IFC/GEF GLOBAL SMALL AND MEDIUM SCALE ENTERPRISE (SME) PROGRAM

SECOND REPLENISHMENT

Environmental Finance Group
Environment and Social Development Department
International Finance Corporation
August 2, 2002

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ABBREVIATIONS

BDS	Business Development Services
CI	Conservation International
CEEF	Commercializing Energy Efficiency Finance
CNG	Compressed Natural Gas
EE	Energy Efficient
ESCO	Energy Services Company
FCG	Fidecomiso para la Conservacion en Guatemala
FI	Financial Intermediary
GEF	Global Environment Facility
HEECP	Hungary Energy Efficiency Co-financing Project
HPE	Hidroelectrica Papeles Elaborados
IFC	International Finance Corporation
IFI	International Financial Institutions
LC	Letter of Credit
M&E	Monitoring and Evaluation
M&O	Management and Operating
MFI	Microfinance Institutions
PDF	Project Development Facility
PV	Photo Voltaic
SME	Micro, Small and Medium-Sized Enterprise
IFC/GEF SME Program	The IFC/GEF Global Small and Medium Scale Enterprise Program
TA	Technical Assistance
UNDP	United Nations Development Program
US$	United States Dollar
VWU	Vietnam's Women's Union
WBG	World Bank Group

PROJECT BRIEF

1. Identifiers:

Project Number:	000000
Project Name:	IFC/GEF Global Small and Medium Scale Enterprise program (the "SME Program")
Duration:	Ten years in total in two phases: a five year investment phase and a five year supervision phase.
Implementing Agency:	The World Bank
Executing Agency:	International Finance Corporation – IFC
Requesting Country or Countries	Global (existing portfolio of 21 countries and a preliminary market pipeline to be finalized during project preparation**)**
Eligibility:	Countries that have ratified related conventions
GEF Focal Areas:	Finance opportunities in climate change mitigation, biodiversity conservation, international waters preservation and land degradation prevention as it relates to GEF focal areas.
GEF Program Framework:	Operational Programs 1-13

2. Project Summary:

Building on the successes of the existing SME Program, IFC is requesting from GEF a second replenishment to re-orient and expand the Program to work specifically with mainstream financial intermediaries (FIs) that target micro, small and medium enterprises (SMEs). This approach will be based on the experience gained under the SME Program and on best practices in SME financing arising from the World Bank Group's (WBG) SME Department and IFC's Global Financial Markets Department. The Program will use capacity building tools, through a comprehensive technical assistance (TA) Program, and innovative finance mechanisms, including a risk sharing facility, to mainstream GEF-eligible SMEs into the formal financial systems. In addition to market mainstreaming through FIs, the Program will be more fully integrated into IFC's SME and Financial Markets activities and will benefit from a broad range of existing relationships that IFC has with FIs. The range of the GEF operational priority areas will be increased from biodiversity conservation and climate change mitigation to include two more priority areas, international water preservation and land degradation prevention as it relates to the GEF focal areas.

3. **Cost and Financing**:	Financing in the form of debt, guarantees and quasi-debt, to be provided to intermediaries and in a few cases to medium-sized enterprises and projects on terms as commercial in nature as possible, broadening the range of instruments from debt as used in the existing SME Program.
GEF:	Four tranches of US$5 million US$20 million **Total Program Cost** US$35 million (The TA Program (US$7 million) and the Program Management and Operating expenses (US$8 million) over ten years will be funded from reflows of principal payments, and interest.)
4. **Associated Financing**:	The Program expects to achieve a portfolio leverage ratio of 1:3 –1:5. IFC and partner FIs, including existing IFC clients and local FIs would be solicited to provide an additional US$60-100 million financing to the targeted financial intermediaries over the five-year investment period. The Program will also undertake fundraising for co-financing of the TA Program.
5. **Operational Focal Point Endorsements**:	Endorsement from 73 countries are on file with IFC. Additional endorsement will be obtained as new countries are added to the Program.
6. **IA Contacts**:	**Hany Assaad** Program Manager Environmental Finance Group Environment and Social Development Department International Finance Corporation Tel: 202-473-0524 Fax: 202-614-1559 E-mail: Hassaad@ifc.org **Maurice Biron** Program Coordinator Environmental Finance Group Environment and Social Development Department International Finance Corporation Tel: 416-690-1250 Fax: 416-690-9757 E-Mail: Mbiron@ifc.org

EXECUTIVE SUMMARY

1. This project concept document requests a second replenishment from the GEF Council to extend and expand the IFC/GEF Small and Medium Scale Enterprise Program (the *SME Program*). This replenishment request to the GEF is for a funding commitment of US$20 million. The expanded Program will continue to have three components: (i) financing (Financing Facility), (ii) technical assistance and capacity building (TA Program), and (iii) Program Management. All three Program components will be reoriented to incorporate lessons learnt and build on the success of the SME Program. The Program will focus its efforts on financial intermediaries (FIs) that target micro, small and medium enterprises,[1] through best practice finance mechanisms, including a risk sharing facility, and capacity building tools through a comprehensive TA Program. The TA Program and Program Management will be funded through Program re-flows. The Program approach is based on the experience gained under the SME Program and on best practices in SME financing arising from the World Bank Group's (WBG) SME Department and IFC's Global Financial Markets Department. The Program reorientation will mainstream and better integrate GEF-eligible SMEs into the formal financial systems, thus achieving sustainable GEF–eligible financing. In addition to market mainstreaming through FIs, the Program will also be more fully integrated into IFC's SME activities and will benefit from many of IFC's internal resources and a broad range of existing relationships that IFC has with FIs. The Program will be designed to leverage financing from IFC and other FIs to ultimately achieve a significant scale up and replicability. The Program will support an additional 12-17 financial intermediaries and projects over 10 years with a 5-year investment period. The non-grant US$20 million financing facility will be structured to achieve a portfolio leverage ratio of 1:3 –1:5 i.e. US$60-100 million of incremental financing, in order for the intermediaries to finance 300-500 sustainable GEF-eligible SMEs. The range of the GEF operational priority areas will be increased from biodiversity conservation and climate change mitigation to include two more areas, international water preservation and land degradation prevention as it relates to the GEF focal areas. A substantial portfolio growth and diversification is expected through this proposed expansion of GEF-eligible activities to additional focal areas and target markets.[2]

2. The SME Program pilot phase began with GEF support in 1995, followed by a first replenishment phase approved in 1997. Both the pilot and the first replenishment phase have proven successful, demonstrating the feasibility of using non-grant funding, on increasingly commercial terms, to finance GEF-eligible activities. An initial independent evaluation in 1997 recommended additional GEF support to increase the SME Program's financial leverage. This leverage would allegedly accelerate dissemination of best practices in GEF private sector financing and help create an adequate base for launching a sustainable Program that generates global environmental benefits. The evaluation concluded that the SME Program was well structured, and the resources were being used diligently and effectively. Building on the results achieved during the pilot phase (1995-1997), IFC concluded that to reach the SME Program objectives, an expanded program was required, one that could finance 100 SMEs through 10-12

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[1] For convenience sake and to remain within accepted practice, the SME abbreviation is used in this document to refer to micro, small and medium-sized enterprises, avoiding the more cumbersome abbreviation of MSME.

[2] GEF-eligible activities and projects are those that address the four GEF focal areas of biodiversity conservation, climate change mitigation, prevention of degradation of international waters and prevention and control of land degradation, in GEF-eligible countries.

new intermediaries. A second independent evaluation completed in January 2000 reconfirmed that the Program has been successful in achieving its GEF objectives, but called for more commercial terms and mainstreaming with IFC's standard financing operations and developing an adequate monitoring and evaluation (M&E) function to address dissemination, monitoring and evaluation of a growing and maturing portfolio.[3]

3. It is anticipated that the expanded Program will provide significant value added to the recipient country and market, the intermediaries, and SMEs, by reorienting the Program focus on mainstream FIs, a comprehensive TA component and innovative finance mechanisms from the Financing Facility[4]. The facility is designed to provide direct financing (debt, guarantees or quasi-debt) to intermediaries to on-lend to SMEs, and in a few cases directly to medium-sized companies. The use of partial guarantees for SME portfolios will provide substantial risk sharing/management following the draft Basel Capital Accord (Basel II) methodology[5], benchmarking intermediaries' SME loan portfolio against best practice. It will also allow the use of GEF funds to mobilize commercial funds where appropriate, leading to a more sustainable Program outcome.

4. It is proposed that the second replenishment would be disbursed in four equal tranches over a four-year period. Each disbursement will be triggered by agreed implementation targets[6]. Re-flows of principal, interest and fees from both the existing and future portfolio will be used to fund the TA Program[7] of US$7 million and to cover the SME Program's Management and Operating (M&O) expenses estimated at US$8 million for a 10 year period.[8] No additional GEF funding will be required to cover the extended Program's TA Program and the M&O costs. The TA Program is a valuable component of the SME Program, which if used effectively, can achieve significant leverage and impact by helping to further develop the market for GEF-eligible activities and to build capacity in financial intermediaries to serve this market. The leverage will be achieved through substantially strengthened financial intermediaries with capacity to implement the TA Program. The multi-year TA Program will support five types of activities: (i) market assessments to identify and demonstrate the potential market for GEF-eligible activities, and country-wide capacity building for GEF-eligible SME financing, i.e. demonstrating that there is a potential market for FIs to target these businesses; (ii) building the capacity of intermediaries to better target GEF-eligible SMEs and to develop appropriate approaches based on international best practices in SME finance; (iii) building local SME capacity, including assistance in project preparation and to prepare feasibility studies, and business plans, (iv) monitoring, reporting and evaluation of GEF-eligible activities; and (v) dissemination of results achieved and lessons learned.

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3 See section II for a detailed description of the existing SME Program.

4 See Paragraphs 55 to 60 for a detailed description of the Financing Facility.

5 The Basel II (proposed in 2001 for final implementation in 2005) recommends a more flexible, and risk-sensitive set of capital standards. The proposed standards will address some of the weaknesses of the 1988 Accord by creating a more risk-sensitive framework and improving risk measurement and management capabilities focusing on minimum capital requirements (measured as: the bank's total capital/(credit risk + market risk + operational risk)), supervisory review processes and market discipline to encourage effective disclosure and sound banking practices.

6 See paragraph 51 for the tranching description.

7 See paragraphs 61 to 65 for a detailed description of the Technical Assistance Program.

8 See paragraphs 66 to 72 for a detailed description of Program Management.

5. A new approach will be integrated into the expanded SME Program to help identify suitable GEF eligible market opportunities for businesses. IFC will utilize its experience with the GEF as well as other sources to help identify a variety of types of businesses for FIs to target. This represents a shift from the expectation that the SME Program would receive proposals from intermediaries for financing or the intermediaries expecting to receive project proposals to finance, to the intermediaries themselves playing a more active role in developing the market in the target countries. Both IFC's and the SME Program's existing SME and FI portfolio and pipeline will complement this new approach providing for a significant project base to secure a substantial continuous investment flow.

