appraisal stage as it sought to address a key impediment to SME development. However, its relevance sharply diminished during implementation due to the change in the macroeconomic environment. The country's improved economic performance after the financial crisis expanded the foreign exchange reserves and increased the liquidity of banks to the extent that they were able to fund SME working capital and import requirements using their own resources at lower rates without relying much on the external financing support. Consequently, the need of participating banks to utilize the ADB loan diminished considerably during project implementation. In addition, strict conditions and restrictions on subloans constrained the utilization of the ADB loan. Thus, participating banks only used a small portion of the ADB loan. There are several other project design-related identified as lessons (paras. 30–32). In view of these, this validation agrees with the PCR's *less than relevant* (*partly relevant)* rating of the project.

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[6] ADB. 2006. *Technical Assistance Completion Report on Small and Medium Enterprise Export Development Project*. Manila (TA 4041-INO).

[7] ADB. 2009. *Completion Report: Small and Medium Enterprise Export Development Project in Indonesia*. Manila.

B. Effectiveness in Achieving Project Outcomes

16. The PCR rated the project *less than effective* (*less effective)*. This validation downgrades it to *ineffective* in achieving the envisaged outputs and outcomes. The project was able to finance only 23 subloans (for 14 subprojects) of the 150 subloans estimated at appraisal. In view of the very small number of subprojects financed, this validation considers that the extent of outcomes achieved in terms of additional employment of semiskilled and unskilled workers and the increase in SME exports, fall far below the minimum level for the *less than effective* rating. The PCR did not monitor the outcomes based on the baseline data and targets in the design and monitoring framework (DMF).

C. Efficiency of Resource Use in Achieving Outputs and Outcomes

17. The PCR indicated that changes in the macroeconomic setting made project implementation difficult. It cited the following delays and other early warning signals, which indicated that the ADB loan was not likely to succeed: (i) the 1-year delay in signing the loan agreement; (ii) delay in loan effectiveness by about 4 months that included one extension; and (iii) the cost of funds differential beginning to shift in favor of the participating banks' own funds as early as the fourth quarter of 2002. However, the reasons for these delays were not indicated in the PCR.

18. The PCR rated the project *inefficient* in achieving targeted outcomes and outputs. This validation concurs. Of the $85 million loan that was expected at appraisal to be fully utilized, only $5.59 million (6.6%) was used. This validation agrees with the PCR that the amount utilized out of ADB's loan was not commensurate to the time, effort, and resources spent to appraise, follow up, and implement the project. Long delays were incurred in disbursing loan proceeds. The subprojects financed by the loan were operating satisfactorily, but these were too few.

D. Preliminary Assessment of Sustainability

19. Both this validation and the PCR rate project sustainability as *unlikely*. As mentioned earlier, the project failed to be sustainable under the drastically changed post-financial crisis economic environment. The change in the overall economic condition was not foreseen during appraisal and participating banks will likely continue using cheaper funds than the ADB loan to finance SME requirements.

E. Impact

20. The PCR indicated that the project's impacts were minimal compared to that envisaged at appraisal. The small number of subprojects financed made little impact on poverty reduction, attainment of balanced and sustainable economic growth, and establishment of commercially, financially viable and sustainable SMEs. The PCR mission noted that these few subprojects added value to job creation and export growth. However, these were not in the magnitude expected at appraisal. This validation agrees that project impacts are negligible (minimal). The PCR did not monitor project impact based on the baseline data and targets in the DMF.

III. OTHER PERFORMANCE ASSESSMENTS

A. Performance of the Borrower and Executing Agency

21. The government and participating banks generally complied with the loan covenants. Participating banks promptly submitted quarterly progress reports and audited annual reports to BEI. In general, the banks met the prudential regulations and guidelines of the Bank of Indonesia and ADB. The covenant for BEI to continue the TAMU was not met. As a result, subproject and socioeconomic data were not available, and therefore verification could not be effectively undertaken.

