India: Micro, Small, and Medium Enterprise Development Project
ABBREVIATIONS

ADB – Asian Development Bank
BTOR – back-to-office report
DMF – design and monitoring framework
JFPR – Japan Fund for Poverty Reduction
MSMEs – micro, small, and medium enterprises
MSMEDP – Micro, Small, and Medium Enterprise Development Project
PCG – partial credit guarantee
PCR – project completion report
PFI – participating financial institution
SIDBI – Small Industries Development Bank of India

NOTE

In this report, “$” refers to United States dollars.

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<th>Director General</th>
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I. PROJECT DESCRIPTION

A. Rationale

1. Micro, small and medium enterprises (MSMEs) have played an important role in India's economy. MSMEs have generated employment and income for a large number of households. During project preparation stage, there were approximately 12.8 million registered MSMEs in India. It was estimated that MSMEs account for around 95% of all industrial enterprises, 45% of gross industrial production, and 40% of exports. Also, MSMEs provide direct employment for approximately 42 million people in India.

2. Traditionally, MSME programs have focused on the lower end of the scale, targeting micro and small enterprises. In 2006, the Small and Medium Enterprises Fund and the Micro, Small, and Medium Enterprises Development Act expanded the concept of enterprise to include not just enterprises engaged in the production of goods but also enterprises engaged in providing services. The act classifies “medium enterprises” as those in which investments in plant and machinery do not exceed 100 million rupees (approximately $2.5 million in 2010 terms).

ADB. 2010. Report and Recommendation of the President to the Board of Directors: Proposed Loan and Partial Credit Guarantee to India for the Micro, Small, and Medium Enterprise Development Project. Manila.
3. Low-income female entrepreneurs in the informal sector in semi-urban and urban settings often have difficulty accessing finance. The Micro, Small, and Medium Enterprise Development Project (MSMEDP) recognized that affordable financial resources is not sufficient to promote microenterprises and that access to such resources by underserved low-income entrepreneurs is essential. The MSMEDP aimed to improve access to commercial financing and provide capacity building services and market opportunities. It intended to foster MSME growth, competitiveness, and employment (footnote 1).

4. The project design consisted of a sovereign loan from the Asian Development Bank (ADB) of $50 million from ordinary capital resources, and a partial credit guarantee (PCG) of $250 million as nonsovereign operations. The borrower was the Government of India while the implementing agency for the loan was the Small Industries Development Bank of India (SIDBI), which was to channel the sovereign loan to smaller MSMEs. The PCG was offered to all public sector banks in India engaged in the MSME subsector and they were expected to benefit from long-term funds raised under the PCG facility. The project was supported by a parallel development grant of $3 million financed by the Japan Fund for Poverty Reduction (JFPR) to help build awareness and capacity of MSMEs targeting women microenterprises in relatively poor states.²

B. Expected Impact, Outcome, and Outputs

5. The project’s design and monitoring framework (DMF) set out the expected impact and outcome and identified three outputs (footnote 1). The expected impact was to “help MSMEs in India realize their full potential, thereby assisting MSMEs in India to be fully developed, especially those led by female microentrepreneurs.”³ The outcome was “improved MSME access to commercial financing and market opportunities, thereby fostering growth, competitiveness, and employment creation. There were three targeted outputs. First was enhance credit delivery through SIDBI and participating financial institutions (PFIs) in the MSME subsector. Second was increased SME productive and managerial capacity and related new jobs created for new markets. Third was increased MSME portfolios in participating banks through the use of ADB’s PCG.

C. Provision of Inputs

6. The project was approved in February 2010 and became effective in May 2010, a month ahead of the original target date. As planned, the loan was closed in June 2015 with no extension.⁴ At completion, 71% of the loan had been utilized. Of this, $0.7 million was under SIDBI’s direct lending operations and $35.0 million under its indirect lending facility through five PFIs. The $250 million PCG was not implemented. Differences in pricing expectations between the Industrial Development Bank of India and ADB, and the change in international capital market conditions meant that the PFIs were unwilling to use the PCG. The associated $3 million grant from JFPR to provide consulting services for women’s entrepreneurship development was completed in June 2018.

