Research, Network and Support Facility (RNSF)

"Support to enhance livelihoods per people dependent on informal economy and improve social inclusion of marginalised and vulnerable persons"

Good Practices and Lessons Learned

RESEARCH QUESTION	**1- ENABLING ENVIRONMENT**
SUB-TOPIC (Research matrix)	Advocacy with government to improve legal and policy frameworks to support informal economy enterprises (1.2)
REGION – CONTRY OF IMPLEMENTATION	Central Asia - Mongolia
RESUME LESSONS LEARNED	The project is aimed at supporting SMEs at the grass-root level through the provision of financial and consulting business development services mainly in rural areas and in the least developed regions. The defined limit of 10,000 EUR of lending per SME: cuts across the project target of reaching a minimum number of SMEs, thus spreading the benefits of co-financed BDS to as many SMEs as possible. Furthermore, it is probably the medium enterprises that are benefiting disproportionately from the upper limit, but they are also the most likely to be able to afford BDS and be able to pay for it after one intervention. We propose the following: Upper limit of 10,000 EUR for Micro; 6,000 EUR for Small; and 3,000 EUR for Medium; Only one intervention per medium SME until the micro and small SMEs targets are reached.
PROJECT NAME	*Support to SME development in Mongolia*
YEAR	08/2011 – 05/2016
FUNDING AGENCY	European Commission
IMPLEMENTING AGENCY	European Bank for Reconstruction and Development
KEY TARGET GROUPS	SME´s, mainly in rural areas
SUMMARY OF THE ACTION	The project supported the sustainable development of a competitive micro, small and medium sized enterprises sector in Mongolia through the enhancement of the business enabling environment and the strengthening of the relevant Mongolian institutions. The overall objective was to contribute to poverty reduction in Mongolia. The specific objective was sustainable development of competitive micro, small and medium sized enterprises sector in Mongolia.

The project is funded by the European Union

A.R.S. Progetti S.P.A. Ambiente Risorse Sviluppo

A project implemented by A.R.S. Progetti S.p.a. in consortium with:
Lattanzio Advisory S.p.a. and AGRER S.A. N.V.

LESSONS LEARNED

The project was focused on enabling environment in general, not explicitly for IE enterprises. However, one of the main aims was the provision of support to SMEs at the grass-root level through the provision of financial and consulting business development services mainly in rural areas and in the least developed regions. Thus the project was supposed to outreach to a number of people and enterprises whose livelihoods depend on the informal economy. The main tools included the provision of loans and business development services, mainly financial services and consulting. The activities were focused mainly on the capacity building of multiple national stakeholders (Government agencies, Employers, NGOs, associations).

As transpires from the Final Evaluation report, **the project encountered many difficulties in reaching out to the beneficiaries in small and micro-SME segment, in particular to those in rural areas and in less developed regions. The project Evaluation report mentions the following shortcomings in terms of outreach:**

"Highly skewed allocation by size: of the firms receiving BDS support, 19% were micro, 59% were small and 22% medium sized; the support was extremely skewed both towards both medium and small enterprises. Proportionately to the size of the sector, across the Mongolian economy as a whole, the medium and small SMEs benefited enormously but at the expense of the micro sector".

"Highly skewed allocation by urban areas (Ulanbaatar/Darkhan and Erdenet): The three urban areas, namely Ulanbaatar (1 Million), Darkhan (180,000 inhabitants) and Erdenet (75,000 inhabitants) received 74% of all projects. From a development perspective, insufficient attention was paid to the rural areas, resulting in concentration of support to the already well-developed urban centres. We note that the Mongolian constitution identified Ulanbaatar as the only urban area, but in BDS terms, there is always a strong emphasis on supporting BDS provision and providers beyond the capital city."

