

Validation Report
December 2021

The Republic of Kazakhstan: Small and Medium Enterprise Investment Program—Tranche 3 and Multitranche Financing Facility

Reference Number: PVR-853
Program Number: 44060-025
Loan Numbers: 3231 and 3261
MFF Number: 0048



Raising development impact through evaluation

ABBREVIATIONS

ADB	– Asian Development Bank
Damu	– Damu Entrepreneurship Development Fund
DMF	– design and monitoring framework
FI	– financial intermediary
GAP	– gender action plan
GDP	– gross domestic product
KKB	– Kazkommertsbank
MFF	– multitranchise financing facility
PCR	– program completion report
PFI	– participating financial institution
SMEs	– small and medium-sized enterprises
SMEIP	– Small and Medium Enterprise Investment Program
TA	– technical assistance
TSB	– Tsesnabank

NOTE

In this report, “\$” refers to United States dollars and “KZT” refers to Kazakhstani tenge.

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PROGRAM BASIC DATA

Program number	44060-025	PCR circulation date	10 Dec 2020	
Loan and MFF numbers	3231, 3261, and 0048	PCR validation date	Dec 2021	
Program name	Small and Medium Enterprise Investment Program—Tranche 3 and Multitranche Financing Facility			
Sector and subsector	Finance	Small and medium enterprise finance and leasing		
Strategic agendas	Inclusive economic growth			
Safeguard categories	Environment		FI-C	
	Involuntary resettlement		FI-C	
	Indigenous peoples		FI-C	
Country	The Republic of Kazakhstan		Approved (\$ million)	Actual (\$ million)
ADB financing (\$ million)	ADF: 0.00	Total program costs	2,800.00	2,800.00
	OCR: 228.00	Loan/grant		
		3231	130.00	130.00
		3261	98.00	98.00
		Tranche 1	150.00	150.00
		Tranche 2	122.00	122.00
		Borrower	800.00	800.00
	Others ^a	1,500.00	1,500.00	
Approval date 3231 3261	15 Dec 2014 24 Jun 2015	Effectiveness date	9 Oct 2015	9 Oct 2015
Signing date	11 Sep 2015	Program completion date Financial closing date	10 Nov 2016 —	10 Nov 2017 8 Dec 2017
Program officer	DC Song	Location ADB headquarters	From Oct 2015	To Dec 2017
IED review Director Team leader	N. Subramaniam, IESP A. Avenia, Evaluation Specialist, IESP ^b			

— = no approved financial closing date, ADB = Asian Development Bank, ADF = Asian Development Fund, IED = Independent Evaluation Department, IESP = Sector and Project Division, MFF = multitranche financing facility, OCR = ordinary capital resources, PCR = program completion report.

^a Other sources include international and private financial institutions.

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I. PROGRAM DESCRIPTION

A. Rationale

1. Kazakhstan's economy was largely concentrated on hydrocarbon and the mining sector. Its narrow focus on oil exports posed a huge threat, given the volatility of the international market. When oil prices declined sharply during the global financial crisis of 2007–2008, the economy was severely affected. As international credit dried up leading to a liquidity crunch, the availability of bank credit for expansion and modernization, including lending to the small and medium-sized enterprise (SME) sector, suffered a slump. Nonperforming loans increased from 8.1% to 36.5% between 2008 and 2009 and grew further to 37.0% in 2012. The liquidity crunch caused by

overdependence on foreign capital exposed the vulnerability of the banking system and weakened SMEs' access to finance.

2. Recognizing the role of SMEs in supporting the country's long-term economic growth and diversification, the government formulated the Roadmap for Business 2020 and the Accelerated State Program for Industrial-Innovative Development of Kazakhstan.¹ Given a narrow economic base focusing on hydrocarbon and mining sectors, the government aimed to diversify the production base and develop the SME sector, which was expected to generate income and employment. A key constraint for SMEs' development was the limited access to medium-term credit, which stalled growth in investments and subsequent employment and hindered SMEs' contribution to sustainable growth.

3. The Asian Development Bank (ADB) approved a \$500 million multitranche financing facility (MFF) for the Small and Medium Enterprise Investment Program (SMEIP).² Backed by government guarantee via participating financial institutions (PFIs) to SMEs, the MFF was to on-lend to SMEs under the Damu Entrepreneurship Development Fund (Damu). It had three tranches and was to address the lack of domestic resources for medium-term lending to SMEs in local currency. The tranche 1 loan of \$150 million was relented by Damu to three PFIs. The tranche 2 loan of \$122 million was relented in equal portions to two PFIs. The third tranche of \$228 million was relented by Damu to four PFIs. Tranche 3 and the MFF are the subjects of this validation.