³ The report and recommendation of the President (RRP) and project completion report (PCR) wording for expected impact in the DMF are different. The DMF in the PCR restated the impact, omitting the words “thereby assisting MSMEs in India to be fully developed.” The wording for expected impact in this validation report is from the RRP.
The project completion report (PCR) did not mention consulting inputs except in Appendix 8, in the discussion of the summary findings from the gender perspective. The related JFPR grant was supported by an advisory committee, three thematic national-level consulting firms, one individual consultant, and an advocacy and communication outreach specialist. Their role was to develop strategies on advocacy and dissemination and were assigned the responsibility of implementing different gender action plan (GAP) activities.

The project was categorized as C (highly unlikely to have adverse impact) for involuntary resettlement and indigenous peoples. The categorization was the same at completion. For environmental safeguards, the category was FI (financial intermediary) treated as C, following ADB’s Environment Policy (2002). SIDBI and PFIs were to establish environmental and social management systems for subloans with environment category A (likely to have significant adverse environmental impacts) and B (potential adverse environmental site-specific impacts). The parallel $3 million grant from JFPR, providing consulting services for women’s entrepreneurship development, was completed in June 2018 and the completion report was to be available in 2019.

D. Implementation Arrangements

As envisaged at appraisal, SIDBI was the implementing agency for the project. The Government of India guaranteed SIDBI's obligations to ADB, with SIDBI's board of directors providing policy direction and strategic oversight. During implementation, SIDBI's risk management department performed oversight function for formulation, periodic review, and amendment of the loan policy, while SIDBI's project management division coordinated project implementation, monitoring, and supervision.

SIDBI provided subloans through PFIs, targeting micro and small enterprises. The PCR indicated that the implementation of subprojects followed the criteria and procedures for subloan appraisal, along with PFI selection criteria for indirect subloans. These, in turn, followed SIDBI’s established systems and were adjusted to cater to the needs of the project while at the same time complying with all pertinent banking regulations. The PCR noted that these provided a robust basis to manage subproject selection, appraisal, implementation, and repayment. However, the project encountered implementation problems on safeguard compliance at startup stage, and in the direct lending modality.

The PCR considered the modality of financial intermediation loan and PCG, and implementation arrangements as appropriate. This validation holds a similar view. The implementation arrangements were adequate to carry out project activities and deliver the expected outputs.

Of the 28 loan covenants, 24 were complied with, two substantially complied with, and two not complied with. The covenants substantially complied with pertained to ensuring female entrepreneurs were giving preference in accessing finance and the financing of subprojects with no significant adverse environmental impact. The first covenant not complied with was on “at least 30% of the proceeds of the loan be given to qualified enterprises.”
The PCR attributed this to the cancellation of about $14.3 million, as SIDBI slowed down in pursuing the direct financing component. The second covenant pertained to meeting ADB’s safeguard requirements prior to subloan approval.

II. EVALUATION OF PERFORMANCE AND RATINGS

A. Relevance of Design and Formulation

13. The PCR rated the project less than relevant. The PCR considered the project relevant at appraisal, since it targeted the underserviced “missing middle”, and offered the needed financial resources to a sector with growth potential. The PCR noted that during implementation, the project became less than relevant due to marked changes in international capital market conditions. This made the intended PCG unattractive to the Indian banks and substantially reduced the project-supported fund flows to the MSMEs. The lack of flexibility in the design also added to the reduced relevance of the project. When the market conditions changed, the project was unable to pursue alternative strategies, such as providing larger loans; or to focus on specific products or geographical areas to make loans commensurate with size.