6. A limited number of incentives will be developed and tested to help encourage commercial financial intermediaries to enter GEF-eligible SME markets and businesses. In addition to the incentive presented through the financing facility and risk sharing, the TA Program will cover market identification and exploration costs as well as identification and introduction of best practice SME finance approaches and techniques. The intermediaries would also be rewarded through a success fee for achieving pre-agreed targets for financing GEF-eligible activities.

7. The SME Program will benefit from the WBG's and IFC's global private sector and SME experience and best practices, and will leverage many of IFC's internal resources, providing substantial technical, legal, and managerial support to the Program's execution. IFC brings an extensive network of existing relationships with FIs, many of which are already engaged in the SME finance field or which are interested in entering this sector. IFC's comparative advantage has been demonstrated in its Conventions forming activities and the GEF projects managed and led by IFC. IFC's experience in managing these kinds of projects will continue to be of value to the management of the SME Program. In addition to the internal close relationships with IFC departments, the Program will also continue to reach out to the business world including financial institutions, environmental and SME-oriented not-for-profits, IFIs, the international development community, government agencies, and civil society, leveraging on IFC's strong convening power to bring different stakeholders together.

8. In order to further mainstream the SME Program within IFC, a senior staff member from IFC's Global Financial Markets Department has been recruited to manage the Program and to incorporate various lessons learned through IFC's experience in SME finance. IFC has adopted a new approach to SME finance at a corporate level, which the Global Financial Markets Department has been developing with financial intermediaries. This experience will be integrated into the Program through the new Program Manager, who directed the Micro and Small Business Finance function of the Global Financial Markets Department over the last two years.

I. THE EXISTING IFC/GEF SME PROGRAM

Background and Past Performance

9. The IFC/GEF SME Program was approved as a Pilot Phase GEF activity in July 1994 and became operational in March 1995 with a first loan agreement to an intermediary extended in November 1995. The first replenishment was approved by the GEF in 1997 and disbursed in two tranches, the second occurring in 2000 following completion of an interim evaluation (see Annex 1 for the SME Program Interim Evaluation report of January 2000).

10. The mandate given to IFC was to design and test procedures that could finance the incremental costs of GEF-eligible projects as carried out by SMEs. SMEs for the purpose of the Program are defined as private sector enterprises with total assets valued at less than US$5 million equivalent.[9] Eligible projects were those that fall under one of the GEF Operational Programs in the conservation of biodiversity and mitigation of climate change areas. The SME Program was designed as a global initiative; available to finance eligible projects in any recipient country that has signed the biodiversity and/or climate change conventions.

11. The Program operates primarily through intermediaries. These intermediaries have been selected by IFC on the basis of their experience with SMEs, financial viability, and financial and environmental technical capabilities. The intermediaries identify, analyze, finance and monitor GEF-eligible SME projects and assume the risk inherent in these projects through the provision of loans or equity investments, excluding grants. This process reflects the incremental costs to undertake GEF activities for the SME Program. This incremental cost at the intermediary level has been approved and accepted by GEF Secretariat. Incremental costs are therefore not analyzed at the sub-project level. Initially, the intermediaries typically received a long term (up to 10 years), low interest rate loan (not more than 2.5% per year) from the Program and combined their own and other sources of funding to complement the financing requirements for the eligible SME projects. Following recommendations stemming from the 2000 evaluation, more commercial terms have been introduced and today the portfolio also includes loans on purely commercial terms without any concessionality. The loan arrangements negotiated with intermediaries, include concessions through fees and risk compensation to support their incremental cost. The fees have been negotiated at levels of 1-2% for the monitoring fee and 4-6% for the completion fee. The risk compensation (described in the paragraph below) resulting in reductions of the loan principal owing the SME Program, were provided ranging from 0-50%. In special instances, technical assistance grants have been provided to SMEs at the intermediary and sub-project levels.

12. The risk compensation constitutes the incremental cost for the additional risk incurred by intermediaries (e.g. foreign exchange and new business activity) in financing SMEs. It is provided as the SME repays its loan to the intermediary and the intermediary provides proof of receipt of such payment. Although this subsidy was found to be effective at overcoming the

[9] Given the global dimension the Program will operate in, other specific classification standards will be difficult to adhere to e.g. ranking companies by their relative size within the local economy as the number of employees or annual turnover size for SMEs often vary widely across and within regions.

additional risk incurred by the intermediaries, the standard 50% amount of repaid funds, was modified downward and negotiated on a loan-by-loan project basis.[10]

Pilot Phase

13. In the pilot phase GEF provided US$4.3 million which was utilized by IFC as follows:

Funds for lending to intermediaries	$ 3,800,000
Technical assistance	$ 105,000
Administrative expenses	$ 312,500
Legal expenses and contingencies	$ 82,500
Total Pilot Phase funding	**$4,300,000**

By January 1997, the SME Program had loan commitments of US$ 3.8 million to five intermediaries, which had committed to financing at least 23 sub-projects, and a pipeline of some 13 interested intermediary applicants.

First Replenishment

14. As part of a first replenishment request of US$16.5 (see Table 1 for a detailed cost break-down), an evaluation in January 1997 recommended additional GEF support to increase the SME Program's base, as it was too small to permit proper accumulation of GEF private sector experiences and create an adequate base for launching a sustainable financing facility that would generate global environmental benefits on an ongoing basis. Building on the results achieved during the pilot phase (1995-1997), IFC determined that to reach the SME Program's objectives, an expanded Program was required, one that could finance up to100 SMEs and their GEF-eligible activities through 10-12 new intermediaries. The review concluded that the SME Program was well structured, and the resources were being used diligently and effectively.

15. In the 1997 replenishment of the SME Program, three specific strategies were developed:

- A sufficient number of projects needed to be developed to provide a basis for future conclusions and lessons, targeting an additional 75 SME projects to be financed.
- Building capacity in non-financial intermediaries through increased training was required.
- Monitoring, evaluation and dissemination of Program results was needed to study the experience of the Program and disseminate accumulated best practices.

16. For the first replenishment approval in January 1997, the budget summary in Table 1 below was proposed by IFC and endorsed by the GEF Council.

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[10] This modification was recommended following the first SME Program evaluation of 2000, and implemented to assure that only the incremental cost of the additional risk facing the intermediary is funded by GEF.

Table 1: Project Budget for the First Replenishment in 1997

(all figures in US$ 000's)	Total	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Actual Year:		1998	1999	2000	2001	2002					
Average SME Program loan portfolio		2,000	3,900	6,120	8,500	10,300	11,100	9,900	7,200	4,200	1,300
Funds loaned to intermediaries and projects	12,000	2,000	2,000	3,000	3,000	2,000					
Technical Assistance Funds											
To Intermediaries	750	100	100	100	100	100	100	100	50		
Monitoring & evaluation	250	50	10	10	10	10	10	50	10	10	80
Dissemination	500	25	35	45	50	50	50	50	50	50	50
Administration expenses:											
Salaries		250	275	285	235	235	235	200	200	105	10
Travel and accommodations		92	92	87	72	72	72	72	72	40	10
Equipment purchase		15									
Office and furniture rental		15	15	15	15	15	15	15	15	15	7
Communications		15	15	15	15	15	15	15	15	15	5
Supplies		6	6	6	6	6	6	6	6	5	1
Total Admin. expenses	3,062	393	403	408	343	343	343	308	308	180	33
Admin. expenses as % of loan portfolio		20%	10%	7%	4%	3%	3%	3%	4%	4%	3%
Inflation and contingencies	937	43	67	90	101	109	128	133	150	97	19

Source: Global Small and Medium Scale Enterprise Program Replenishment, Project Document, International Finance Corporation, January 1997, Schedule A, p. 18.

17. In January 2000, an interim evaluation was completed, fulfilling a pre-condition set by the GEF for disbursement of the second tranche of US$8.25 million of the first replenishment totaling US$16.5 million. This second evaluation recommended: (i) more commercial terms to intermediaries and projects, and preserving the incremental fee structure for completion (4%) and project supervision (1%); (ii) benchmark thresholds for incremental risk premiums to the intermediaries based on market norms and experience; (iii) re-establish an Advisory Panel to confirm sub-project GEF-eligibility; (iv) "mainstream" the SME Program along with regular IFC activities and train the intermediaries in GEF Operational Programs; (v) implement a marketing strategy; and (vi) finally, establish a conventional private equity fund with similar objectives to the SME Program.

18. The January 2000 evaluation offered a firm base for continuing the SME Program, indicating that the SME Program had demonstrated that GEF funds could be used to support global environmental activities of SMEs through non-grant financing mechanisms that also achieved commercial viability and promoted financial sustainability. Although the SME Program required various adjustments to its Program delivery, it was felt that the SME Program had largely met its interim goals and objectives as originally intended. By January 2000, the SME Program was committed to 15 borrowing intermediaries, which were involved with some 100 sub-projects with SMEs.

19. As of May 2002, the SME Program had approved 23 intermediaries (2 of the 23 approved intermediaries cancelled their loan agreements). The existing 21 intermediaries (16 non-financial

and 5 financial intermediaries) have produced 139 sub-projects. These projects covering the given GEF Operational Programs, have achieved global environmental benefits in climate change and conservation of biodiversity by financing energy efficiency and use of renewable energy and conservation of various eco systems including e.g. conservation harvesting, solar home systems, ESCOs, eco-lodges and energy efficiency homes. Also, loan funds remained to finance two new potential intermediaries. The following two tables depict the SME Program's current status of intermediaries and sub-projects. Table 2 provides an overview of the approved portfolio by GEF focal area of forecasted climate change and biodiversity financing for each intermediary receiving financing. The table also lists two potential new intermediaries, as well as the two approved intermediaries that were cancelled by the applicants.