B. Expected Impacts, Outcomes, and Outputs

4. The envisaged impact of the program was sustained job creation and economic growth. The expected outcome was increased access by SME subborrowers to medium-term credit on a sustainable basis. The expected outputs were medium-term financing to SMEs; improved effectiveness and efficiency of Damu; and improved financial sector outreach, with a focus on women entrepreneurs. Tranche 3 did not include improved effectiveness and efficiency of Damu as it was already achieved through tranche 1. In 2013, the MFF had minor revisions in its design and monitoring framework (DMF) and implementation period. The indicators were updated to reflect the revised implementation period accordingly.³

C. Provision of Inputs

5. In September 2010, ADB approved the MFF for SMEIP for a total loan amount not exceeding \$500 million. Tranche 1 in the amount equivalent to \$150 million was approved in November 2010, became effective in September 2011, and was completed in September 2013. Tranche 2 amounting to \$122 million was approved in December 2013, became effective in November 2014, and was fully disbursed to the PFIs in December 2014. In December 2014, tranche 3 was approved for \$130 million and was followed by an additional funding of \$98 million approved in June 2015. Both loans under tranche 3 became effective in October 2015 and were closed in November 2017. Under tranche 1, ADB approved a \$650,000 capacity development

¹ Government of Kazakhstan, 2010. *Business Road Map 2020*. Astana. Government of Kazakhstan 2010. *The Accelerated State Program for Industrial-Innovative Development for Kazakhstan 2010-2015*. Astana.

² ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Proposed Multitranchise Financing Facility*. Manila.

³ The changes were approved by ADB in August 2013 upon the request of Damu following the ADB review mission from 17 to 30 April 2013. ADB. 2014. *Amendments to the Framework Financing Agreement on the Small and Medium Enterprise Investment Program in Kazakhstan*. Manila.

technical assistance (TA) to improve Damu's efficiency and effectiveness.⁴ Under tranches 2 and 3, there were no provisions for consulting services, and TA projects were not provided.

6. The program was categorized financial intermediary (FI) for environment.⁵ The subprojects had minimal or no adverse environmental risk. It was also categorized FI-C for involuntary resettlement and indigenous peoples. There was no involuntary resettlement nor impact on indigenous peoples. The SMEIP was categorized under effective gender mainstreaming. A gender action plan (GAP) was developed to promote better monitoring, outreach, and access to finance for women entrepreneurs. Of the four output indicators for tranche 3, two were related to women.

D. Implementation Arrangements

7. Damu was the executing agency responsible for the overall implementation of the program, including tranche 3. The same management unit for tranche 1 continued to manage tranches 2 and 3. Damu and the PFIs were the implementing agencies of the program. The PFIs were selected based on their relatively good standing and strong commitment to expand SME lending portfolios. These PFIs were the Bank Center Credit, Kazkommertsbank (KKB), and Alliance Bank under tranche 1 and the Bank Center Credit and Tsesnabank (TSB) under tranche 2. In 2018, TSB's financial condition deteriorated, and it defaulted on the loan covenant requiring PFIs to comply with the prudential requirements, which included capital adequacy requirements of the central bank, the National Bank of Kazakhstan. Consequently, Damu prepaid \$61 million of the tranche 2 loan in December 2018 and the remaining balance of \$61 million in September 2019, a month before the scheduled maturity date.

8. Under tranche 3, the PFIs were the Delta Bank, Kazinvestbank, KKB, and TSB. From 2013 to 2016, the quality of loans throughout Kazakhstan's banking system declined significantly due to massive deterioration in terms of trade, dramatic fall of oil prices, and loss in the value of the tenge after the transition to a floating exchange rate, which adversely affected the PFIs.⁶ KKB's rating was downgraded to CCC+ in May 2016, thereby resulting in a breach of the loan covenant that required PFIs to have a rating of at least B-. Accordingly, Damu prepaid KKB's portion of the loan more than 3 years early from date of maturity. Kazinvestbank's license was revoked by the National Bank of Kazakhstan in December 2016 following an "acute liquidity shortage caused by deposit and interbank funding withdrawals."⁷ Consequently, Damu prepaid Kazinvestbank's portion of the loan in July 2017. Delta Bank's rating was downgraded to CCC+ in December 2016 following an outflow of corporate and interbank deposits.⁸ As a result, Damu prepaid Delta Bank's portion of the loan in December 2017. TSB was unable to liquidate \$14.5 million of its \$86 million loan within 18 months, despite two extensions from ADB. Consequently, Damu prepaid that portion of the loan plus interest in June 2017. The balance was repaid in December 2018. Kazinvestbank and Delta Bank ceased to exist while the two other banks underwent change in control. KKB was acquired by Halyk Bank and merged into its parent bank in 2018, and TSB was acquired by First Heartland Jysan Bank in 2019. The implementation arrangement was appropriate to deliver the needed funds for SMEs through the PFIs. However,