"Financial leverage: a major unintended project bonus is the fact that 32% of the SMEs were able to access 75 million EUR. However, two points are worth noting: firstly, a median loan size of €146,500 almost certainly means that the access to finance was mainly by medium-sized enterprises (many if not most of which are already bankable) and secondly, EBRD lent 28% of the amount (21.8 million EUR) resulting to concerns about the dual role played by EBRD in this (and other project) activities, namely partly as a development bank and partly as a commercial rival in a small and immature financial market."

"Highly skewed BDS providers: out of the database of 150 (mostly) active BDS providers, only 1 has recently been added which is not based in Ulanbaatar. From a BDS development perspective this is poor performance and needs to be improved, including reconsidering the EBRD internal rule of working only with consultancy companies, rather than individuals, outside Ulanbaatar."

As demonstrated in the Evaluation report, EBRD rules made it difficult to implement the project priorities in particular in relation to the specific project goals and the vulnerable target groups, such as the people whose livelihoods depend on the informal economy. As noted out in the project Evaluation report:

"The micro component was affected by the application of EBRD-wide Business Advisory Services rules. While recognising the importance of having a framework for the management of the overall programme, this cannot be applied rigidly across 25 countries regardless of their specificities, needs and priorities. This would be an absurd approach, especially in view of the fact that the micro component would not have happened at all (according to EBRD discussions) without EUD funding and that such funding will exist for over a decade in Mongolia. The evaluation raised important gaps which require a more customised response in relation to the new phase of support for the next five years."

"The recommendations must take into consideration the previously mentioned caveats: the access to finance elements of the evaluated project were mainly connected with the macro (regulations) and meso level (agricultural leasing and micro finance) and there was no explicit element of SME access to finance in relation to the micro level where the focus of the intervention was on business development services (BDS)."

Another issue highlighted by the project Evaluation report was the potential conflict of interests between the EBRD´s role as project implementing agency and its role of bank and investor:

"The EBRD has two other roles to play in Mongolia: as a development bank / investor in SMEs/financial institutions, and as the implementer of the access to finance components of the project. There have been claims of possible conflicts of interest in the EBRD´s role in the evaluated project, such as the support for XacLeasing (owned by XAC Bank, which is partly owned by EBRD) and EBRD/XAC bank lending to medium-sized / bankable SMEs, which the commercial banks operating in a relatively small market could have lent to. The potential for conflicts of interest increases in relation to the new project. Therefore, in the Inception Report, Progress Reports and Final Report, the EBRD will specifically declare any interests (e.g. direct or indirect ownership of financial institutions), any possibilities of a conflict of interest arising and what has been done to ensure that this does not happen. If there is the possibility of it happening, it must set out how the issue will be communicated in a transparent manner, such as to the PSC and Mongolian Bankers´ Association.

"The project has demonstrated that financial initiatives can and do go wrong: all 12 lessees of the agricultural leasing product with XacLeasing are in default. This requires the EBRD to analyse and set out all the possible risks and liabilities that might arise from the two access to finance project components, including an explicit discussion: of i) the moral hazard issue and ii) the possible liabilities that might arise to the EBRD and the EUD. "

"Since competition is a critical factor in stimulating greater access to finance for SMEs, the evaluation team strongly recommends that in future, the EBRD also considers other financial partners than just the market leaders. If this is not feasible, the EBRD should explicitly set-out what it has been done to engage second / third tier institutions and why it is not possible to work with them. This is not to suggest in any way that the EBRD should not follow its normal due diligence and other procedures."

Therefore, the evaluation team recommended foregoing EBRD lending to bankable SMEs, especially medium sized enterprises:

"The EBRD is a development bank, not a commercial one. It has no role in lending to SMEs that are already bankable and capable accessing finance through commercial banks. This would mean zero additionality, unfair competition vis-à-vis other banks as well as potential for market distortion. Therefore, it should be a requirement that if a medium-sized firm utilising the micro component wishes to access finance, the EBRD will not provide such finance if it is a bankable business, as it almost certainly will be. This role will be left entirely to the commercial banking sector. The EBRD´s role will be restricted to lending to micro and small businesses, but only and if they are not bankable and therefore unable to access commercial finance independently of the EBRD."