Table 2: SME Program Portfolio Overview – Environmental Focal Area

	Loan Approved or Potential (in US$'000)	Location and Number of Projects	Focal area of Intermediary/ Project	Forecast Climate Change Financing (in US$'000)			Forecast Biodiversity Financing (in US$'000)
				PV	Other		
Approved Intermediaries:							
1. EEAF (reduced from $800k)	400	Central America/Caribbean		133	132		
		Dominican Republic	CC - PV	75			
		Mexico - 2	CC - ESCo		60		
2. CARESBAC	600	Poland - 6			350		250
			CC - RE				
			CC - EE				
			CC - EE				
			Biodi - cert. fruit				
			CC - RE				
3. FUNDECOR	500	Costa Rica - 63					500
			Biodi - sust. Forestry				
			Biodi - reforestation				
4. El Sewedy	500	Egypt - 34	CC - EE		500		
5. WWF (reduced from $500; then fully prepaid)	250	Papua New Guinea - 1	biodi - sust. Forestry				250
6. Grameen Shakti	750	Bangladesh - 1	CC - PV	750			
7. Econoler International	800	North Africa/Middle East			800		
		Tunisia - 1	CC - ESCo				
8. Conservation Int'l	1,000	Global - 6					1000
		Mexico, Indonesia/Guat./Ghana	biodi - cert. coffee				
9. FCG	500	Guatemala - 12					500
			biodi - cert.coffee				
10. Selco Vietnam	750	Viet Nam - 1 (1408 units)	CC - PV	750			
11. Save Valley Wildlife	1,000	Zimbabwe - 1	biodi - ecotourism				1000
12. International Expeditions	750	C. and S. America - 1					750
13. Barclays Bank of Botswana	1,000	Botswana - 0	biodi and CC		500		500
14. Peer Consulting	1,000	South Africa - 3	CC - EE		1000		
15. PILCO	750	Egypt - 1 (599 units)	CC - solar W/H		750		
16. Wilderness Gate	1,000	Central America - Honduras - 1	biodi - ecotourism				1000
17. Cogener	500	Tunisia - 1	CC - EE		500		
18. Soluz	500	Honduras - 1 (1,528)	CC - PV	500			
19. Boundary Hill	200	Tanzania - 1	biodi - ecotourism				200
20. E&Co.	1,000	Global - Honduras, Jamaica - 2	CC - EE and RE		1000		
21. Credicoop	600	Chile - 0	CC - EE and RE		600		
sub-total	14,350			2,208	6,192		5,950
				15%	43%	59%	41%
Potential Intermediaires							
22. IUCN	1,000	global	Biodiversity				1000
23. Symbio-Impax	400	Poland	Biodiversity				400
sub-total	1,400			0	0		1,400
							100%
Potentials plus Approved	15,750			2,208	6,192		7,350
				14%	39%	53%	47%
Approved Intermediaries but cancelled:							
24.Shell Solar South Africa	1,000	South Africa	CC - PV	1000			
25. Mt. Gahavisuka	210	PNG	biodi-ecotourism				210
	1,210						

Notes: CC = Climate change
EE = Energy efficiency
PV = Photovoltaic
RE = Renewable energy

20. Table 3 shows the current portfolio status including amounts approved, disbursed, principal repaid and concessions (amounts forgiven for monitoring and evaluation fees and the risk compensation) to the intermediaries. Given the existing intermediaries and plan to finance

two new ones, it is expected that an additional 30 SMEs will be financed through the existing SME Program funds (combined funds from pilot phase and first replenishment).

Table 3: SME Program Portfolio Overview – Financial Flows

	Borrower	Country of project location	Loan Amount Approved	Amount Disbursed to date	Principal repaid to date	Amount Foregiven to date	SME Projects Approved to date	SME Projects Proposed by Borrower
			------------- (in US$'000)			--------------		
1	CARESBAC	Poland	600	600	109	94	6	4
2	EEAF (reduced from $800k)	Mexico, Dominican Rep.	400	400	288	35	2	6
3	FUNDECOR	Costa Rica	500	500	90	59	63	50
4	El Sewedy	Egypt	500	500	136	273	34	6
5	WWF(reduced from $500k)	Papua New Guinea	250	250	241	9	1	5
6	Econoler Int'l	Tunisia	800	400	176	23	1	3
7	Grameen Shakti	Bangladesh	750	750	34	214	7,463 *	3,200
8	SELCO Vietnam	Vietnam	750	400	19	25	1,408 *	1,600
9	Conservation Int'l	Global- Mex.,Indo., Guat.,Ghana	1,000	1,000	45	107	6	8
10	FCG	Guatemala	500	500	24	33	12	10
11	Pilco	Egypt	750	750	-	100	599 *	700
12	Save Valley Wildlife	Zimbabwe	1,000	500	49	20	1	1
13	Peer Consultants	South Africa	1,000	500	-	1	3	5
14	Cogener	Tunisia	500	500	-	-	1 *	1
15	Wilderness Gate	Central America	1,000	500	-	4	1	4
16	International Expeditions	C and S America	750	375	-	15	1	4
17	Barclay's Bank of Botswana	Botswana	1,000	500	-	-	0	7
18	Soluz Honduras - loan	Honduras	400	400	-	-	1,528 *	1,500
	Soluz Honduras - equity	Honduras	100	100	-	-	-	-
19	Boundary Hill	Tanzania	200	200	-	-	1	1
20	E&Co	Global - Honduras/Jamaica	1,000	500	-	5	2	5
21	Credicoop	Chile	600	-	-	-	0	20
	Totals		**14,350**	**10,125**	**1,212**	**1,015**	**139 ****	**144**

Note: * PV sales for Shakti, SELCO Vietnam, Pilco (solar water heaters) and Soluz Honduras are reported at last quarter end.

* * SME Projects Approved to date and by Borrower totals include: Grameen Shakti, Selco, Pilco, Save Valley, Cogener, Soluz H. and Boundary Hill as single projects.

21. Table 4 below summarizes five years of expenditures and loan portfolio as compared to the approved Table 1, depicting positive and favorable balances at the end of the fifth year. As can be seen from the table below, the Program's loan portfolio grew more rapidly than projected in the original estimated budget.

Table 4: Five -year Summary of TA Program and Administration Expenses in Relation to the Project Budget as of January 1997 (Table 1)

In US$'000	Budget Year 1	Actual 1998	Budget Year 2	Actual 1999	Budget Year 3	Actual 2000	Budget Year 4	Actual 2001	Budget Year 5	Est. 2002	Total for 5 years	1998 to 2002
Technical Assistance Funds:												
To Intermediaries	100	70	100	61	100	-	100	75	100	24	500	229
Monitoring & evaluation	50	-	10	-	10	65	10	18	10	-	90	83
Dissemination	25	-	35	13	45	30	50	-	50	13	205	57
Total TA	175	70	145	74	155	95	160	93	160	37	795	369
Administration expenses:												
Salaries	250	169	275	194	285	240	235	204	235	124	1,280	931
Travel and accommodations	92	57	92	79	87	81	72	50	72	19	415	286
Equipment purchase	15	10	-	3	-	-	-	-	-	-	15	13
Office and furniture	15	11	15	11	15	11	15	11	15	8	75	52
Communications	15	9	15	6	15	6	15	3	15	3	75	27
Legal	-	11	-	10	-	-	-	38		13	-	71
Supplies	6	-	6	-	6	-	6	-	6	-	30	-
Total Administration expenses	393	266	403	303	408	338	343	306	343	167	1,890	1,379
Inflation and contingencies	43	-	67	0	90	-	101	0	109	0	410	0
Total Admin. + Inflat/conting.	436	266	470	303	498	338	444	306	452	167	2,300	1,379
Total TA & Admin.	611	336	615	376	653	433	604	398	612	204	3,095	1,748
Loan portfolio Forecast	2,000	5,050	3,900	10,050	6,120	12,050	8,500	13,750	10,300	13,750	10,300	13,750
Total Admin as % of total loan portfolio	20%	5%	10%	3%	7%	3%	4%	2%	3%	1%	18%	10%

Source: Budget: Schedule A of the Replenishment Project Document, January 1997. Actuals are based on accounting records of the SME Program. (The last column summarizes the total budget and total actual execution over five years (1998-2002.)

22. An update to the January 2000 interim evaluation of the SME Program, was carried out to provide additional information for this second replenishment request and is presented as Annex 2. This evaluation, completed in July 2002, must of necessity remain partial as it is still premature to fully evaluate Program results due to the long-term nature of the SME Program loan tenure averaging 10 years. The evaluation focuses on the Program's environmental benefits (under GEF's biodiversity and climate change focal areas), program structure and portfolio review, with particular emphasis on the incremental cost structure and justification in accordance with GEF policy. It also includes a review of the implementation of the 2000 evaluation report's recommendations as well as provision of specialized guidance to IFC to help respond to the evaluation result's recommendations. The evaluation update concludes that the SME Program is well structured and that suitable procedures are in place to achieve GEF objectives with respect to project identification and financing. The report concludes that the Program is functioning better than originally intended and that the SME Program has illustrated that it is possible to meet GEF objectives using non-grant financing mechanisms on increasingly commercial terms, although there is a need to continue to address evolving monitoring and evaluation procedures and dissemination.

23. While the portfolio of borrowing clients has begun to mature, more administrative efforts are required to manage ongoing GEF requirements, including addressing dissemination, monitoring and evaluation. Several existing intermediaries wish to consider new loans, including Fidecomiso para la Conservacion en Guatemala (FCG) and Conservation International (CI) from the SME Program, while others, such as Fundecor[11], El Sewedy, Pilco and Selco[12], are seeking to

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[11] Fundecor was recently awarded the prestigious King Badouin International Development Prize for sustainable achievements in improving the lives of people in the developing world.

[12] SELCO was awarded the US Department of State, 2001 Award for Corporate Excellence for small and medium enterprises for outstanding corporate citizenship, innovation and exemplary international business practices in Vietnam.

expand their environmental activities building on their accumulated experience either through new loans or technical assistance. Although funds available to lend to new intermediaries are almost fully committed, the SME Program has received numerous requests from prospective applicants interested in financing.

24. See box 1 below for a description of some of the intermediaries financed under the SME Program including, SELCO Vietnam Inc., CI, FCG, Fundecor, Peer Consultants and Caresbac and Symbio. Please refer to page 167 of Annex 2 for description of an additional set of intermediaries including, Pilco, Cogener, Wilderness Gate, Soluz Honduras, Boundary Hill, E&Co and Credicoop:

Box 1

SELCO Vietnam Inc., was established in 1997 to provide, install and maintain rural SHSs in Vietnam. It is estimated that about 3 million households will not be connected to the electric grid within the next ten years and can afford a PV powered energy system. Selco-Vietnam (a Delaware registered company) is licensed by the Government of Vietnam to operate within the country with a head office and assembly warehouse in HCMC, besides 4 provincial sales/service centres. Its majority owner Solar Electric Light Company (SELCO) USA has other subsidiaries operating in Sri Lanka and India with an affiliate in China. Selco Vietnam is being assisted by Vietnam Womens' Union, which promotes and collects purchase orders and payments through a commission/fee structure. VWU is a peoples' organization that manages hundreds of large scale social development programs with 11 million members, staff and volunteers in most rural communities including micro-credit funds and several for-profit businesses. Selco Vietnam uses the a state owned bank, the Bank for Agriculture and Development to provide consumer credit for the purchasers. Selco Vietnam obtained a $750,000 loan in late 1998 to purchase inventory, establish the consumer credit system and build its service/sales network. The company has sold up to 2,000 systems and is continuing to build its distribution although it is encountering some company start up hurdles related to management and market establishment.