22. The operational and financial performance of BEI as the implementing agency, and the two participating banks, Danamon Indonesia and Bank Negara Indonesia, were *satisfactory*. Bank Danamon Indonesia and Bank Negara Indonesia had comfortable liquidity positions and returns on assets that were within ADB's prescribed limit. BEI operated profitably during 2004–2008, achieving acceptable returns on equity and assets. The capital adequacy ratio of BEI and the two participating banks were above ADB's minimum limit of 8%. The PCR provided fair and adequate discussion on the financial performance of the implementing agency and participating banks.[8]

23. The PCR did not provide a rating on the performance of the borrower and the executing agency. This validation rates the performance of the executing agency as *satisfactory*. However, the covenant to continue the TAMU and the requirement for BEI to submit its own PCR were not met.

B. Performance of the Asian Development Bank

24. The PCR did not rate ADB's performance. This validation agrees with the PCR that a more rigorous forecast on the likely economic environment should have been made at appraisal (PCR para. 56). Incorporating this in the design could have scaled down the amount of the ADB loan or made the interest rate more competitive and the loan structure more flexible.

25. ADB should have periodically monitored the evolving macroeconomic and market conditions, which could have resulted to more informed decisions and corrective actions during implementation. By the time ADB agreed to remove some of the restrictions on the use of the ADB loan, it was already too late since the government and participating banks decided not to proceed further with the loan. An earlier discussion with these concerned parties could have shown that there was no chance for the project to succeed and that the loan needed to be canceled. This would have saved the government and the participating banks substantial amounts of commitment fees paid on the unused portion of the loan, as well as time, effort, and resources spent in pursuing the loan.

26. Subloan and subproject data were not available because the benefit monitoring and evaluation mechanism was not set up within the TAMU. This validation concurs with the PCR's assessment that ADB review missions should have ensured that BEI actually met these appraisal requirements. The missions should have continued working properly within BEI to make project data available when required. ADB did not follow up on the TAMU's continuing operation during its supervision of the project.

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[8] A summary of their financial and operating performance was presented in Appendix 3 of the PCR.

27. The project was transferred to the Indonesia Resident Mission in July 2004, or about 2 months after the loan became effective. The resident mission's capacity for project management relating to the financial sector appeared weak as indicated by the delay in taking action on the unused portion of the loan, and shortcomings in general project supervision as reflected in the unavailability of necessary project data and lack of continuous analysis and reporting. This validation rates ADB performance as *less than satisfactory.*

C. Others

28. There were no identified issues on resettlement, gender, and indigenous people during project implementation. BEI did not prepare its internal PCR as required under the loan agreement.

IV. OVERALL ASSESSMENT, LESSONS, AND RECOMMENDATIONS

A. Overall Assessment and Ratings

29. Overall, this validation rates the project *unsuccessful,* validating the PCR's *unsuccessful* rating. The project was *less than relevant, ineffective, inefficient,* and *unlikely to be sustainable* (see table). The project's intended outcomes such as increased exports by SMEs and increased SME employment opportunities were not achieved. Implementation of the project was inefficient as only 6.6% of the ADB loan was used, and only 15% of the expected subloans were financed. The project failed to be sustainable under the drastically changed post-financial crisis economic environment.

Overall Ratings

Criteria	**PCR**	**IED Review**	**Reason for Disagreement and/or Comments**
Relevance	Partly relevant	Less than relevant	
Effectiveness in achieving outcome	Less effective	Ineffective	In view of the very small number of subprojects financed, this validation considers that the extent of outcomes achieved, in terms of additional employment of semiskilled and unskilled workers and the increase in exports by SMEs, fall far below the minimum level for the *less than effective* rating (para. 16).
Efficiency in achieving outcome and outputs	Inefficient	Inefficient	
Preliminary assessment of sustainability	Unlikely to be sustainable	Unlikely to be sustainable	
Overall assessment	**Unsuccessful**	**Unsuccessful**	
Borrower and executing agency	Not rated	Satisfactory	
Performance of ADB	Not rated	Less than satisfactory	Failed to monitor the changes in the macroeconomic and market environment. Removal of restrictions on the use of loan proceeds made too late (para. 27).
Impact	Minimal	Negligible	The number of subprojects financed by

Criteria	PCR	IED Review	Reason for Disagreement and/or Comments
			the loan was too small to have a significant impact on employment and growth of the SME sector (para. 20).
Quality of PCR		Satisfactory	Refer to para. 35.

