



Validation Report

Reference Number: PVR-241
Project Number: 31282
Loan Number: 1849 (SF)
December 2012

Sri Lanka: Southern Province Rural Economic Advancement Project

Independent Evaluation Department
Asian Development Bank

ABBREVIATIONS

ADB	–	Asian Development Bank
BME	–	benefit monitoring and evaluation
EIRR	–	economic internal rate of return
MPI	–	Ministry of Plan Implementation
NDB	–	National Development Bank
OPEC	–	Organization of the Petroleum Exporting Countries
PCR	–	project completion report
PMO	–	project management office
RRP	–	report and recommendation of the President
SME	–	small and medium-sized enterprise
SPC	–	Southern Provincial Council

NOTE

In this report, “\$” refers to US dollars.

Key Words

adb, asian development bank, ied, independent evaluation department, lessons, performance evaluation, poverty reduction, project completion report, rural development, sri lanka

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PROJECT BASIC DATA

Project Number:	31282	PCR Circulation Date:	Dec 2010	
Loan Number:	1849 (SF)	PCR Validation Date:	Dec 2012	
Project Name:	Southern Province Rural Economic Advancement Project			
Country:	Sri Lanka		Approved (\$ million)	Actual (\$ million)
Sector:	Agriculture and natural resources	Total Project Costs:	42.70	57.20
ADB Financing: (\$ million)	ADF: 25.00	Loan: (SDR equivalent)	25.00	28.10
	OCR: 0.00	Borrower:	19.38	18.64
Cofinancier:	OPEC Fund for International Development	Beneficiaries:	6.70	15.40
		Others:	4.00	6.20
		Total Cofinancing:	2.00	2.50
Approval Date:	26 Oct 2001	Effectiveness Date:	5.00	5.00
Signing Date:	10 Jan 2002	Closing Date:	10 Apr 2002	12 Dec 2002
Project Officers:	P. Dayal S. K. Sahni K. M. Tilakaratne	Location:	31 Jul 2008	05 Aug 2010
			ADB headquarters ADB headquarters Sri Lanka Resident Mission	
Validators:	P. Choynowski, Consultant A. Morales, Evaluation Officer, IED1	Peer Reviewer:	G. Rauniyar, Principal Evaluation Specialist, IED1	
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ADB = Asian Development Bank, ADF = Asian Development Fund, IED1 = Independent Evaluation Department (Division 1), OCR = ordinary capital resources, OPEC = Organization of the Petroleum Exporting Countries, PCR = project completion report, SDR = special drawing right, SF = special funds.

I. PROJECT DESCRIPTION

A. Rationale

1. Agriculture, the predominant economic activity in the Southern Province of Sri Lanka, contributed about 30% of provincial gross domestic product and about 48% of jobs.¹ Statistics showed that the level of poverty by province was proportional to the rural share of its population and in the Southern Province, 80% of the population was rural with a poverty level of about 40%. Poverty in the province originated from low productivity in agriculture and sluggish growth of the nonfarm sector. The link of rural areas to poverty was seen as a direct result of inefficient and unproductive agriculture upon which rural populations depend on.

2. The province has received considerable development assistance but the region continued to remain at a disadvantage. The government recognized that investment in broad-based rural development projects resulted in minimal sustainable impact. It also recognized that primary agriculture production alone was unlikely to generate significant increases in jobs. Moreover, the government needed to improve productivity and market access for small-scale enterprises. On this backdrop, the government decided to move away from the approach of

¹ ADB. 2001. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Southern Province Rural Economic Advancement Project*. Manila.

integrated rural development projects to one focused on accelerating economic growth. The new approach emphasized promotion of commercial activities in farm and nonfarm sectors in collaboration with the private sector, which the government called rural economic advancement. The poverty reduction strategy² of the Asian Development Bank (ADB) also at that time strongly emphasized the development of agriculture and rural sectors in Sri Lanka where poverty was most prevalent.

B. Expected Impact

3. According to the project framework in the RRP (footnote 1), the project was to accelerate economic growth and employment opportunities in the Southern Province. The framework mentioned that project impact was to be verified through an enhanced per capita regional gross domestic product and a reduction in unemployment rate but it did not give specific targets.