⁴ ADB. 2010. *Technical Assistance to Kazakhstan for Improving Capacity to Support SME Development*. Manila.

⁵ If a project involves investment of ADB funds to or is through a financial intermediary, it is categorized FI.

⁶ National Bank of Kazakhstan. 2017. *Financial Stability Report*. Nur-Sultan.

⁷ Standard & Poor's. 2016. *Ratings Direct: Kazakhstan-Based KazinvestBank Downgraded to D on License Revocation*. (28 December).

⁸ Standard & Poor's. 2016. *Ratings Direct: Ratings on Kazakhstan-Based Delta Bank Lowered to 'CCC+/C' On Weakened Liquidity and Placed on CreditWatch Developing*. (30 December).

the overriding macroeconomic and banking environment weakened the ability of banks in sustaining their operations under the program.

9. Of the 70 covenants under tranche 3, one was not complied with. This pertained to the timeframe allotted for disclosure of the annual audited consolidated statement of utilization of funds, which was not adhered to due to the protracted period allotted for clarifications and review. Four covenants were partly complied with. The first was the audit reports that lacked important requirements such as the separate opinions on the use of loan proceeds. Two others were on the compliance of TSB and Kazkommertsbank with eligibility criteria for PFIs. Fourth was the requirement to use 50% of the SME loans for investment purposes. The covenants were adequate to regulate the use of the loan proceeds, select the PFIs, and distribute the SME loans.

II. EVALUATION OF PERFORMANCE AND RATINGS

A. Relevance of Design and Formulation

10. The program completion report (PCR) rated both tranche 3 and the MFF less than relevant.⁹ It indicated that the program was in line with government's and ADB's priority for SMEs and supported the need for SME access to finance. It also addressed gender-related issues by improving outreach to women and providing them with business development services. However, the PCR underscored that several areas in the design could have been improved for better results. In particular, the use of credit lines alone was not sufficient to address SME finance development. Other constraints for medium-term access credit were not addressed. These constraints included the banks' aversion to SME lending and high collateral requirements, limited availability of lease finance, the lack of domestically mobilized resources for medium-term SME credit, high regulatory burden on SMEs, and the slow recovery of foreclosed collateral due to inefficient judicial system and underdeveloped legal framework. Further, the use of commercial banks as the sole channel for credit directed lending toward larger SMEs that could meet banks' high collateral requirements crowded out smaller SMEs that also needed access to finance.

11. The PCR also indicated that the DMF indicators for both the MFF and tranche 3 were imprecise and did not require data collection that would have provided a complete assessment of the program. Output indicators should have tracked the number of borrowers instead of loan accounts, and SME loans should have been more clearly defined. For outcomes, the volume of SME loans of the Kazakh banks at the MFF's completion could have been compared to the baseline instead of the cumulative amount of lending under Damu programs, which were largely subsidized on-lending funded by the government. Moreover, no meaningful conclusions could be drawn on the trajectory of each PFI's SME lending since no baseline data were collected on the number of SME loan clients per PFI, the percentage of SME loans to the total, and the volume of SME loans in the PFI's portfolio.

12. This validation notes that tranche 3 was in line with ADB's Country Partnership Strategy 2012–2016 for the Republic of Kazakhstan, which sought to strengthen access to finance for SMEs and women.¹⁰ It was also aligned with the government's goal of economic growth through the diversification of production base and the development of the SME sector. The rationale for the MFF was to allow flexibility in the timing of new credit lines and for lessons learned in each tranche to feed into the design of subsequent tranches. However, this validation notes that, in

⁹ ADB. 2020. *Project Completion Report: Small and Medium Enterprise Investment Program–Tranche 3 and Multitranchise Finance Facility in Kazakhstan*. Manila.