Conservation International (CI), promotes the conservation of biodiversity in the world's biologically rich and threatened ecosystems. It aims to demonstrate the short and long term value of using natural resources on a sustainable basis by building enterprises and linking them with international markets through conservation finance. CI fosters local capacity for conservation creating alliances with indigenous people and institutions for fulfilling its objectives. As part of a SME Program $1 million loan, CI is providing a revolving 3-yr. working capital financing facility to five cooperatives representing shade-grown coffee indigenous farmers in the Chiapas, Mexico, a buffer zone of El Triunfo Biosphere Reserve. CI provides affordable credit to assist with post-harvest expenses and earn better prices from buyers (Starbucks and Green Mountain Coffee Roasters) in return for the farmers adopting certified growing practices, to not clear the forest and obey land-use restrictions. CI has used its network to link the farmers to the private sector buyers, and has now found co-financing for pre - harvest costs. Besides achieving CI's own goal of conserving the biodiversity in this important hotspot, it is expected that individual farmers will obtain a better distribution of economic benefits through more disposable income.

Box 1 (cont.)

Fidecomiso para la Conservacion en Guatemala (FCG), was established in 1991 as a small private environmental fund supporting projects and activities in conservation of biodiversity and sustainable use of natural resource and management by five experienced Guatemalan environmental NGOs. FCG borrowed US$ 600,000 from the SME Program to finance SME GEF biodiversity conservation. Working with the national NGOs and government agencies, FCG has developed various SMEs including a project of five SMES near the town of El Estor located in the Atlantic lowlands on the shores of Lake Izabel. These SMEs receive capital to fund eco-tourism activities in return for contributing revenue towards a conservation trust that maintains the Bocas del Polochic Wildlife Refuge, the second largest wetland area in Guatemala, known mainly for the high diversity and large populations of resident and migratory shore and wading birds, with a complex system of flooded grasslands, swamps, and shallows. It is also the last large refuge for Caribbean manatees and American crocodiles. Other expected GEF benefits are: establishment and strengthening of systems of conservation areas, including protected areas; development of environmentally sustainable nature-based tourism; and, integrated pilot projects to provide alternative livelihoods to communities, consistent with biodiversity conservation and sustainable use.

Fundacion para el Desarrollo de al Cordillera Volcanica Central (FUNDECOR), is a Costa Rican non-profit foundation operating exclusively within the Conservation Area of the Central Volcanic Cordillera (the ACCVC) region north of San Jose. The ACCVC contains an area of approximately 290,000 hectares of which some 70,000 hectares are protected within 5 national parks. The remaining area acts as a buffer zone for the parks. The non-park land is owned by approximately 1,400 small landowners (20 hectares average sized property). These small landowners are FUNDECOR's clients. FUNDECOR's services to the landowners include, professional forester advice and supervision for the establishment of tree plantation and the preparation and registration of sustainable forest management plans for existing forests and the supervision of harvests carried out in accordance with these plans and monitoring of property that the owner intends to leave in an undeveloped state. FUNDECOR received a US$ 500,000 SME Program loan in 1996 to advance wood purchase contracts with small landowners in the ACCVC.

Peer Consultants, is a small but well established and respected USA based civil and environmental engineering company. Peer Consultants set up Peer Africa in Johannesburg in 1995 to promote environmentally sustainable development in Africa. Peer Africa has developed passive solar heating and cooling systems appropriate to the skills and materials available in the townships in a design package they refer to as the Eco-house. Peer borrowed US$1 million from the SME Program to stimulate demand for these energy efficient housing designs and techniques by lending to South African housing SME contractors and micro-finance institutions (MFIs) at below market rates. These subsidized loans are conditional on the sub-borrowers using Peer's designs and specifications for Eco-houses/energy efficient upgrades. Having completed 3 recent housing projects (up to 300 homes completed) with SME builders, Peer Africa plans to complete a 3-year 2,000 eco-house project in Cape Town contracting SME builders. The National Urban Reconstruction and Housing Agency (NURCHA), a South African development institution set up by George Soros will guarantee 60% to the SME Program, and has worked with local lenders and PEER to create a loan/savings scheme.

Caresbac and Symbio, Caresbac, an early intermediary of the Program financed a start up company Symbio Impex Polska Sp. z.o.o. in 1998. Symbio's mission is "to harness the wealth of Poland's farms and rich natural endowments in a sustainable manner to provide the local and international markets with an abundant supply of high quality organic fruits and vegetables, resulting in more wholesome foods for consumers, biodiversity conservation of Polish land, and profitability for Symbio and its farmers". Its principal activity is the coordination of production, certification, and export of organic soft fruits and vegetables from Polish family-owned farms in buffer zones of Landscape Parks and forests in southeastern Poland. Symbio's has developed a business model, now entering the fourth year of implementation, for increasing economic returns to the small, independent Polish family farm while at the same time enhancing biodiversity conservation on the farm and in the surrounding landscape. Working with NGOs, government agencies and universities Symbio is developing its capacity to grow. CARESBAC used US$180,000 of SME Program funds to co-finance Symbio, including TA provided by the SME Program to develop the farmers' capacity. The SME Program will now extend an $400k guarantee to a Polish bank to provide a needed working capital line of credit over a 3-year period to Symbio.

SME Program Knowledge Sharing and Dissemination

25. In order to develop the understanding of existing intermediaries and prospective applicants concerning the SME Program procedures and GEF policies and procedures and eligible activities, the Program hosted two conferences (in October 1997 and May 1999). The conferences were well attended and well received with positive follow up feedback particularly on the risk training suggesting that these workshops could be replicated for a wider and regular application. As part of the May 1999 event, a project fair of businesses was organized and a training session on IFC's environmental and social review procedures and guidelines for FIs.

26. Besides having attended workshops, the SME Program requires that intermediaries attend IFC's environment risk management training of 3-4 days to develop an adequate internal environmental management system in order to ensure compliance with IFC's environmental and social standards before receiving Program funds.

27. As part of an intermediary's on-lending, the SME Program has provided several technical assistance assignments for sub-project studies (e.g. Caresbac provided TA to Symbio and Conservation International extended TA to EternoVerde). The Symbio study showed the benefits of organic farming in buffer zones and has led to follow on financing by the SME Program to increase the GEF benefits on a wider scale. The Eterno Verde study is looking at the redistribution of economic benefits to organic coffee growers adapting to certified organic methods in an important biodiversity area; this model has great replication potential.

Country Ownership

28. As a replenished GEF pilot Program until 1997, the SME Program was considered a programmatic multi-country GEF project; therefore it was not required to obtain a GEF-eligible country focal point endorsement for each proposed loan activity although the focal points were kept regularly informed. Following its first replenishment by GEF in 1997, the SME Program was required to advise the GEF Operational Focal Point in all GEF-eligible countries about the GEF Council’s approval and to enquire whether there were any objections to the SME Program operating in that country. In absence of any objection, the SME Program was to advise the Operational Focal Point when a new loan was made to an intermediary operating in that country or when an intermediary invested in a sub-project operating in that country.

29. The SME Program took affirmative action to keep GEF focal points informed of the Program activities. Notification letters were sent to focal points in March 1997, signed by the World Bank GEF Executive Coordinator and followed by additional letters in October, 1997, from the GEF’s CEO. Each focal point was asked to acknowledge receipt of the letter with or without comments. By February 1998, the SME Program had received no-objections from a total of 72 countries while 57 did not respond (see Annex 3). To bring closure to a very time-consuming task, it was agreed among the GEF Secretariat, WB and IFC that the Program will follow these procedures:

a) for potential intermediaries from countries whose focal points have acknowledged the notification, thus indicating no objection: in these cases, the Program would advise the responsible focal point once an intermediary had been selected and each time an SME Project was approved. This procedure was only to be followed for all new intermediaries selected;

b) for potential intermediaries from countries whose focal points have not acknowledged the notification: in these cases, the Program advised the potential intermediary that it must obtain the written support of the responsible GEF Operational Focal Point (or if there is no Operational Focal Point, the GEF Political Focal Point) before the Program would review their application. IFC would then advise the focal point if the potential intermediary was selected and as each SME sub-project was approved, and;

c) for potential intermediaries intending to operate in more than one country (e.g. commercial banks, international NGOs, not-for-profit financiers or regional venture capital funds): these institutions were not required to have Focal Point support prior to being selected. However, before a project submitted by one of these intermediaries was approved by the SME Program, GEF Focal Point support in the proposed country of activities was needed. If a Focal Point had already expressed no objection to the operation of the SME Program no other form of focal point support was required. If, however, one of these intermediaries proposes a project in a country, which had not responded to the no-objection notification letter, the intermediary was required to obtain written support for the project from the responsible GEF Focal Point before the project could be submitted to the SME Program for approval. As in cases a) and b) above, the Focal Points were also advised each time an SME Project was approved.[13]

30. The SME Program has not encountered any major problems by SME borrowers of global intermediaries in seeking or obtaining a Focal Point support letter. In fact as the Program has become better known, IFC is often approached by GEF Focal Points requesting that the Program be expanded to include operations in their country.

Lessons Learned

31. Lessons learned from the existing SME Program can be summarized as follows:

- SME finance has a role to play in advancing GEF goals of improving the global environment. GEF-eligible SME finance can be made sustainable and profitable through intermediaries as illustrated by the low loan default rates in the SME Program portfolio.
- SME Program operation, primarily through intermediaries has proven key in achieving local ownership and sustainability. This approach has proven to be an innovative approach that has gradually increased the portfolio and asset quality through a thorough selection of local business development through local intermediaries.
- In accordance with GEF requirements, the Program obtains evidence of country ownership through GEF Focal Point support letters and also establishes other indicators of country ownership as evidenced by local business activity within civil society in participating countries. This provides an important learning curve on GEF for the intermediary and the SME/sub-project.

[13] These procedures have worked satisfactorily. In fact, the process was beneficial in obtaining Brazil's focal point support in December 1999 since several prospective applicants prompted dialogue with the focal point to provide approval (unfortunately by the time the approval was provided, the applicants' plan had changed); having Brazil's focal point support will enhance delivery of the SME Program under this next replenishment.

- Working with both financial intermediaries and environmental NGOs requires a substantial amount of TA to build needed capacity in financial and/or environmental assessment techniques.
- SME financing requires a substantial amount of individual, time consuming, client servicing, innovative methods and procedures and a flexible financing infrastructure to cater to specific SME needs
- SMEs have lower entry costs for developing new business in comparison to larger corporations.
- The use of risk compensation and fees to off-set incremental cost of the intermediaries encourages performance and commitment to proper portfolio management for Program purposes.
- Measurement of GEF biodiversity benefits remain challenging and may not be accomplished cost effectively within the existing SME Program portfolio.