C. Objectives or Expected Outcomes

4. The project's objectives were to (i) establish and expand micro-, small-, and medium-sized enterprises in agriculture-related sectors; (ii) provide and maintain key economic infrastructure; and (iii) enhance public and private sector capacities to support the process of economic growth. The attainment of project objectives was to be verified through (i) the number of enterprises increased; (ii) the number of local government infrastructure upgraded and improved; (iii) private sector participation in project activities; and (iv) financial allocations for infrastructure operation and maintenance. There were no specific targets given in the project framework. It neither stated any numeric baseline nor achievement targets for project impact.

D. Components and Outputs

5. The project comprised two interrelated parts that were to be implemented simultaneously. The first part was intended to stimulate economic activity in the region and included support to enterprise development services and a credit line. The second part aimed to build a conducive environment for economic growth and covered the provision of rural infrastructure, capacity building on technical, financial and infrastructure maintenance aspects, and project administration and management support. The various components and their corresponding expected outputs are briefly highlighted below.

- (i) **Enterprise development services.** The project sought to establish a professional enterprise development service for entrepreneurs to access necessary services, products, market information, and contacts by training and guiding participants in the project's credit component. Other activities included an inventory of potential agribusiness opportunities, identification of markets for new and existing products, and provision of advisory and technical support concerning enterprise development.
- (ii) **Credit for economic growth.** The project was to address the financing needs of potential entrepreneurs in the Southern Province and provide access to long-term resources. Subprojects were to be agriculture related with special focus on unemployed youth and women. The credit line was to finance medium- and long-term investment needs of about 1,500 small and medium enterprises and about 7,000 microenterprises.
- (iii) **Capacity building for *pradeshiya sabhas* to maintain rural roads.** This component aimed to demonstrate to the local governments (*pradeshiya sabhas*) best practices in

² ADB. 1999. *Fighting Poverty in the Asia and the Pacific: The Poverty Reduction Strategy of the Asian Development Bank*. Manila.

rural road maintenance with one rural access road used as a demonstration in each *pradeshiya sabha*. Upon completion, *pradeshiya sabhas* were to identify rural roads for upgrading and preventive maintenance work, and receive project funding for maintenance. About 30 kilometers of most important roads were to be eligible for funding in each *pradeshiya sabha*.

- (iv) **Market upgrading and improvement.** The project would support market development and upgrading by financing the improvement of 20 markets. Financing was to be contingent on *pradeshiya sabhas* drawing up plans for user fees and management of the facilities by market traders associations. Consulting services were to be provided to help design market upgrading that best meets the needs of market users.
- (v) **Financial management advice.** The project aimed to provide advice and training on sound financial management and resource utilization for staff and elected members of the *pradeshiya sabhas* as part of a package of rural road and market upgrading activities. Public finance advisers recruited under the project were to provide the advice.
- (vi) **Project management office.** The project included provision of support for establishing a project management office (PMO) to coordinate and monitor project activities, including establishing enterprise development and information centers, administering the infrastructure component, and undertaking project implementation monitoring and evaluation. Financing was to be provided for staff, equipment, and materials needed by the Department of Local Government to supervise and implement rural road and market improvement activities, and to train staff.
- (vii) **Support for the Ministry of Plan Implementation, Southern Provincial Council, and *pradeshiya sabhas*.** The project also was expected to assist the Ministry of Economic Development (then Ministry of Plan Implementation [MPI]) and Southern Provincial Council (SPC) staff in acquiring skills to promote private participation and develop capacity to work and coordinate with partners through training in enterprise development, business promotion, marketing, public relations, and information management. For the *pradeshiya sabhas*, support was to be provided for project implementation.