¹⁰ ADB. 2012. *Country Partnership Strategy, Kazakhstan: 2012-2016*. Manila.

practice, due diligence was required by ADB for each tranche similar to stand-alone processes and that the government's extensive decision-making process limited the operational flexibility expected from an MFF framework.¹¹ In essence, while the rationale for the MFF modality was sound, it did not provide the operational flexibility intended. Moreover, this validation notes that credit lines were not the appropriate modality to address the key issue of limited access to credit for SMEs. Credit lines may initially stimulate lending, but these are inadequate in meeting long-term demand for SME financing since access to finance is also linked to other factors such as the financial infrastructure, regulatory environment, and overall health of the financial sector. The design was solely focused on credit lines and did not address constraints that affect long-term availability of SME finance.

13. The MFF and tranche 3 were to deliver medium-term financing to SMEs. However, there was no indicator in the DMF that measured the volume and growth of medium-term loans with tenors of 1–3 years and 3–5 years. Also, the DMF did not specify any indicator that would measure the sustainability of the PFIs' SME lending operations. The DMF could have been more meaningful if such an indicator was included along with others that measured the quality of the PFIs' SME portfolio under the program and their repayment performance. Given the shortcomings of the design, this validation assesses the MFF and tranche 3 less than relevant.

B. Effectiveness in Achieving Program Outcomes and Outputs

14. The PCR rated tranche 3 effective based on the achievement of three expected outcome and four of the five output indicators. Under the Damu programs, SME lending increased to KZT1,440 billion, exceeding the target of KZT1,060 billion. The planned output on medium-term financing to SMEs was partly achieved since only 403 new loan accounts were opened (against the target of 3,100). The planned volume of PFI loans was met since PFIs issued SME loans amounting to KZT65.440 billion, substantially exceeding the target increase of KZT50 billion. The target for women was also met with the share of women borrowers reaching 39%, higher than the target of 33%. The target output on improved financial sector outreach with a focus on women entrepreneurs and lending outside bigger cities was delivered. Women who received training through Damu's business development services comprised 57% of the total entrepreneurs who were recipients of the training, higher than the target of 46%. Lending outside the cities of Almaty and Nur-Sultan comprised 81.3% of tranche 3 subloans, which was above the target of 50%. Based on the achievement of target outcome and most outputs, this validation assesses tranche 3 effective.

15. The PCR also rated the MFF effective based on the revised DMF outcome targets met and five out of six indicators achieved. This validation notes the difference in targets between the original and revised DMF of the MFF. With reference to the original DMF, the outcome target on the increase in the amount of outstanding SME loans was achieved, with SME loans amounting to KZT3,340 billion at the end of 2014 higher than the target of KZT2,129 billion. However, data on the number of SME loan accounts opened by the PFIs were not collected. On the revised DMF for the MFF, SME lending under Damu programs increased to KZT1,944 billion by end of 2018, substantially higher than the outcome target of KZT850 billion.

16. The MFF output 1 on medium-term financing to SMEs was partly achieved both in the original and revised DMF. In the original DMF, the number of SME loans disbursed by PFIs was not achieved with only 13,589 loans disbursed to SMEs by end 2014 compared to the target of

¹¹ ADB. 2017. *Kazakhstan Country Partnership Strategy Final Review Validation, 2012-2016*. Manila; ADB. 2015. *Project Completion Report Kazakhstan Small and Medium Enterprise Investment Program Tranche 1*. Manila.

29,083. The number of women borrowers under the Damu programs comprised 40% of the total borrowers at the end of 2014. The target for the number of loan accounts opened by SMEs in the revised DMF was not achieved. Only 2,355 accounts were supported under the program, much lower than the target of 5,000. The loan sizes were larger than what ADB and Damu expected during the program processing. Other indicators for the same target output in the revised DMF were met. The total amount of loans disbursed was KZT256.5 billion (against the target of KZT82.5 billion). The amount of loans disbursed continued to increase after the closing of the MFF from KZT1,737 billion in 2018 to KZT2,439 billion in 2020.¹² As of the end of 2018, the percentage of women borrowers was 61%, which was higher than the revised and final target of 26%. Damu's outreach to women continued with ADB's follow-on project that also targeted women borrowers.¹³ Output 2 on improved effectiveness and efficiency of Damu was delivered. In April 2014, Standard & Poor's Ratings Services assigned Damu a "BBB+/A-2", which met the requirement to get a credit rating for both the original and revised DMF. Thereafter, Damu continued to obtain a credit rating every year. In September 2021, it obtained a Standard and Poor's rating of "BBB-/A-3".¹⁴ Damu's business processes and procedures were streamlined with 94% of them automated as of May 2020, which met the target in the revised DMF. Output 3 on improved financial sector outreach with a focus on women entrepreneurs was also achieved in both the original and revised DMF of the MFF. Damu collected gender-disaggregated data for the program, which met the target in the original DMF. The percentage of women who participated in Damu's SME top management training increased from 40% in 2011 to 45% in 2018. Lastly, loan applications received from women entrepreneurs comprised more than 30% of the total applications from tranches 1, 2, and 3, exceeding the 26% target in the revised DMF.