II. THE PROPOSED EXPANDED PROGRAM

Program Rationale

32. The SME Program reorientation aims to expand the program scope through a focus on mainstream financial intermediaries targeting GEF-eligible SMEs. The financing facility and TA Program are designed to provide best practice financing mechanisms and capacity building tools. The finance facility combined with capacity building will provide for a more efficient integration of GEF-eligible SMEs into the formal financial systems and off-set the incremental cost inherent in GEF-eligible SME financing. The Program will draw upon IFC's experience through internal and external partnerships leveraging both a broad range of relationships that IFC has with FIs, the WBG SME Department's project development facilities, external best practice providers and local business development institutes to support the FIs and SMEs.

1. Expanded Program Objectives

33. Building on the Program's successful implementation and best practice experience, the Program seeks a further GEF replenishment to:

i. significantly scaling up and replicating SME activities;

ii. mainstreaming GEF-eligible SME financing through financial intermediaries (FIs);

iii. building capacity of FIs and SMEs and introducing and disseminating best practices (e.g. introducing innovative financial technologies);

iv. achieving greater leverage of GEF funds through the financing facility while further mainstreaming the Program activities within IFC; and

v. monitoring, evaluating and disseminating Program results.

2. Global Environmental Objectives

34. The existing SME Program was supported by the GEF to provide SME financing to be used for projects that could address one of the GEF's two global environmental priorities:

- *Biodiversity Conservation*: the preservation or sustainable use of biological diversity; and
- *Climate Change Mitigation*: the reduction or absorption of greenhouse gases as a means of reducing climate change.

35. The expanded program will, in addition to the two GEF focal areas mentioned above, also target *International Waters Preservation*: the degradation of international waters including, waters bodies, integrated land and water projects and contaminants to these water bodies and, *land degradation prevention*, including prevention and control of land degradation, e.g. deforestation and desertification as reflected in related GEF focal areas. It should be recognized that this addition to the IFC/GEF SME Program activity, may require time to develop appropriate GEF-eligible activities for financing through SMEs or commercial FIs.

36. As in the current Program, GEF funds will be used to fund incremental costs at the financial intermediary level, and not at the SME project level. The incremental cost funding by way of technical assistance and fee compensation, as well as risk sharing through the finance facility is used to overcome the barriers facing these institutions to finance these GEF-eligible SME projects.

37. The expanded SME Program will disseminate IFC's global knowledge through both a comprehensive TA Program and an innovative finance facility to help overcome risk perceptions surrounding SME financing to activities that benefit the global environment. The IFC/GEF SME Program, building on lessons learnt from both its pilot and first replenishment phases, aims to scale up and widely replicate successful tools and approaches that result in empowering a broader segment of the SME sector to produce global environmental benefits on a sustainable basis.

GEF Rationale

38. The SME Program has been successful in developing a significant number of commercially viable financing operations and sub-projects with SMEs that generate global environmental benefits. The Program has demonstrated both profitable SME operations and the potentially sustainable role of intermediaries during both its pilot phase and its full-scale program phase following the first replenishment. This success underpins the rationale behind reorienting and expanding the current program to a mainstreamed model that will strengthen and expand GEF benefits.

39. The expanded Program will benefit from lessons learnt from the current Program and work with FIs targeting the GEF-eligible SME market. The Program is structuring a financing facility, which can utilize a range of instruments, including both traditional debt instruments and partial guarantees sharing the portfolio risk with others. The planned TA Program will provide additional leverage by helping to develop the market for GEF activities and build capacity in SMEs and in FIs to serve this market.

40. A Program expansion targeting financial intermediaries will also allow for a significant scale-up through the level of financial leverage it is expected to achieve. This will enable IFC to transfer its experience globally, replicating successful approaches and mainstreaming the Program within IFC alongside its traditional core investment activities by adding GEF funds in parallel to IFC investment funds, invested by IFC's regular investment departments.

41. The expanded Program will develop an M&E plan to better measure Program performance and GEF objectives. The M&E framework addresses the complexity of quantifiable

environmental and financial indicators capturing the Program's GEF benefits, drawing on GEF lessons learned and disseminating best practices. The information gathered will expand GEF's knowledge base in environmentally sound, commercially sustainable private sector SME project development.

SME Barriers to be Overcome

42. SMEs account for the creation of a disproportionately large share of new employment in an economy compared to larger corporations and thus make a significant contribution to the growth of an economy. The growth of SMEs and their impact on economic development in turn depends to a great extent on access to financing for the enterprises. However, in general the SME sector is the least serve by traditional financing. In many countries SMEs rely on personal savings and family funds for almost all their capital needs, to set-up a business as well as to finance its working capital needs. One of the biggest development challenges is addressing the issue of access to finance for SMEs.

43. In many developing countries and economies in transition, a number of FIs are starting to realize that SMEs can be a promising market to pursue. However, the quandary is how to do so profitably. SMEs typically represent a significant, largely untapped market. The Program will capitalize on the innovations learning in SME finance that is evolving in IFC's Financial Market Group and the WBG's SME Department to bring cutting edge approaches to financial intermediaries that will be targeting GEF-eligible SMEs (see Annex 4 for more detail on IFC and WB current best practice).

44. This potential opportunity is particularly important in those countries, where there is intense competition for the large corporate customers resulting in decreasing margins and reduced volumes of business. Profitable SME lending typically requires a different approach than traditional corporate lending; among others, appropriate risk management systems and marketing structures need to be put in place. IFC is engaging with a number of financial intermediaries (FIs) to support banks that express a strong interest in extending their SME portfolio or plan to enter the SME market. In addition, TA will be needed for those banks that are just entering the market and would benefit from the experience gained elsewhere.

45. Based on its experience so far, IFC has identified the important pre-requisites for a successful expansion of sustainable conventional SME financing. Apart from basic peace and stability, these include: (i) functioning financial [14] and legal systems; (ii) sound, or potentially sound, domestic financial intermediaries; (iii) access to additional domestic foreign investment capital; (iv) access, in some cases to concessional financing to mitigate some of the risks faced by commercial investors; and (v) availability of funds to support associated technical assistance and capacity building initiatives at intermediary and borrower levels as well as with respect to general market development. New, emerging, approaches to SME lending, including credit scoring and market segmentation, offer scope for improved viability.

[14] In particular: (a) interest rate polices and regimes that facilitate the mobilization of domestic savings and adequately provide for the costs and risks associated with SME lending; and (b) limited 'crowding-out' by government borrowings.

Structure of the Expanded SME Program

46. The proposed GEF funding of US$20 million for a second replenishment of the IFC/GEF SME Program, would be drawn over a two-year period. The Program going forward is proposed to finance 12-17 financial intermediaries during a five-year investment period. IFC and partner FIs, including existing IFC clients and local FIs would be solicited to provide an additional US$60-100 million financing to the targeted financial intermediaries over the five-year investment period. As the Program develops experience with commercial FIs and financing of GEF-eligible SMEs, will allow IFC to achieve a track record of successful financing and attract private sector investors to provide additional financing. A 1:5 leverage ratio is an ambitious target, that can only be achieved if the Program demonstrates that there is a substantial market for GEF-eligible activities and projects that SMEs can undertake, and show that FIs can be profitable in targeting these particular markets. The leverage will be generated over time through a significant pro-active business and market development and technology transfer made possible by an innovative financing facility, managed centrally by the Program but implemented locally through both the FIs and the substantially expanded TA component and Program partnerships, including e.g. WBG SME Department's Project Development Facilities and local business developers.

47. Along with the investment capital, the expanded Program requires approximately US$7 million in grant funds to provide technical assistance and capacity building support over the five-year investment period. The Program would be supported by a range of associated IFC investments and World Bank Group capacity building, private sector advisory services, business development and investment climate work targeting the development of FIs as well as the development of SMEs.

48. The SME Program would continue to have three components:

(i) the financing component (to be called the ***Financing Facility***);

(ii) (ii) the technical assistance and capacity building component (to be called the ***TA Program***); and

(iii) the management and administrative component (to be called the ***Program Management***).

49. All three components make up the IFC/GEF *SME Program*. The SME Program will reorient all three of these components to incorporate lessons learned and to build on the success of the current SME Program (the Pilot Phase and the First Replenishment) in order to *scale-up*, *mainstream* through FIs and *expand* the Program activities and its financial leveraging and private capital mobilization.

50. Table 5 shows the existing program expenditures and the proposed expanded program funds divided on three components over the ten year life of the proposed expanded SME Program:

Table 5: SME Program Actual and Proposed Funding

Funding Sources:		Actual & Proposed Usages:	
Pilot Phase:	**4,300**	*Pilot Phase:*	**4,300**
From GEF	4,300	Funds for lending to intermediaries	3,800
		Technical assistance	105
		Administration expenses	313
		Legal expenses & contingencies	83
First Replenishment:	**17,500**	*First Replenishment:*	**17,500**
From GEF	16,500	Financing to intermediaries & projects	12,000
Net reflows (principal & interest)	1,000	Technical assistance	1,500
		Administration expenses	3,100
		Inflation & contingencies	900
Second Replenishment:	**35,000**	*Second Replenishment:*	**35,000**
From GEF	20,000	Financing Facility	20,000
Net reflows (principal & interest)	15,000	Technical Assistance Program	7,000
		1. Market, FI & SME level TA	*6,000*
		2. Monitoring & evaluation	*700*
		3. Dissemination	*300*
		Management & Operating expenses	7,000
		Inflation & contingencies	1,000
Total SME Program Funding:	**56,800**	**Total SME Program Usages:**	**56,800**

51. The funding from GEF would total US$40.8 million as follows: (i) the Pilot Phase of US$4.3 million; (ii) the first replenishment of US$16.5 million; and (iii) the proposed second replenishment of US$20 million. This second replenishment would be disbursed over four consecutive years, in equal tranches of US$5 million. Each disbursement, following the first disbursement, is contingent upon the Program's implementation success measured by a total of 4 approved investments in: (a) mainstream commercial intermediaries that provide financing to SMEs undertaking activities that contribute to GEF objectives; and/or (b) medium-sized enterprises undertaking global environmental projects.

52. Funding for the TA Program and the Program M&O expenses, estimated to total US$15 million over the 10-year life of the expanded Program, will come from the reflows of principal payments and interest from both the existing and the expanded Program. Table 6 below shows the estimated projections for the SME Program. These projections are preliminary estimates based on the existing Program agreements and the projected activities. Given the innovative nature of this Program the actual results may significantly differ from today's projections. These projections are given for illustrative purposes to demonstrate that the TA Program and the M&O expenses will be funded through reflows. As shown in table 6, it is projected that the net reflow for the pilot and the first replenishment phases would total an estimated US$8.2 million, while the reflows from the second replenishment phase would total an estimated US$12.9 million over the 10-year period. If the outcome of the Program is as projected, there would be a positive balance remaining at the end of the 10-year period of an estimated US$6.1 million. These funds would be returned to GEF unless there is an agreement to allocate the remaining balance for further market development activities related to a further expansion of the Program.