6. During project implementation, two major changes were effected in project scope, both at the request of the government and endorsed by ADB's Board. The first change, made in April 2004, involved new flood rehabilitation works that rehabilitated 605 km of rural gravel roads and built 19 pedestrian bridges after a flood in May 2003. The second change made in August 2006 involved a project design change from the improvement of rural gravel roads to the creation of fewer asphalt and concrete pavement roads. This was to help increase the capacity of *pradeshiya sabhas* to maintain the rural paved roads and reduce the maintenance costs. These additional civil works in the project components were made mainly through project funds transfer from the credit component to the infrastructure rehabilitation and creation components. As a result of the scope changes, the share of civil works component increased from 29% to 66% of total project costs, while the credit component was reduced from 47% to 24%.

E. Provision of Inputs

7. The project was estimated to cost \$42.7 million equivalent, of which \$13.2 million (31%) was foreign exchange cost, and \$29.5 million equivalent (69%) local currency cost. The cost estimates included physical and price contingencies and taxes and duties. ADB was to provide a loan of \$25 million from its special funds resources to finance 58% of total project cost. The Organization of the Petroleum Exporting Countries (OPEC) Fund was to provide \$5 million to finance portions of rural roads and markets. ADB was to administer the OPEC Fund loan. The remaining local currency cost of about \$12.7 million equivalent was to be met by the government (\$6.7 million), participating financial institutions (\$2.0 million), and beneficiaries

(\$4.0 million). The total expenditure at completion was \$57.2 million, of which 49% (\$28.1 million) was financed by ADB.

F. Implementation Arrangements

8. The MPI was to be the executing agency for the project and responsible for budgeting, ensuring timely flow of funds to the SPC and the National Development Bank (NDB) for overall monitoring of implementation progress, coordinating development assistance, providing policy advice and guidance to the SPC and NDB, and resolving issues or disputes. The SPC responsible for overall implementation and coordination of the project components working through the PMO, and the NDB was responsible for supervising the financial services component and for training staff of participating financial institutions. A project management committee was to act as the steering committee for the project and be responsible for (i) resolving all project-related issues, (ii) approving the annual work plan, and (iii) periodically reviewing project progress. It was also to coordinate project activities with other national and provincial programs. The project was to be implemented over 6 years. The PCR reported that the implementation arrangements were complex. At appraisal, the Ministry of Plan Implementation was the EA, but this arrangement changed five times, and that the project implementation arrangements at appraisal were overambitious.

9. Goods and services financed by ADB and the OPEC Fund were to be procured in accordance with ADB's Procurement Guidelines and the government's Revised Guidelines on Tender Procedures for Foreign-Assisted Projects.³ All consulting services, including those financed by the OPEC Fund were to be engaged according to *ADB Guidelines on the Use of Consultants*⁴ and arrangements satisfactory to ADB.

10. The rural economic advancement approach required capacity in the MPI and the SPC to discharge new responsibilities and attitudinal shifts. A start-up period of 1 year was built into project implementation to address any relevant issues that may arise. To mitigate any problems in initiating and operating a partnership between the SPC and the private and nongovernment organization-operated enterprise development service, and ensure a clear delineation of operational modalities, the lead enterprise development service agency was to be housed in the PMO to function as a technical support unit of the public sector.

11. Associated with the loan for the project were 34 loan covenants. Most of the covenants were related to project implementation, counterpart financing, and reporting requirements. Of the 34 covenants, 29 were fully complied with, 3 partly complied with, and 2 was not applicable due to change in project scope.

II. EVALUATION OF PERFORMANCE AND RATINGS

A. Relevance of Design and Formulation

12. The project completion report (PCR)⁵ rated the project *highly relevant*, stating that the project was in line with the strategies of the government and ADB. As mentioned above (para. 6), two major changes were made to project scope and design, by more than doubling the civil works component while halving the credit component that started late and was slow in

³ ADB. 2010. *Procurement Guidelines*. Manila.

⁴ ADB. 2010. *Guidelines on the Use of Consultants*. Manila.

⁵ ADB. 2010. *Completion Report: Southern Province Rural Economic Advancement Project in Sri Lanka*. Manila.

generating subloans. The PCR observed that the changes were consistent with the project's overall objectives and that the rationale for the project was valid given the characteristics of rural poverty in the Southern Province.