17. Four of the five activities in the tranche 3 GAP were completed and all three targets were achieved. The activity on the PFIs' periodic reports on SME loan performance disaggregated by gender was not completed. Although Damu collected and maintained gender-disaggregated data on various activities of the program, the data on loan performance was not tracked during implementation and was difficult to obtain after project completion since some of the PFIs ceased to operate or were absorbed by other banks. The targets on the number of women borrowers, percentage of women participating in business development services training, and PFIs engaging in outreach activities to attract female entrepreneurs were all achieved. The program promoted better outreach and access to finance for women entrepreneurs. The outcome target for the MFF specified in the revised DMF was achieved. Of the six output targets, five were achieved. In view of the achievement of most targets specified in the DMF, this validation assesses the MFF effective.

C. Efficiency of Resource Use

18. The PCR rated tranche 3 and the MFF efficient based on the achievement of the intended outcomes within the planned implementation periods. The target for SME loans under the Damu programs was exceeded by 36% and for the MFF by 129%. However, the target for the number of loans was not achieved due to the larger-than-expected loan sizes granted by the PFIs.

19. This validation notes that the full amount for the credit line under tranche 3 was disbursed to Damu, and the funds were recycled 3.4 times through 3,781 subloans totaling KZT112,144

¹² Damu. 2021. *Annual Report 2020*. Almaty.

¹³ ADB. 2016. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Administration of Technical Assistance Grant to Damu Entrepreneurship Development Fund for the Supporting Resilience of Micro, Small, and Medium-Sized Enterprises Project*. Manila

¹⁴ Standard and Poor's Global Ratings. 7 September 2021. *Damu Entrepreneurship Development Fund Upgraded to "BBB-/A-3" On Improved Government Oversight: Outlook Stable*.

million.¹⁵ There were no reports of major delays or problems in the processing of loans at the subloan level. There was a 1-year delay in closing tranche 3, but the PCR did not discuss the reasons.¹⁶ Notwithstanding the challenges faced by the PFIs due to the systemic problems in the Kazakh banking system and the difficult macroeconomic environment, the subloans were disbursed promptly except for TSB, which instead utilized the funds for its own treasury for as long as possible. The envisaged outcome was achieved with the resources used. This validation assesses tranche 3 efficient.

20. For the MFF, the full amount of credit lines for the three tranches was disbursed to the PFIs and the funds benefited 2,328 borrowers. Initial disbursements under tranche 1 were slow due to PFIs' difficulties in understanding and complying with ADB's safeguard requirements, which were resolved with ADB's support in building their capacity and environmental and social management systems.¹⁷ In general, the processing of loans at the subborrower level was efficient throughout the three tranches.

21. The MFF through the attached TA under tranche 1 helped streamline the business processes of Damu. This streamlining effort included changes in risk management practices and reforms in corporate governance, which improved Damu's operations and contributed to its investment-grade credit rating, one of the expected outputs of the overall facility. The funds for the three tranches were efficiently utilized, and Damu's business processes were improved. This validation assesses the MFF efficient.

D. Preliminary Assessment of Sustainability

22. The PCR rated tranche 3 less than likely sustainable due to the insolvency of Delta Bank and Kazinvestbank and the early exit of KKB and TSB following the deterioration of their financial conditions. This validation assesses that, while funds had been disbursed to SME subborrowers, sustaining the credit flow is less than likely since PFIs exited the program. The funds are unlikely to be recycled further for SME financing needs due to insolvency and poor financial condition of PFIs. This validation assesses tranche 3 less than likely sustainable.