14. This validation assesses the project less than relevant. The project was consistent with India’s development objectives as set out in the Eleventh Five-Year Plan (2007–2012), which has poverty reduction and social development as one of its core goals. A key thrust of the country partnership strategy for India is job creation and access to jobs. The project catered to both of these objectives. However, the shortcomings in the initial project design were significant and many. Impact and outcome were ambitious, given the size of the Indian market, and there was lack of specific, monitorable indicators for measuring project outputs. The focus on the “missing middle” and women entrepreneurs would have required substantially different and tailored approaches. Lessons learned from previous experiences were not sufficiently embedded in the design. The JFPR grant did not appear to be closely aligned with the project as a means to achieve the outcome or outputs. The project design showed it was not flexible enough to cope with changing conditions. When the international capital market conditions improved, providing easier access to Indian banks, it made the PCG less attractive. The events that occurred may not have been foreseeable. However, experience in India suggests this is a volatile market requiring projects to have a certain built-in flexibility.

B. Effectiveness in Achieving Project Outcome and Outputs

15. The PCR rated the project less than effective. Its DMF established sector-wide indicators as outcome targets, achievements on which were mixed. This validation adds that the measurement of the contribution of the project to these sector-wide indicators is challenging, and when positive results are reported, the evidence provided is insufficient to corroborate the findings. For example, the PCR noted that the project’s GAP was successful in 12 out of 13 targets achieved. The project’s record of channeling 60% of subloans to women enterprises was assessed to be significant. It provided a demonstration effect, given the low percentage of women enterprises in MSME (7.4% in fiscal year 2007).

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10 Flexibility could have been achieved through greater scope in specifying target MSME groups and sectors and allowing greater flexibility in pricing the PCG.
16. However, the claim based on the first target—60% of loans were provided to women beneficiaries—assumed the previous shortcomings identified by the safeguard audit and several back-to-office reports (BTORs) had been corrected. The only evidence of any independent verification of the second target was provided by the baseline conducted by Insight Development Consulting Group funded by JFPR. The survey for data collection focused on JFPR clients and the impact of JFPR activities. The third target on establishing a mechanism (i.e., Credit Guarantee Scheme) to support innovative proposal targeting women entrepreneurship in selected states, used as proof of achievement a scheme set up in 2000, 10 years before the loan was approved, and a series of training courses. Other GAP targets can also be questioned. The targets may well have been achieved, but the pieces of evidence presented were insufficient to make an informed judgment. At the very least, the targets and indicators used to measure GAP achievements were poorly chosen.

17. As previously noted, two covenants were not met (para. 12) The first covenant related to 30% of loans required to be directly lent by SIDBI. The second covenant pertained to poor environment management systems; and assessment, review, supervision, monitoring and reporting procedures at SIDBI and the PFIs identified in August 2011. Several BTORs, including in October 2011 and March 2012, also identified the second covenant as a problem. Despite SIDBI and the PFIs improving their systems, a safeguard due diligence audit in March 2013 indicated 378 out of 940 subloans to be ineligible. Due to the limitations in the DMF’s outcome and outputs and the indicators used to measure them, as well as the similar problems in the selection of GAP targets and indicators, this validation cannot confirm the outcome and outputs; therefore, assesses the project less than effective.

C. Efficiency of Resource Use

18. The PCR rated the project less than efficient as only 71% of resources were utilized. Furthermore, the proposed PCG was canceled. Moreover, the difficulties in complying with the environmental safeguards and the difficulties with the PCG, which led to its cancellation, had caused start-up delays and affected project implementation.

19. This validation assesses the project less than efficient. The underutilization of the sovereign loan, the cancellation of the PCG, the request by SIDBI for the 30% restriction to be lifted, and the problem with safeguard compliance and the need to replace ineligible subprojects made the project inefficient in delivering its outcome and outputs. Also, the economic and financial internal rates of return were not calculated at appraisal nor at completion.

D. Preliminary Assessment of Sustainability

20. The PCR rated the project likely sustainable based on two factors. The outcome and output and indicators for MSME growth—enhancing MSME access to commercial financing with increased lending to MSMEs and female entrepreneurs—were likely to be sustained. SIDBI had also maintained sound financial performance indicators and increased its loans. According to the PCR, more than 6,000 loans were provided by SIDBI and PFIs, 60% of which were to women, and are likely to have some impact on MSMEs. It is also likely that these loans will affect further MSMEs borrowing, economic growth, and employment.