13. This validation considers that some of the reasons associated with the change in scope could have been anticipated and addressed at the design stage rather than during the implementation stage. For example, it is not clear why the type of maintenance works for the rural roads was not thought out carefully at the design stage. The PCR indicated that the project processing was short, taking only 4 months from appraisal to Board approval. This implies that there was a possibility of a rush in designing the project. Overall, the project design had too dissimilar components (i.e., enterprise development and roads) and was too complex to address rural poverty efficiently. The project design also did not factor in the possible challenges, particularly the difficult credit market conditions and the difficult project coordination in executing such a project with multiple components. The executing agency was changed five times during implementation. The PCRs of the government and ADB both noted the complex project implementation arrangements. These factors highlight design shortcomings. Nevertheless, the reallocation of project funds to disaster rehabilitation through a major scope change had some merit, and this validation considers that the project turned out still *relevant* for the intended rural economic advancement in the region.

B. Effectiveness in Achieving Project Outcomes

14. The PCR rated the project *effective* in achieving outcomes. It stated that the credit component's effectiveness "was clearly demonstrated in the rapid uptake of the reduced credit loan funding;" 83% of the credit line was disbursed during 2005–2007. In Appendix 2, the PCR stated that the actual number of credit loans provided to small and medium-sized enterprises (SMEs) was 701 and 3,493 to microenterprises, compared to 1,500 SMEs and 7,000 microenterprises at appraisal, a shortfall of 51%. This shortcoming was affected mainly by the reallocation of 43% of the credit component to the civil works. Although SMEs and microenterprises were established, the PCR did not provide information on how many were actually in operation, how many failed or went bankrupt, or how many sustainable jobs were created. It is insufficient to base the effectiveness rating on a disbursement rate because it is not related to the expected outcomes of income generation and job creation.

15. To support the effectiveness rating, the PCR mentioned increases in traffic on rural roads and growth in economic activity in rural markets. The PCR reported that a post-project survey determined a range of unanticipated benefits from the rehabilitation works. Since these works were incorporated in the project as emergency additional works after appraisal, no assessment of actual performance to expected outputs is possible. Although the outcomes may be related to higher incomes and employment as opposed to other factors such as a generally improved economic environment, the PCR did not provide evidence that these outcomes resulted from the project's intervention and they are also not relevant to the main objectives, namely establishing viable microenterprises and creating capacity in road maintenance. The PCR mentioned the effectiveness of the institutional support and training component, particularly for provincial council and local government staff. However, institutional support and training were project outputs, rather than outcomes. Given these shortcomings, this validation downgrades the rating to *less than effective*.

C. Efficiency of Resource Use in Achieving Outcomes and Outputs

16. The PCR rated the project *efficient* in achieving outcomes and outputs. The actual expenditure exceeded original allocations due to price escalation, an increase in the number of activities in some components, and currency fluctuation, which saw the Sri Lanka rupee appreciating by 37% against the US dollar. The RRP reevaluated the economic internal rate of return (EIRR) of the rural roads component at an EIRR of 21%, compared to 23% in the RRP. For the market upgrading and improvement component, the EIRR was reevaluated at 85% compared to 26% in RRP. There was no EIRR calculation for the credit component in the PCR, only the statement that “the rates of return for the 10 indicative enterprises identified at appraisal were still applicable and considered economically viable, indicating their economic benefits to the local economy.” The PCR assessed the credit component as *less than efficient* because employment fell 34% short of the target.

17. The EIRR of 21% for the rural roads component seems reasonable. On the other hand, the EIRR of 85% for the market upgrading and improvement component seems excessive. The high value is likely because of the assumption that half of incremental income generated in the market was an economic benefit. This assumption is arbitrary. However, this validation suggests that the project EIRR should have been calculated for the project as a whole, including the credit component. In terms of process efficiency, the project had significant delays and design changes. Based on the information provided by the PCR, this validation rates the project as *efficient* on balance.