ADB = Asian Development Bank, IED = Independent Evaluation Department, PCR = project completion report, SME = small and medium-sized enterprise, TAMU = technical assistance management unit.
Note: From May 2012, IED views the PCR's rating terminology of "partly" or "less" as equivalent to "less than" and uses this terminology for its own rating categories to improve clarity.
Source: ADB Independent Evaluation Department.

B. Lessons

30. The lessons brought out by the PCR are valuable to ADB. A more rigorous economic assessment at appraisal on the likely environment under which the project would operate during implementation is important. This is particularly applicable to investment lending projects, which could be affected by changes in economic conditions and financial market environment. This validation views that periodic assessments of changing macroeconomic conditions could result to more informed decisions during implementation and better early warning signals.

31. Moreover, decisive action needs to be made on the unused portion of the loan to keep from incurring unnecessary resources and commitment fees. The PCR pointed out that project design was based on a traditional credit line modality of a public sector development finance institution. The loan structure included pricing that was not competitive.

32. Furthermore, strict conditions and restrictions on the loan proceeds constrained utilization of ADB's loan. Based on experience with this project, the PCR views that a public sector-type modality does not have much prospect for financing private banks and private sector enterprises, particularly in a growing economy with sizable liquidity and foreign exchange reserves. This validation agrees with this view. SMEs will seek the cheapest funds and the most convenient sources available. Additionally, banks will use the cheapest source of funds to finance SME investments. The PCR suggested a more viable instrument for SME promotion using ADB's credit guarantee scheme under the Partial Credit Guarantee Facility, i.e., ADB's private sector window. This facility could be extended to selected viable banks operating at the regional level to guarantee SME loan portfolios up to a certain level without a counter guarantee from the government. ADB may consider this option in similar projects faced with high liquidity and foreign currency reserves in the market.

C. Recommendations for Follow-Up

33. This validation agrees with the recommendations of the PCR. Specifically, a monitoring and evaluation mechanism needs to be established within the implementing agency. All pertinent data should be made available to ADB review missions and for analysis. Before transferring a project to the resident mission, resident mission staff members should be trained in the skills and expertise needed for effective project management during implementation. ADB may consider the following general recommendations: (i) take into account economic conditions at the time of appraisal, and during project implementation; (ii) take decisive action to cancel the unused portion of the loan when early warning signals indicate that the project is unlikely to succeed; and (iii) extend partial guarantees under the Partial Credit Guarantee Facility to selected regional private banks to guarantee up to a certain level of SME loan portfolios without a counter guarantee from the government.

V. OTHER CONSIDERATIONS AND FOLLOW-UP

A. Monitoring and Evaluation Design, Implementation, and Utilization

34. Based on the original project design, the TAMU was to monitor the financial and economic performance of subprojects, and evaluate their socioeconomic and environmental benefits. In addition, a random sample of subprojects was to be selected for ongoing, long-term benefit monitoring and evaluation by TAMU in coordination with ADB staff. These were not achieved because BEI disbanded TAMU during its internal reorganization. Hence, subproject data for analysis and for PCR review were not available.

B. Comments on Project Completion Report Quality

35. This validation assesses the quality of the PCR as *satisfactory*. The PCR generally followed the guidelines of Project Administration Instructions 6.07A. It provided a fair and adequate assessment of project implementation and outputs. The presentation of participating banks' operational and financial performance was informative. Lessons and recommendations were sound and derived from the analyses and findings. The PCR did not monitor project outcomes and impact based on the baselines and targets in the DMF as a major portion of the loan was canceled.

C. Data Sources for Validation

36. Data sources used for this validation included back-to-office reports, aide memoires, memorandum of understanding of the project review mission, minutes of the management review meeting, ADB's PCR, report and recommendation of the President on the proposed loan, and technical assistance completion report.

D. Recommendation for Independent Evaluation Department Follow-Up

37. None.