<u>Table 6: SME Program Cash Flow FY03-FY12 (in US$'000)</u>

Fiscal Year end June 30,	**Totals**	**Up to FY02**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Pilot & First Replenishment Phases												
Funds available from First Replenishment												
Disbursements to intermediaries	13,125	10,125	1,200	500	1,300	-	-	-	-	-	-	-
Net repayments of principal	8,064	1,240	1,133	679	645	1,041	867	945	800	567	147	-
Compensation & incentives	3,461	1,049	294	398	422	264	354	261	215	105	100	-
Loan losses & write-offs	1,600	-	226	226	392	356	145	100	155			-
Total	13,125	2,289	1,653	1,303	1,459	1,662	1,366	1,306	1,169	672	247	-
Interest payments	1,737	495	363	219	191	154	138	92	49	27	6	-
Net reflows (principal & interest)	8,201	1,736	1,270	672	444	840	861	937	693	594	153	-
Second Replenishment Phase												
Financing Facility												
Disbursements from GEF	20,000		5,000	5,000	5,000	5,000	-	-	-	-	-	-
	-											
No of FIs/projects approved	17		2	5	4	4	2	-	-	-	-	-
Loans & guarantees committed/disbursed	20,000		2,360	5,900	4,720	4,720	2,300	-	-	-	-	-
Total investment commitments			2,360	8,260	12,980	17,700	20,000					
Net repayments of principal/guarantees	10,472		-	-	307	1,074	1,720	2,450	2,573	1,641	985	(279)
Compensations & incentives	4,115		-	-	-	-	-	-	472	1,180	944	1,519
Loan losses & write-offs	5,413		-	-	165	578	876	1,090	1,070	822	534	279
Total	20,000		-	-	472	1,652	2,596	3,540	4,115	3,643	2,463	1,519
Interest income & guarantee fees	2,443		47	212	404	509	513	400	233	97	13	15
Net reflows (principal & interest)	12,915		47	212	710	1,582	2,234	2,850	2,806	1,738	998	(264)
Total reflows - all phases (principal & interest)	**21,116**	1,736	1,317	885	1,155	2,422	3,094	3,787	3,500	2,333	1,152	(264)
TA Program												
1 TA Program commitments (for FIs, SMEs & market identification)	6,000		937	1,400	1,400	1,400	600	263	-	-	-	-
2 Monitoring & evaluation	700		60	30	150	80	80	250	20	20	10	-
3 Dissemination	300		30	20	20	70	20	20	100	20	-	-
Total TA Program	7,000		1,027	1,450	1,570	1,550	700	533	120	40	10	-
Program Management												
Management & Operating Expenses	7,000		698	1,127	1,124	1,110	1,094	748	393	236	236	234
Contingencies & inflation	1,000		30	76	110	145	179	151	92	64	73	80
	8,000		728	1,203	1,234	1,255	1,273	899	485	300	309	314
Balance of Funds	**6,116**	1,736	(438)	(1,768)	(1,649)	(383)	1,121	2,354	2,895	1,993	833	(577)

53. The Program will have two distinct phases:

1. <u>Investment Phase</u>: expected to last for 5 years during which the financing to the FIs are structured and committed.
2. <u>Supervision Phase</u>: expected to continue for another 4 to 5 years, during which limited new financing would be provided to FIs, with the efforts of the Program Management Team focused on supervising the investments made and guarantees in place.

54. The Financing Facility will cover new projects to be committed over the five-year investment period. This is in addition to the existing portfolio of SME Program investments expected to total US$15.8 million in commitments[15]. This portfolio will continue to be actively managed.

55. It is envisaged that by year 7, the Program will be able to demonstrate an effective financing model to target SMEs. The goal is to encourage the replication of this model within each country where it has been applied and proven successful, without additional GEF support. However, it will prove difficult to replicate the model across borders without first demonstrating its success in a particular country.

[15] See Table 2 page 7.

I. The Financing Facility

56. One of the biggest development challenges is addressing access to finance for SMEs. The challenge is even larger for new and/or non-traditional activities such as ventures addressing climate change mitigation, biodiversity conservation, pollution prevention of international waters and prevention of reversal of land degradation. Lack of access to finance due to high perceived risk for SME borrowers and environmental projects, lack of collateral value and excessive requirements as well as poorly prepared projects and business plans combined, create the largest barriers for financing on competitive terms. SMEs undertaking such environmental activities face significant financing barriers.

57. Because of these entry barriers, SMEs represent a significant, largely untapped market of potentially profitable clients for financial intermediaries in emerging and transition markets. This potential opportunity is particularly important in those countries, where there is intense competition for the large corporate customers resulting in decreasing margins and reduced volumes of business. However, profitable SME lending typically requires a different approach than traditional corporate lending; among others, appropriate risk management systems and marketing structures need to be put in place requiring intermediaries to build capacity and resources.

58. In response to these entry barriers, a Financing Facility has been designed to provide four financing modalities targeting *intermediaries, mid sized companies and SMEs* as follows:

a) Direct financing to *intermediaries* in markets where foreign currency financing is needed due to limited availability of funds for environmental projects, and where FIs are capable of managing the foreign exchange risks (e.g. through the availability of foreign exchange hedging mechanisms, or through underlying portfolio control systems).

b) Direct debt financing to *mid-sized companies* on an exceptional basis only, not exceeding US$2 million per company and not exceeding 25% of the financing facility i.e. US$5 million.

c) Partial guarantees to *intermediaries and mid-sized companies* issued for: (i) SME loan portfolios through synthetic and possibly full securitization; and (ii) mid-sized companies through guarantees of local debt, Letters of Credit (LCs) or guarantee of a domestic bond issue.

d) Quasi debt to both *intermediaries and SMEs* through subordinated loans with special features.

59. The SME Program will offer different types of financing depending on the needs in the specific country. Direct debt financing is intended for intermediaries or companies that have constraints in accessing liquidity. Guarantees are intended to share the risk with the provider of financing. Quasi debt can take different forms to share the risk and returns between the SME Program and the intermediary or the SMEs, and can include a subordinated debt instrument to cover the first loss position, or a performance based income participating instrument, by which revenues are shared on a pre-agreed formula based on the performance of the underlying sub-projects. As developments in financial markets occur, and depending on the local markets and the needs of the FIs, there may be other forms of financing that the SME Program would be able to offer. The Program Management Team will continuously explore other forms of financing, leveraging IFC's work in the capital markets and its pioneering efforts in developing new more

appropriate forms of financing for the SME sector. The SME Program will avoid equity investments in either FIs or SMEs as this form of financing requires a different approach than the more focused debt (or debt-like) financing modalities proposed for the Program's expansion.

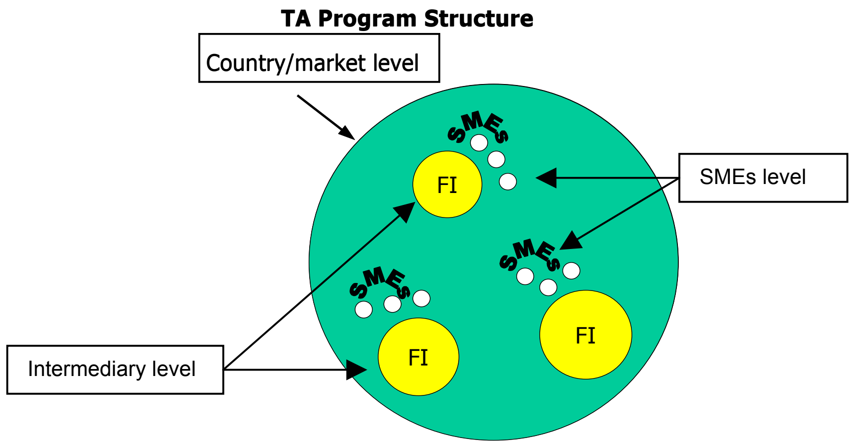
60. In addition to traditional financing instruments through direct loans or quasi-debt, IFC has designed and developed a supplemental risk-sharing instrument to support intermediaries interested in entering the SME market (see Annex 5 for a detailed description of this partial guarantee instrument). The aim is to focus on existing credit structures in one target country and develop and implement a comprehensive strategy for mobilizing the existing financial resources. Increased liquidity should accelerate the development of local markets for implementing GEF-eligible activities, through SMEs providing expanded opportunities for both indigenous industry and for technology transfer from other countries. This financing instrument is designed to improve loan volumes, returns and financing terms through the guarantees and balance sheet management by reducing capital reserve requirements. This concept will require strong underwriting procedures, appropriate SME risk management systems and techniques, early warning monitoring, strict reporting and credit ratings.

61. The financing provided by the SME Program to new intermediaries or enterprises will be priced at or near market rates. It will be designed to absorb a higher risk level than other funding in order to make the perceived risk of financing the targeted SMEs more acceptable to the private sector. In order to entice the intermediaries to enter the market of GEF-eligible SMEs, and to introduce special monitoring procedures to accommodate the M&E standards of the Program, performance-based incentives will be provided through monitoring and success fees. This approach is intended to better link concessions to risks and costs. The level of these fees will be tailored to the specific projects, but will not exceed 5% of the credit allocated for the monitoring fee and a maximum of 25 % for any success fee paid.

II. The Technical Assistance Program

62. The SME Program will include a comprehensive US$7 million TA component, developed to strengthen the capacity of the intermediaries and the SMEs (see Annex 6). The current TA Program will be expanded to create a better infrastructure for SME finance both for individual SMEs and intermediaries as well as within each market as a whole thus creating a solid SME framework. Needed operating know-how, expertise, and systems will continue to be transferred to these clients through focused TA projects building institutional capacity, developing new financial products and services, training programs, improved systems and technologies to enhance productivity, and enhanced risk management, market studies, feasibility studies and business plans. In addition, the TA Program will include funding of up to US$1 million for monitoring and evaluation, as well as for dissemination of lessons learnt and market information.

Figure 1: The SME Program's Three Levels of TA Intervention



63. The proposed Program is designed to address the impediments to SME finance in a comprehensive manner by combining four TA elements that complement each other with an investment Program, in order to provide a solid foundation for a major scale-up of financing being made available to SMEs on an ongoing and increasingly sustainable basis. The TA Program will assist in building basic information services and market infrastructure for the intermediaries (e.g. credit bureaus, shared credit scoring solutions and payments systems) and support both intermediaries and SMEs through the creation of new distribution channels and technologies and good corporate governance.