D. Preliminary Assessment of Sustainability

18. The PCR rated project sustainability as *less likely*. Sustainability of the credit component is a concern because: (i) the subsidiary loan agreement between the government and NDB for the operation of the revolving fund expired on 31 January 2011 and there is uncertainty over the operation of the revolving fund; (ii) disbursement of the revolving fund credit line by NDB continues to be slow; (iii) NDB relaxed the need for participating financial institutions to use enterprise development service providers; and (iv) NDB reduced the flexibility of interest rate margins for participating financial institutions. Although project roads remain in good condition, vegetation has encroached on hard shoulder areas, and in general roads are not adequately maintained by the *pradeshiya sabhas*. A similar situation applies to pedestrian bridges. *Pradeshiya sabhas* are not allocating sufficient funds for regular road maintenance. Rural market maintenance is also a concern. The PCR indicated in its para. 48 that the outcome in terms of creating capacity for road maintenance in the *pradeshiya sabhas* could be problematic. Some *pradeshiya sabhas* failed to provide for maintenance according to agreed-upon market management plans. This validation concurs with the PCR that the project is *less than likely sustainable*.

E. Impact

19. According to the PCR, improved rural markets created an additional 4,000 market trader opportunities. By generating jobs and upgrading businesses, the project addressed key poverty issues. Project beneficiaries ranged from the economically disadvantaged poor to higher income groups, and poor agricultural producers who were able to access credit and local markets for their produce. About 25% of jobs created were for women. There is a lack of information on income generated and jobs created by the project, particularly relating to sustainability of enterprises. The PCR provided no rating on project impact. This validation rates impact as *significant*.

III. OTHER PERFORMANCE ASSESSMENTS

A. Performance of the Borrower and Executing Agency

20. The PCR stated that the performance of the borrower was *partly satisfactory*. The executing agency's role was transferred five times to five different ministries. This had an adverse effect on the continuity of project supervision. The project director was changed three times. There were delays in appointing and maintaining the head of the enterprise development and monitoring and evaluation unit. The PMO's key staff members were also responsible for implementing a component of the Tsunami-Affected Areas Rebuilding Project, thus increasing their workload. The government PCR lacked key information. The PCR rated the performance of NDB *partly satisfactory* because of (i) slow mobilization of the initial credit funding of subloans, (ii) slow mobilization of institutional support to participating financial institutions, and (iii) a 3-year delay in establishing the revolving fund. This validation concurs with the PCR rating of *less than satisfactory* for borrower's performance.

B. Performance of the Asian Development Bank

21. The PCR rated ADB performance as *satisfactory*. The processing of the project was relatively short, 4 months from appraisal to Board approval in October 2001. Regular ADB missions facilitated loan effectiveness. The project was delegated to the Sri Lanka Resident Mission on 1 March 2006. ADB undertook 18 review missions to monitor, supervise, and administer the project. These missions provided advice on (i) technical issues; (ii) procurement procedures; (iii) bid document preparation, documentation, and evaluation; (iv) civil works quality assurance; and (v) loan administration. ADB approval of the government's request for change of scope from the gravel roads to surface roads was delayed. Throughout the project, ADB worked to resolve procurement and contracting delays. However, it appears that ADB overlooked the requirement or covenant that the borrower implements a benefit monitoring and evaluation (BME) system. There was however no loan covenant that legally bound the borrower to implement the BME. Nevertheless, this validation concurs with the PCR rating of ADB's performance as *satisfactory*.

C. Others

22. The PCR stated that the project had few adverse environmental effects. Liquid and solid waste disposal, noise, and dust did not present significant environmental issues. The rural roads works were simple rehabilitation and maintenance with no serious environmental impact. Maintenance of rural roads had a positive environmental effect by preventing sheet erosion. Market upgrading improved drainage and traffic movement, although some noise, dust, and disturbance were experienced during upgrading. Solid and liquid waste disposal at the markets was also not a significant issue. The PCR provided no assessment of other safeguards, gender, governance, anticorruption, or fiduciary aspects.