21. The long-term impact on SIDBI and PFIs' operational procedures is likely to be short-lived. Cultural business norms and procedures are difficult to change and are reinforced daily. With the project paying little attention to changing behavior or providing demonstration effects, it is likely, that with time, the PFIs will revert to previous norms. Neither the PCR nor any of the
supporting documents indicated otherwise. Experience from other SME programs show that support for SME financing without significant linked programs to reform regulations and financial intermediary practices will result in short-term impacts.11

22. Other ways to achieve long-term sustainability is to introduce market disruptors. In a rapidly changing global financial marketplace, there is a range of new innovative products and ecosystems that can be introduced as “game changers”. Some of these products can help existing financial institutions change behavior permanently. Such innovations exist for both targeting the missing middle and women entrepreneurs. By this measure, the use of a sovereign loan combined with a PCG is hardly innovative. On the whole, there is no evidence offered or presented to suggest the changes occurring from the $35.7 million sovereign loan are likely to lead to a sustainable outcome of improved MSME access to commercial financing and market opportunities. Thus, this validation assesses the project less than likely sustainable.

III. OTHER PERFORMANCE ASSESSMENTS

A. Preliminary Assessment of Development Impact

23. The PCR rated the contribution of the project to development impact less than satisfactory based on the size of the loan being much smaller than initially anticipated. The PCR credited the project for contributing to capacity building among women entrepreneurs and helping ease access to credit, as well as unleashing better business opportunities. It also credited the project for sensitizing SIDBI and PFI participants on gender considerations. The end-line survey shown in the PCR (para. 11, Appendix 8) was provided as evidence that the project had positive economic and social impacts on women entrepreneurs. However, the end-line survey was for women participating in the JFPR-funded training, not necessarily for their experience with SIDBI and the PFIs. Moreover, the questionnaire basically asked participants about their positive experience after they had received support.

24. The DMF should have provided the evidence for the project’s development impact. However, the DMF was poorly constructed and had used indicators that reflected changes in the MSME sector rather than the impact of the project. As measured by the impact and outcome in the DMF, the project had minimum impact.12 If measured by the size of the sector’s need, which the PCR lists as $650 billion (para. 11), the $35.7 million sovereign loan had marginal impact. This validation assesses the project’s development impact less than satisfactory.

B. Performance of SIDBI

25. The PCR rated the performance of SIDBI, as the implementing agency, generally satisfactory. SIDBI provided ownership and assumed responsibility. SIDBI developed the robust criteria for subloan selection and implementation, as well as for the eligibility of

11 The PCR team clarified that they rated the institutional sustainability of the delivery mechanism through SIDBI and PFIs likely sustainable, in view of the strong regulatory oversight and guidance provided to SIDBI and PFIs through the central bank and other designated regulators. There are also ongoing policy efforts to enhance the proportion of bank and nonbank financial companies lending to MSMEs (by making it eligible to be a part of the priority sector lending), and a range of programs to promote women MSMEs.

12 This assumes a methodology for measuring the DMF impact and outcome against what could realistically be expected and narrated in a results chain. It ignores the indicators used by the DMF, which do not measure the impact of the project.
PFIs to achieve the project objectives. On implementation of safeguards, SIDBI took corrective actions to achieve compliance. SIDBI also complied with the ADB policy and the Reserve Bank of India regulations. This validation assesses SIDBI performance satisfactory.

C. Performance of the Asian Development Bank

26. The PCR rated ADB’s performance less than satisfactory based on the finding that at appraisal, the achievement of the PCG was already in doubt but no consideration was given to changing the structure of the project to accommodate this risk. During implementation, ADB performance was perceived to be mixed (PCR, para. 57). Corrective measures to meet the requirements for environmental safeguards took longer than anticipated, which led to the replacement of a large number of subloans. This validation assesses ADB performance less than satisfactory. However, this validation finds little evidence to support the PCR view that ADB performance on GAP implementation was satisfactory.