23. The PCR rated the MFF likely sustainable considering three aspects. First, it enabled Damu to lend medium-term financing to SMEs. Second, it improved Damu's effectiveness and efficiency resulting in investment grade credit rating. Third, Damu's focus on women entrepreneurs continued after the MFF ended. Over the decade spanning from 2010 to 2019, Damu remained profitable in 9 out of 10 years and continued to play an important role in the government's development strategy. In 2020, Damu continued to be profitable in its operations.¹⁸ This validation notes that while subloans of the three tranches were market-based, the government provided interest subsidy through Damu for priority sectors.¹⁹ This intervention fragmented the market and tended to undermine the sustainability of program outcomes. Market-based loans offered by PFIs for SME capital investments were eased out by government subsidized programs.²⁰ Nonetheless, after the completion of the MFF, Damu increased its

¹⁵ Based on Basic Data C.2 presented in the PCR.

¹⁶ The Basic Data B of the PCR indicated that the actual closing date was 10 November 2017, which was a 1-year delay from the planned closing date of 10 November 2016.

¹⁷ ADB. 2016. Validation Report Kazakhstan: *Small and Medium Enterprise Investment Program Tranche 1*. Manila.

¹⁸ Damu. 2021. *Annual Report 2020*. Almaty.

¹⁹ Target groups for subsidy were entrepreneurs in one-factory towns, small towns and villages, and entrepreneurs in priority sectors of the economy and manufacturing.

²⁰ Examples of subsidized lending programs are those offered by KazAgroFinance, a state agency tasked to support the agriculture sector; and Damu-Oniris, a program supporting the manufacturing sector via subsidized loans.

aggregate volume of SME lending above the levels achieved during project implementation. Despite the failure of two of the seven PFIs that participated in the MFF, Damu continued to increase the number and volume of loans to SMEs using the remaining financial institutions in the country and expanded its conduits to include microfinance institutions and leasing companies. It also created a separate unit to specifically cater to the needs of microfinance institutions. In terms of funding, Damu has obtained a credit line from the European Investment Bank of €200 million,²¹ provided guarantees to the European Bank for Reconstruction and Development, and issued a KZT200 million green bond in 2020 in partnership with the United Nations Development Program.²² ADB also followed through with a loan of \$200 million equivalent supported by a TA of \$500,000 to support access to finance of microenterprises and SMEs.²³ In 2020, KZT30 billion capital was infused in Damu to support SMEs during the economic downturn brought about by the COVID-19 pandemic.²⁴ In view of Damu's profitable operations over the years, increasing volume of lending to SMEs after MFF completion, expansion in the use of lending conduits, additional capital, and continued funding support of development partners including ADB, this validation assesses the MFF outcome of increased access to medium-term credit likely sustainable.

III. OTHER PERFORMANCE ASSESSMENTS

A. Preliminary Assessment of Development Impact

24. The PCR rated the development impact of tranche 3 and the MFF satisfactory. The PCR highlighted the creation of 1,283 jobs under tranche 3 and 5,527 jobs through the MFF as a whole. The MFF had a positive effect on the SME sector's contribution to gross domestic product (GDP) and employment. It helped improve Damu's internal and business processes and ability to work with international lenders. Also, the facility had a positive impact on gender mainstreaming as women had the opportunity to access finance, obtain business development training, and earn income.

25. Under tranche 3, this validation notes that only one was achieved out of the two impact targets. The target for employment in SMEs was not achieved. As of January 2019, SME sector employment was at 3.3 million (against the target of 3.5 million). The target for SMEs' contribution to GDP was met with the sector contributing KZT17.6 trillion to GDP in 2018, higher than the target of KZT10.0 trillion. This validation notes that it is difficult to determine the contribution of tranche 3 to this growth. The financing extended to 550 SME subborrowers at an average loan size of KZT203,898 (\$1,409) under tranche 3 indicates an incremental contribution to GDP. This validation assesses the development impact of tranche 3 less than satisfactory due to the partly achieved impact indicators and minuscule contribution to GDP.

26. For the MFF, the envisaged impact in the original DMF was partly achieved. The target 3.5 million employment in the SME sector was not achieved as only 2.8 million was recorded as of January 2015. The target SME sector's contribution to GDP was met at KZT10.3 trillion in 2014 (against the target of KZT5.0 billion). In the revised DMF, the target SME sector's contribution to GDP was achieved at KZT17.6 trillion in 2019 (against the target of KZT5.4 trillion). The target for employment is likely to be achieved since sector employment reached 3.4 million in January 2020

²¹ Damu Entrepreneurship Development Fund. 2021. Damu Raised 200 Million Euros From EIB. 8 Jan. https://damu.kz/en/news/detail.php?ELEMENT_ID=29454.