IV. OVERALL ASSESSMENT, LESSONS, AND RECOMMENDATIONS

A. Overall Assessment and Ratings

23. The PCR rated the project *successful* and assessed it as *highly relevant, effective, efficient, and less likely sustainable*. This validation concurs with the efficiency and sustainability ratings, but differs with the relevance and effectiveness ratings (see table). The validation rates the project *relevant* instead of *highly relevant* due to design limitations and other associated

factors outlined earlier. It rates the project *less than effective* as the PCR did not give sufficient evidence to rate the project *effective*. It also did not demonstrate that the claimed outcomes were relevant to the main objectives, namely establishing viable microenterprises and creating capacity in road maintenance. This validation rates sustainability as *less than likely* based on uncertainties on the operation of the credit line through the revolving fund, and the ongoing maintenance of rural markets. Overall, this validation downgrades the project rating to *less than successful*.⁶

Overall Ratings

Criteria	PCR	IED Review	Reason for Disagreement and/or Comments
Relevance	Highly relevant	Relevant	Design complexity and shortcomings (para. 13). The project lacks exceptional value adding features leading to high level outcomes and impact to substantiate the <i>highly relevant</i> rating.
Effectiveness in achieving outcomes	Effective	Less than effective	There are attribution issues and insufficient information on income generation, job creation, and the status of microenterprises. Also, the claimed outcomes are not relevant to the main objectives, namely establishing viable microenterprises and creating capacity in road maintenance. (paras. 14–15).
Efficiency in achieving outcomes and outputs	Efficient	Efficient	
Preliminary assessment of sustainability	Less likely sustainable	Less than likely sustainable	
Overall assessment	Successful	Less than successful	An aggregation of the individual ratings.
Borrower and executing agency	Partly satisfactory	Less than satisfactory	
Performance of ADB	Satisfactory	Satisfactory	
Impact	No rating	Significant	See para. 19.
Quality of PCR		Less than satisfactory	See para. 27.

ADB = Asian Development Bank, EIRR = economic internal rate of return, IED = Independent Evaluation Department, PCR = project completion report.

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

24. The PCR identified two lessons regarding clear delineation of responsibilities of implementing agencies in the project administration memorandum and the financial capacity of *pradeshiya sabhas* to develop and maintain rural infrastructure. This validation concurs with

⁶ The Sri Lanka Resident Mission disagreed with the downgrading by arguing that IED's overall assessment mainly depended on the credit component which was *less than successful* due to design problems and some delays, but all the other components had achieved the targets with changes in scope and reallocation of funds during the implementation that were made to deal with a flood, correct the design issues, and support the client requirements. This validation responded to the arguments in the relevant sections and the overall ratings table.

these lessons. However, the validation does not agree with the PCR's claim that the responsiveness and flexibility demonstrated by the project was laudable, and the project provided a worthy example for the design and management of future projects. As pointed out earlier (para. 13), changing the scope of a project during implementation as excessively as in this case cannot be considered as a good practice, even when in response to a flood.

C. Recommendations for Follow-Up

25. The PCR made three recommendations to ensure the continuity of the revolving fund. This validation concurs with these recommendations. The PCR also recommended that projects of this type include a BME system. It is not clear why this recommendation was made because the RRP provides for BME and the project framework makes reference to it. However, there was no loan covenant that legally bound the borrower to implement the BME.

V. OTHER CONSIDERATIONS AND FOLLOW-UP

A. Monitoring and Evaluation Design, Implementation, and Utilization

26. Although the project had a provision for BME, the PCR did not mention why it was not implemented.

B. Comments on Project Completion Report Quality

27. The PCR's major shortcoming was insufficient analysis and inadequate assessment of effectiveness and efficiency. Lack of evidence weakened any justification for project performance reported in the PCR. Overall, the quality of the PCR was *less than satisfactory*.

C. Data Sources for Validation

28. The sources of data for this validation consist of (i) the project RRP, (ii) project files and related documents, (iii) ADB and government PCRs, and (iv) Sri Lanka Country Partnership Strategy 2009–2011 Final Review Validation.

D. Recommendation for Independent Evaluation Department Follow-Up

29. The PCR makes no recommendation regarding the project performance evaluation report. This validation also does not recommend any further IED action.