D. Others

27. None.

IV. OVERALL ASSESSMENT, LESSONS, AND RECOMMENDATIONS

A. Overall Assessment and Ratings

28. The PCR rated the project less than successful. The project was rated less than relevant as a result of the changes in circumstances, which reduced the size of operations and led to the cancellation of the proposed PCG. The project was less than effective as it only partially achieved the intended outcome and outputs. It was also less than efficient given the underutilization of the $50 million sovereign loan. The PCR rated the project likely sustainable given the nature of the subloans and associated systems.

29. Overall, this validation assesses the project less than successful. It assessed the project less than effective, and has the same view as the PCR findings, except where the PCR assessed the achievement of the GAP targets successful. The PCR rated 12 of the 13 GAP targets successful. However, this validation notes some of the evidence presented for these were insufficient to make an informed judgment. Given that the project canceled the PCG and utilized only 71.4% of the sovereign loan, this validation, similar to the PCR, has assessed the project less than efficient. On project sustainability, this validation assesses the project less than likely sustainable as the evidence offered for sustainability did not appear to be robust enough to support the finding. The table below summarizes the overall ratings by the PCR and this validation report.

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B. Lessons

30. The PCR identified five lessons for future projects. MSME subsector investments size should be commensurate with the implementing agency’s capacity, and/or have sharper focus such as specific geographical areas. MSME development issues have to be addressed holistically, including policy and regulatory framework, as well as supply- and demand-side constraints. The DMF could have specified clear and measurable targets with source data and reports. It could have adequate management information system and reporting that can efficiently track all relevant financial transactions, providing effective project management support, especially during the start-up period.

31. At the results framework and methodology level, additional lessons included developing, at the design stage, clear targets on the recipients of the project. Targeting women entrepreneurs and the missing middle are two significantly different MSME subsectors. Both are legitimate targets for an MSME finance project but require different designs. Projects with diverging target loan receipts face difficulties from the beginning.

32. Projects need to have robust systems for verifying results. For an MSME project, the design could have ideally included an end-of-project survey to independently measure impact. The project presented results that did not allow reviewers to make confident conclusions about what was achieved. Surveys on loan recipients need to clearly measure the impact of the loan and provide a narrative or a results chain to show how the results were achieved. This would also be the case for the GAP targets. The pieces of evidence presented need to withstand scrutiny by an independent evaluator.

33. The PVR adds a lesson on the results framework. The DMF needs indicators that measure the actual impact of the project rather than national or sectoral changes. Clear and measurable targets with data sources are important but these should measure the impact of the project. Selected project indicators have to be able to clearly demonstrate attribution and/or contribution to the stated impact, outcome and outputs.

C. Recommendations for Follow-Up

34. The completion report for the parallel grant from JFPR is due to be completed in 2019 (footnote 2). It should be reviewed to identify what lessons it can provide for future MSME loans. It may be able to contribute to informing how MSME development issues can be addressed more holistically, a lesson highlighted in the PCR (para. 14).
V. OTHER CONSIDERATIONS AND FOLLOW-UP

A. Monitoring and Reporting

35. The noncompliance with environmental safeguards was raised several times in BTORs. However, it took some time before the issue was addressed. There needs to be a more rigorous follow-up system so recommendations and findings identified in BTORs are addressed in a more timely manner.

B. Comments on Project Completion Report Quality

36. The PCR was generally well written. The PCR structure and content followed the PCR guidelines. However, it did not mention actual versus targeted consulting service provisions, nor did it indicate if this was not applicable. Some final editing may have helped with the flow of some complex sentence structures. Based on the above analysis, the assessment of the PCR quality is rated satisfactory.

C. Data Sources for Validation

37. Data sources for this validation are the national developments plans, country partnership strategy, PCR, RRP, BTORs, midterm review, aide memoire, annual environmental monitoring reports, expanded list of environmentally benign activities dated March 2014, MSMEDP credit note, and approved environmental and social safeguard framework report in May 2012.

D. Recommendation for Independent Evaluation Department Follow-Up

38. No further IED follow-up is recommended.