²² Damu. 2020. *Financial Statements and Independent Auditor's Report*. Almaty.

²³ ADB. 2016. *Damu Entrepreneurship Development Fund Supporting Resilience of Micro, Small, and Medium-Sized Finance Project*. Manila.

²⁴ Damu. 2021. *2020 Audited Financial Statements and Independent Auditor's Report*. Almaty.

(against the target of 3.5 million by the end of 2021). This validation notes that SMEs' contribution to GDP and total employment are higher order impact indicators; hence, measuring the facility's impact and contribution to their increase is challenging. These macro indicators are influenced by other factors, such as the policy and legal environment in place, along with other interventions. Therefore, these cannot be directly attributed to the program.

27. The MFF had a positive impact on the lives of women, particularly in rural areas, by providing access to finance, opportunities to engage in business, and developing their entrepreneurial skills. The facility also benefited rural households with 70% of borrowers located outside Almaty City and Nur-Sultan, exceeding tranche 3's target of 50%. However, the facility's focus on the use of credit lines (an issue with the design) led to a limited development impact. From a broader perspective, the constraints to long-term SME financing were not addressed. Credit lines can only have a limited impact on SME sector development. Notwithstanding the design issues, the MFF achieved the impact targets of the revised DMF. Based on this achievement, the positive impact on women, and the improvement in the Damu's business processes, this validation assesses the development impact of the MFF satisfactory.

B. Performance of the Borrower and Executing Agency

28. The PCR rated the performance of Damu as the executing and implementing agency satisfactory. Damu followed the agreed design in implementing the program. It regularly monitored the program and closely coordinated with the PFIs, and the loan covenants were satisfactorily complied with. This validation notes though that Damu could have informed ADB about the adverse information on the PFIs, including the rating downgrades prior to the release of press reports. This validation assesses the performance of Damu satisfactory.

C. Performance of the Asian Development Bank

29. The PCR rated ADB's performance in tranche 3 and the MFF satisfactory. ADB fielded inception, midterm, safeguards, and review missions. It proactively attended to outstanding issues, such as the slow initial disbursement and audit requirements. ADB's assistance added value to the PFIs' SME operations. Unlike state programs that limit the scope of sectors depending on government's priorities, the loans under the MFF had no restrictions on the sectors financed. The loan funds' cost was lower compared to other sources. It addressed the lack of medium-term financing for SMEs. This validation notes that ADB could have done better in formulating a design to focus on the broader issues and constraints to meet the long-term demand for SME financing. On the whole, this validation assesses the performance of ADB satisfactory.

D. Others

30. There were no issues related to governance. The government's project completion report noted that the MFF was timely and appropriate. The program allowed Damu and the PFIs to increase lending to SMEs at a lower cost.

IV. OVERALL ASSESSMENT, LESSONS, AND RECOMMENDATIONS

A. Overall Assessment and Ratings

31. The PCR rated tranche 3 less than successful and the MFF successful. This validation assesses tranche 3 less than relevant, effective, efficient, and less than likely sustainable. The project had design shortcomings in identifying key constraints. It was effective as the outcome

target was achieved and most of the output targets were met. It was efficient as the resources were efficiently used and Damu's business processes were improved. It is less than likely sustainable due to the PFIs' insolvency and exit from the program. This validation assesses tranche 3 less than successful. This validation assesses the MFF less than relevant, effective, efficient, and likely sustainable. Its design focused mainly on credit lines and did not address the key constraints identified at appraisal, and the indicators used in the DMF were inadequate in measuring the desired results of the facility. Loans for the three tranches were fully utilized and Damu's business processes were improved. Overall, this validation assesses the MFF successful.