64. The four TA Program components include:

1. *Market Level:* Target country capacity building for GEF-eligible SME financing and market assessments to identify and demonstrate the potential portfolio volume for GEF-eligible activities and favorable SME legal and regulatory framework and infrastructure, including a market assessment, capacity building to develop financial market infrastructure and building local bank training capacity and dissemination of best practices in SME GEF-eligible lending.

2. *Intermediary Level:* Building the capacity of intermediaries to better target GEF-eligible SMEs and to develop appropriate approaches for SME finance, supporting the establishment of much-needed financial markets infrastructure.

3. *SME Level:* Building local SME capacity, including for feasibility studies, business plan and project preparation, monitoring and reporting and evaluation of GEF-eligible activities.

4. *Monitoring, Evaluation and Dissemination:* To better quantify GEF related benefits, TA funds will be used to: (i) develop a standardized system to monitor and quantify the environmental benefits that contribute to GEF objectives; (ii) assist intermediaries to implement a monitoring system and report on an agreed set of parameters; (iii) develop a system to report on the Program results to GEF; and (iv) design and implement a plan to disseminate information on the markets for GEF-eligible activities and to share Program findings (see paragraphs 82 and 83).

65. The SME Program will draw upon IFC's experience through internal and external partnerships leveraging both the WBG SME Department's project development facilities, external best practice providers and local business development institutes to support the intermediaries and the SMEs through e.g. introducing tested financial technology and training programs to train the local trainers in SME financing.

Funding

66. It is proposed to fund the TA Program from the re-flows of the existing SME Program, including principal and interest repayments, in its initial phase. Based on the outcome of the TA Program, fundraising initiatives are also planned to raise additional co-financing, donor funds and support in order to scale up the TA Program. Overall funding requirements for this initiative covering the ten-year period 2003–2012, are estimated at between 20-25 % of the total Program budget, depending on the target markets, participating intermediaries and SMEs. The required GEF funding for the initial TA Program phase is estimated at up to US$7 million dollars, of which $6 million will be targeted at market development, intermediaries and SMEs and US$1 million for monitoring, evaluation and dissemination.

III. Program Management

67. A Program Management Team will manage the SME Program over the ten year life of the expanded program. The team will be responsible for developing structure, processing new investment opportunities and continue managing and supervising the existing and new portfolio. The team composition will develop with the portfolio development to meet the needs of the Program. Initially the Team will be headed by a Program Manager and will include a Program Coordinator, and a Program Officer. The Program Manager has been transferred from IFC's Global Financial Markets Department to develop an expanded and innovative SME financing vehicle, to further mainstream the SME Program within IFC, and to incorporate various lessons learned through IFC's experience in SME finance. IFC has adopted a new approach to SME finance at a corporate level, which the Global Financial Markets Department has been developing with financial intermediaries. This experience will be integrated into the Program through this staff addition.

68. It is anticipated that Program Management will be expanded from the current two-person team to a four-person team as the Program grows. It is proposed to add a TA Program Manager and possibly a Monitoring and Evaluation Coordinator.

69. The existing Program Review Committee and GEF Advisory Panel will continue to play an important role. However, the committee and panel will not review the sub-projects a FI would be targeting as this review would represent a major constraint of time if each FI is to target a growing portfolio of SMEs. Instead, the committees will review the type of activities and the specific markets that are being considered to be included in the FI's SME portfolio.

70. The Program's annual operating and management expenses is estimated to total US$7 million for the ten year life of the expanded program, with an additional US$1 million for contingencies and inflation. These estimates include all the costs of the Program Management Team, which include salaries, travel and office expenses, as well as project preparation costs such as legal fees. The Management Team's direct costs associated with the supervision and monitoring of the portfolio are included in this budget. These are in addition the M&E

expenditures that will be covered by the TA Program, including the hiring of experts and consultants to undertake the evaluations or to set up the monitoring systems. The annual budget will be based on a fiscal year basis (July 1 to June 30) submitted for approval to the Program Review Committee in the last quarter of each fiscal year. Since it is difficult to ascertain the Program Management and operating expenses over a ten year period, part of the funds that will reflow to the Program from the principal and interest payments will be set aside to cover possible unforeseen increases in costs and expenditures. At the end of the life of the SME Program, all funds remaining will be returned to GEF.

71. Following SME Program practice, all intermediaries are first screened and evaluated by the Program Management Team and then reviewed as appropriate by the Program Review Committee. The Review Committee would make investment decisions and decisions for the TA Program exceeding US$300,000 per contract. TA contracts below the US$300,000 threshold will be at the SME Program Management discretion, requiring clearance by the Program Manager. It would be IFC's intention to refine the Program implementation processes over time in order to streamline necessary supervision and oversight.

72. All FI financing and direct SME financing projects will require environmental clearance before approval, as well as prior notification of the local GEF Focal Point before approval. To this end, a review system for use by the intermediaries will be designed to ensure GEF eligibility, local GEF Focal Point notification and to ensure compliance with IFC's environmental and social safeguard policies.

73. The SME Program requires that intermediaries attend IFC's environment risk management training of 3-4 days to develop an environmental management system and subsequently comply with IFC's environmental and social review procedures and guidelines before and after receiving any financial support from the Program.

The Target Market

74. The projects, which will be supported by the SME Program will be clearly defined as those that contribute to GEF Program priorities. The country selection process will be driven primarily by IFC's assessment of a number of key criteria related both to SME finance and the GEF-eligibility of activities that are proposed to be financed. Recipient country governments, through their GEF Focal Points, will be notified and engaged where appropriate to ensure a strong consent of a country level awareness and endorsement as well as to ensure that the funded projects are national priorities that also help to foster greater country level awareness of the GEF and its objectives. The existing SME Program operates primarily through intermediaries. There are currently 21 approved intermediaries of which16 are non-financial and five are financial intermediaries. These intermediaries have been selected based on their experience with SMEs, financial viability and financial, technical and environmental capabilities. In addition to the approved 21 intermediaries,12 to17 new, mainly, financial intermediaries will be selected. The financial intermediaries will account for the majority of the extended Program's lending operations. The selection process emphasis is on funding GEF-eligible activities reflecting: (i) global and geographical parity, (ii) target market development and business opportunity, and (iii) target market activities.

75. The intermediaries will be selected based on the following operational criteria:

1. Mainstreaming of SME Program activities with IFC investment operations: prioritization of intermediaries that already work with IFC and have mainstream IFC financing.
2. Demonstrated leaders in the banking sector, established strong financial intermediaries with pilot initiatives that e.g. introduce best practices and tested technologies.
3. Demonstrated commitment, through e.g. assigning a top executive to champion SME focused activities or the creation of an SME Program management unit and allocation of required resources to administer the initiative within the intermediary.
4. Demonstration effect, through selection of experienced intermediaries with substantial volume and reach to achieve replication of the SME initiatives both locally in the country as well as regionally and globally.
5. Solid technical and financial capacity to deliver sustainable projects with GEF benefits, generating no adverse environmental or social impacts.

76. The SMEs will be subject to the same selection criteria in addition to generally accepted business viability criteria (including collateral, a positive credit history, profitability and financial performance, cross-selling opportunities, management and reporting systems, manageable business risk and a strong market position in a conducive market structure).

77. All FIs will be evaluated and approved by IFC on a case-by-case basis. The Program will leverage IFC's regional and sectoral expertise as every individual investment operation with a new intermediary will be negotiated separately, thus constituting a separate investment opportunity for IFC and possible mobilization of other co-financing. This will also help to further mainstream the IFC/GEF SME Program with the rest of IFC's SME oriented project portfolio.

78. Based on a preliminary market assessment, reflecting development impact and available opportunities to achieve GEF's objectives, the initial markets for the extended SME Program will likely be selected from the following countries:

i Africa: Ghana, Kenya, Nigeria, South Africa
ii Middle East and North Africa: Egypt, Jordan, Morocco
iii South East Asia: Bangladesh, India, Pakistan and Sri Lanka
iv Asia: China, Indonesia, Philippine, Thailand
v Eastern Europe: Georgia, Russia, Ukraine
vi South Europe and Central Asia: Azerbaijan, Kazakhstan,
vii Latin America: Argentina, Brasil, Chile, México

79. A significant investment flow is expected through the Program's mainstreaming with IFC's traditional investment operations. The Program will tap into IFC's existing SME and FI portfolio and pipeline complementing the existing Program pipeline, the market studies and the new approach that promotes intermediaries active business development and service promotion.

80. Providing the Program is implemented successfully, replication of successful approaches, including transfer of lessons, methods and technology, targeted capacity building and twinning arrangements may be extended through the SME Program expansion into other countries.

81. Annex 7 provides an overview of the types of markets and activities the SME Program will be targeting. The initial target market surveys will provide more specific market information

for each of the countries involved. The market segment focus is on activities already deemed to be eligible within the GEF Operational Programs for biodiversity conservation, climate change mitigation, pollution prevention in international waters and prevention or reversal of desertification and land degradation. The activities cover the entire project cycle ranging across a variety of possible SMEs including engineers, planners, manufacturers, suppliers, retailers, wholesale and servicing companies in a wide variety of markets covering both traditional and innovative GEF-eligible activities (see Box 3 for examples of markets and activities).

Box 2:

Eco-tourism, e.g. eco-lodges, water treatment, e.g. water purification, organic and low impact agriculture, e.g. small scale farming, water management, irrigation devices, water pumps, wind breaks etc., forestry and fishing, e.g. eco-fish cultivation and eco-hunting, lighting, heating (e.g. PV: street lights, billboard lighting, street lights, thermal systems, refrigerators, hydropower, e.g. run of the river and other micro and pico facilities, thermal hydro:, natural gas e.g. CNG powered public transportation, bio-digestors, biomass gasification, windmills, thermal steam generation, charcoal stoves. These possible markets and activities will be complemented following the completed planned initial market studies.

Solar street lights: Ecosolar based in India, produces solar street lights. The Solar Street Light is a stand-alone solar photovoltaic application, where a CFL tube operates for a stipulated time, every day. A solar photovoltaic panel mounted on the pole, converts solar energy into electrical energy, and charges the battery placed in a box mounted on the pole, on which the light is also mounted. The light automatically turns ON, drawing energy from this battery and operates for the pre-decided duration, ideal for remote areas.

Run-of-the-river-facility: Hidroelectrica Papeles Elaborados (HPE) a hydro electric owner and operator in Guatemala, and Nuon, the largest electricity distributor in the Netherlands, represents one of the largest green certificate transactions to date, with Nuon committing to purchase 100% the environmental benefits of HPE for the next ten years. The certificates are being transacted from HPE's 8.2 MW run of river Poza Verde facility in Guatemala and will be used by Nuon as part of its green energy products.