Finally, the lessons learned identified by the project evaluators and recommendations included also the issues **multiple projects and funding limit and the need to provide for a wider Micro Consultants Register:**

"The EBRD-defined limit of 10,000 EUR per SME cuts across the project target of reaching a minimum number of SMEs, thus spreading the benefits of co-financed BDS to as many SMEs as possible. Furthermore, it is probably the medium enterprises that are benefiting disproportionately from the upper limit, but they are also the most likely to be able to afford BDS and be able to pay for it after one intervention. In the case of medium-sized firms, the additionality of co-financed BDS support may decrease to close to zero after the first intervention. The current EBRD-defined rule should be modified in the case of the future Mongolian micro activities. We propose the following: Upper limit of 10,000 EUR for Micro; 6,000 EUR for Small; and 3,000 EUR for Medium; Only one intervention per medium SME until the micro and small

SMEs targets are reached.

"After 8 years of undertaking micro activities in Mongolia there is only 1 non- Ulanbaatar based company (out of 150) in the EBRD database. This fact speaks for itself and is illustrative of the fact the insufficient policy attention has been paid to the importance of developing BDS provision beyond the capital city. The project team is well aware of the difficulties of engaging Ulanbaatar -based BDS providers for non- Ulanbaatar projects. This may also be part of the reason for the heavy concentration of projects in Ulanbaatar / Darkhan/ Erdenet. If necessary, the EBRD-wide rules (e.g. only companies, limit of 20 projects / 75,000 EUR per company before being removed from the Micro register) will need to be modified in order to promote and develop non- Ulanbaatar -based BDS providers in recognition of the different market conditions applying. Over time, the approval rules may be tightened and brought in line with the ones for Ulanbaatar -based BDS providers. The EBRD should work closely with MMCI, including targeting greater delivery of business consulting courses beyond Ulanbaatar, concentrating on locations with economic development potential."

CONCLUSIONS AND RECOMMENDATIONS

The project did not sufficiently reached out to small and micro-enterprises, neither to the companies in rural areas i.e. to the people whose livelihood are most likely to be affected by their dependence on the informal economy. This is an illustration of the issues discussed also in the Volume 3 (Global Policy Review), in particular the fact that IFI´s and other international banks lack the proper operational framework to access and work with the people and firms in the informal economy.

The project ended up covering medium enterprises rather than small and micro-enterprises. The minimum loan amount disbursable under the EBRD rules was prohibitively high for smaller enterprises. The roster of business consultants did not include enough experts that were in touch with the IE enterprises. The covered companies were concentrated in more developed regions and in urban area, contrary to the project intensions.

As formulated in the project Evaluation report: "The overall project management on the part of the EBRD could have been better: although the EBRD is an expert institution in access to finance, in Mongolia it lacked experience in implementing a (nonaccess to finance) policy-making technical assistance project. The project was re-orientated towards the areas that EBRD Mongolia was technically comfortable with, rather than what the original project was seeking to achieve."

FURTHER TAGS	▪ Strengthening legal and policy frameworks to support the informal economy (legal and planning approaches) (1.3; 1.4) ▪ Capacity strengthening of government and civil society organisations, including on micro-finance (1.9) ▪ Identification of profitable informal economy activities for start-ups (3.2; 3.5) ▪ Finance management, basic accounting training for informal economy entrepreneurs (3.2; 3.6) ▪ Training on managing credit sales for informal economy entrepreneurs (3.2; 3.6)
SOURCE	**RNSF Research Volume 4.3:** https://europa.eu/capacity4dev/iesf/documents/rnsf-research-volume-43-gp-ll-15-ec-funded-projects
REFERENCE	**EUROPEAID Project page**: https://ec.europa.eu/europeaid/projects/support-sme-development-mongolia-0_en