Overall Ratings: Tranche 3 and MFF

Validation Criteria	PCR	IED Review	Reason for Disagreement and/or Comments
Relevance Tranche 3 and MFF	Less than relevant	Less than relevant	
Effectiveness Tranche 3 and MFF	Effective	Effective	
Efficiency Tranche 3 and MFF	Efficient	Efficient	
Sustainability Tranche 3 MFF	Less than likely sustainable Likely sustainable	Less than likely sustainable Likely sustainable	
Overall Assessment Tranche 3 MFF	Less than successful Successful	Less than successful Successful	
Preliminary Assessment of Impact Tranche 3 MFF	Satisfactory Satisfactory	Less than satisfactory Satisfactory	
Borrower and executing agency Tranche 3 and MFF	Satisfactory	Satisfactory	
Performance of ADB Tranche 3 and MFF	Satisfactory	Satisfactory	
Quality of PCR		Satisfactory	Para. 36

ADB = Asian Development Bank, IED = Independent Evaluation Department, PCR = program completion report.
Source: ADB (IED).

B. Lessons

32. The PCR identified three key lessons on the implementation of the credit line. First, examining PFIs' projections more conservatively in light of the weakened economy and significant devaluation of the tenge can help analyze the PFIs' absorptive capacity. Second, giving incentives to well-performing PFIs and penalizing those with abusive practices can help increase SME borrowers. Third, the arrangement for foreign currency loans to Damu under tranches 2 and 3 was not satisfactory to Damu due to high risks and lack of flexibility. For gender aspects, four lessons were identified. First, GAP targets have to be clear to the PFIs to avoid delay in reporting. Second, it is more efficient to communicate with PFIs directly to ensure that GAP activities and targets are understood. Third, the PFIs should have ownership from the beginning of the project. Lastly, capacity building for PFIs can be an effective approach.

33. This validation offers two additional lessons.

- (i) **Program-level lessons.** TAs are important in complementing credit lines particularly in supporting the capacity of PFIs to improve their products, strengthening credit risk assessment, expanding outreach, and reaching the lower segment of the market and women. Unlike tranche 1, which supported the improvement of Damu's business processes, there were no TAs for tranches 2 and 3 supporting capacity building for PFIs, which could have increased their effectiveness and impact. This validation adds that in view of the lack of domestically mobilized resources for medium-term SME lending, it is important to identify and address the constraints to supplying these funds over the medium and long term as these will require policy, legal, and regulatory reforms.
- (ii) **Results and methodology-level lessons.** It is important to include the borrowers' repayment performance and the PFIs' sustainability in the credit program indicators that measure portfolio quality to better monitor and assess their performance.

C. Recommendations for Follow-Up

34. The PCR had three recommendations. First, ADB should prepare a list of acceptable auditors at the beginning of program implementation. Second, English translations of audited entity-level financial statements of any licensed financial institution receiving funds under an ADB program should be published on ADB's website. Third, ADB should ensure that DMF indicators for SME financial intermediary loans are able to track trends in individual banks' SME lending. On gender mainstreaming, similar projects should include more products tailored to women, keep interest rates low, provide business development skills training to women, and include capacity building for the PFIs. An independent due diligence is critical in assessing each PFI's qualifications and creditworthiness, and a more in-depth analysis is recommended for selecting the PFIs. Where ADB's market-based rates policy on subloans is concerned, pricing should be adjusted when the source of funds is lower than the alternative cost of funds. Project agreements should require the PFIs to disclose subloan performance data.

V. OTHER CONSIDERATIONS AND FOLLOW-UP

A. Monitoring and Reporting

35. Damu regularly monitored the program implementation, including disbursements, loan utilization, and PFIs' financial performance. It collected gender-disaggregated data on the number of borrowers, loan accounts opened, jobs created, loan purpose, and business sector to produce monitoring data. However, the Damu reports did not reflect the female entrepreneurs' loan performance, since the PFIs did not report on the relevant gender-disaggregated data. The DMF could have been better formulated with the inclusion of indicators that would have measured portfolio quality, repayment performance, and sustainability of the PFIs' SME operations.

B. Comments on Program Completion Report Quality

36. This validation assesses the PCR's quality satisfactory. While the discussion was coherent and comprehensive, adequate evidence was provided to substantiate the ratings. Its appendix 1 clearly presented actual achievements vis-à-vis the expected outcome and outputs. Supplementing the discussion in the main text, the summary of the project's GAP results and achievements presented in its appendix 3 was informative.

C. Data Sources for Validation

37. This validation used information from the report and recommendation of the President, national strategies, country partnership strategy, back-to-office reports of review missions, periodic financing request reports, and Damu's facility completion and annual reports.

D. Recommendation for Independent Evaluation Department Follow-Up

38. The PCR indicated that a project performance evaluation report may be prepared immediately. This validation does not recommend further Independent Evaluation Department follow-up.