Wind power rural electrification: Xiangtan Bergey Windpower Limited is a start-up, small wind turbine manufacturing venture located near the city of Changsha, Hunan Province, China. E+Co provided a $230,000 loan to support the venture in manufacturing mini-wind turbine systems to service the needs of rural electrification and remote facilities (outposts, schools, clinics, etc) in China.

Program Monitoring and Evaluation

82. Monitoring and evaluation (M&E) of program results in relation to GEF objectives is an important element of the SME Program. The Program Management Team will develop a standardized framework for forecasting, monitoring and reporting of the SME Program's global environmental benefits, financial sustainability parameters and production of sound financial reporting mechanisms, appropriate GEF and IFC environmental guidelines and international conventions. The framework would build on IFC's experience with the Hungary Energy Efficiency Co-Finance Program (HEECP), the Efficient Lighting Initiative and other GEF-funded projects such as UNDP/GEF Small Grants Program, to be developed and implemented with GEF cooperation. Consultants will assist in the development of an appropriate M&E framework in consultation with IFC, WB and GEF. This work will be funded from the TA Program (see paragraph 64 above). IFC will rely on available GEF guidance in developing a satisfactory framework that defines the monitoring and verification activities to be undertaken in

each of the target markets as well as the performance indicators quantifying the success of the program. Guidelines will also be developed to assist FIs in implementing the M&E framework and training curricula and dissemination efforts will be developed to support the implementation of the framework.

83. It is suggested that the project monitoring would rely partly on direct reporting provided by the SMEs to the intermediaries pertaining to the legal agreements entered into. In addition to the direct reporting, some independent verification would also be conducted on an ongoing basis. Independent evaluations would be contracted separately for each area, biodiversity, climate change, international waters and land degradation.

84. It is proposed that a mid-term evaluation of the expanded SME Program would be undertaken after three years, as has been the case in the past. A final evaluation will also be conducted at the end of the Program life.

Replicability

85. The SME Program offers substantial potential for replicability both through dissemination of best practices and lessons learned as well as by sharing the Program structure with appropriate market actors that are able to leverage the generated experience and information in other countries with IFC's help. The replication process is likely to occur following market forces in a manner similar to that achieved by the HEECP. The SME Program has also benefited from IFC's general experience in administrating GEF projects, including streamlining monitoring and evaluation functions and use of guarantee structure.

86. The SME Program is intending to scale up and replicate its activities substantially through established commercial intermediaries with substantial volume and reach to achieve both local replication in the country as well as regional replication to other countries. This extensive replication and scaling up could require additional GEF funds in the future if GEF Council supports such a future expansion.

87. The planned TA Program will support the Program's replication efforts. The SME Program will continue, through the TA Program, to organize workshops, gathering participating intermediaries together, and facilitate sharing of information through project discussions and training to learn from and teach each other proven methods and technology. These efforts are assumed to be required until the termination of the Program.

Program Benefits

88. Program benefits will include:

- direct implementation of cost-effective environmental projects that produce associated global and local environmental and economic benefits, including climate change mitigation, biodiversity conservation, international waters preservation, and land degradation prevention as it relates to GEF focal areas;
- development of capacity both globally and in the target markets to provide financing to SMEs targeting sustainable global environmental activities;

- establishment of a sustainable and competitive market for environmental project finance with multiple private sector FIs offering financial products to address the needs of a variety of sectors;
- development of capacity among project developers to structure "bankable" projects and to present them effectively to banks;
- mobilization of both domestic and international sources of debt financing for environmental projects;
- mobilization of investment capital for infrastructure modernization critical for meeting global environmental guidelines and targets; and
- best practice replication and dissemination.

Barriers Addressed by the Program

89. The Program addresses the following barriers to mobilization of commercial environmental SME finance in support of global environmental benefits:

- Shortage of access to finance for SMEs due to structuring aspects of environmental SME transactions as well as lack of experience and expertise of intermediaries with environmental finance;
- Perceived high end-user credit risks, especially for SMEs, which have lacked access to financing from commercial intermediaries in these markets;
- Capital market conditions (including historical experience with large-scale defaults resulting from weak credit procedures), which cause intermediaries to be particularly risk adverse and overly cautious in their credit risk management practices;
- Imposition by intermediaries of high collateral requirements which are onerous for potential borrowers;
- Lack of collateral value associated with some types of global environmental projects/equipment (e.g. ESCOS); and
- Lack of well-prepared investment-ready environmental projects, which are in part due to lack of project development capacities of environmental SME businesses, limited seed capital available to many local SMEs, relatively high project preparation costs and risks, and lack of familiarity on the part of end-users of the benefits and business aspects of projects that can produce global environmental benefits.

Barriers	Program Responses
a) Lack of access to finance: experience and capacity deficit in host country financial sector.	Provision of direct loans and risk sharing financing to induce/support intermediary lending. TA support to intermediaries to develop understanding of market opportunity; facilitate introduction to SMEs; technical support for developing credit analysis skills and financial products.

b) High perceived risk for SME borrowers and environmental projects by intermediaries.	TA support to develop credit analysis skills for appraising environmental project risk; provision of credit enhancement to mitigate actual risk to intermediaries.
c) Lack of collateral value associated with environmental projects/equipment.	Provision of risk sharing to mitigate intermediaries' risk; TA support to intermediaries to develop project finance capabilities and value the positive security features of environmental projects: cost savings that improves free cash-flow of end-user, and essential use nature of environmental equipment.
d) Excessive collateral requirements imposed by intermediaries.	Provision of credit enhancement to mitigate actual risk to intermediaries.
e) Extraordinarily risk-averse financial markets resulting from historical experience with poor credit procedures.	Provision of partial guarantee to mitigate actual risk to intermediaries. Selection of priority markets, e.g., SMEs, where project finance techniques can be applied, viability of borrowers demonstrated and competition between FIs can result in new lending.
f) Lack of well-prepared projects.	Selection of markets where fundamental economics of environmental projects are attractive; TA support to SMEs to assist in project structuring and presentation

90. These barriers combine to create a general lack of access to financing on terms that are matched to GEF-eligible activities and SME finance methods that are attractive to the SME end-users. In addition to these barriers, there are several SME-specific barriers and conditions, which impede the markets in individual countries, as detailed in Annex 4. The SME Program implementation strategy will explicitly address these barriers either through the TA Program designed for those countries and/or the Financing Facility.

III. Issues and Risks

91. As the SME Program is still an innovative and pioneering GEF initiative that seeks to address constraints in emerging and transition countries to financing of SMEs undertaking GEF-eligible activities, there are a number of issues and risks associated with the implementation of the proposed Program expansion and restructuring. The most significant of these issues and risks are:

1. <u>Market Acceptance: slow implementation and deal flow</u>: Although preliminary market assessments exists and subsequent market feasibility studies will be undertaken by specialized firms, the risk remains that the indicated potential may be overestimated and possible changes in market conditions may distort the initial estimates. Since the Program includes a number of innovative approaches, including the use of partial risk guarantees and the move toward assisting intermediaries in the development of the market, the speed of implementation may be hampered by the acceptance in the market of the type of financing proposed for the targeted market of GEF-eligible SMEs. It is difficult to predict how fast the intermediaries will adopt the proposed approaches for funding GEF-eligible activities, and how fast they can grow their SME portfolios. Successive implementation of the Program in new countries will depend on the successes achieved in the first targeted countries.

2. Replication: Replication from one country to another may be limited by: (i) the level of concessional financing made available by the SME Program and beyond (both for financing and for TA); (ii) the level of development of the financial sector in the country; (iii) the existence of a minimum critical number of SMEs undertaking GEF activities; and (iv) the interest of FIs, or at least one of the more prominent FI in the country to consider financing these SMEs. Each additional country will be considered independently and a determination will be made if sufficient conditions are prevailing to undertake the preliminary market assessment. If the market assessment demonstrates that there is not a sufficient critical number of SMEs for an FI to pursue the market, then the SME Program Team will select another country.

3. Country macro-economic conditions, including legal environment: Adverse or unexpected macro-economic deterioration either in the global or in the local economy (e.g. increased inflation and increased interest rates or economic contraction) will have a direct impact on the success of the financing proposed as well as the speed of implementation of the Program._Weak banking regulations, property rights, as well as environmental regulations, may hamper the introduction of SME financing in the country and may limit Program impact.

4. Lack of risk profile comparison: FIs in emerging and transition countries have traditionally avoided financing SMEs due to perceived high risk associated with this market. Therefore there is very little available experience to build on and there are few if any FIs that have a portfolio of SME loans that can be used are a reference portfolio to help determine the expected country specific risk profile of SMEs.

5. Proposed guarantee mechanism proves inadequate: The perceived credit risks associated with SMEs may be too high for FIs to be encouraged to try out the targeted market and the guarantee mechanism may not be sufficient to buy down the risk. To mitigate this risk, the SME Program will have the flexibility to use other form of financing including quasi-debt to participate further in the risk sharing with the FIs. Moreover, since the SME Program has a global reach, countries, where it proves difficult to interest FIs to participate in the Program, will be dropped and other countries will be targeted. The impact of this on the overall program is that it may take longer to achieve the Program goals and it may cost more to do so.

6. Monitoring and Evaluation: the modalities of implementing a viable M&E plan for this sector are still relatively unproven. It is also not clear what a cost-effective approach will entail.

7. Higher Administrative Costs: as the existing SME Program portfolio matures and a substantial Program expansion and restructuring occurs, there may be more effort required of the Program Management Team than anticipated impacting the administrative costs negatively. These additional efforts would require additional resources for the Program Management Team and thus would push up M&O costs resulting in reduced funds available for other purposes such as the TA Program.

8. Lower reflows than anticipated: the financial model anticipates a certain level of reflows to cover the administrative costs and TA Program. The Program currently entails a significant technological transfer and business development component relying on

funding for capacity building tools from reflows which, if reduced in scope and scale, would impact the Program implementation.

92. IFC and the Program Management Team will endeavor to address these issues and risks to make the expanded IFC/GEF SME Program a success. It will address these risks and issues through the following:

- IFC's significant experience in managing a portfolio of financing to intermediaries.
- A diversified portfolio of strong and committed intermediaries operating in a wide range of markets covering several different activities.
- A well designed and targeted TA Program, addressing the needs of the specific markets.
- Streamlined monitoring and evaluation approaches to help limit administrative effort.

ANNEX 1: SME PROGRAM EVALUATION, JANUARY 2000

SME PROGRAM EVALUATION

JANUARY 21, 2000

Evaluation Team:
Econergy International Corporation
Energy Ventures International
EA Capital

Distribution List:

JARLE HARSTAD
Michael Sanio
Louis Boorstin
Dana Younger
Doug Salloum

Contents

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GLOSSARY OF KEY TERMS

Evaluation Team	Contracted firms and individuals performing the evaluation of the Program according to IFC contract entitled "SME Program Evaluation".
Intermediary	The recipient of IFC/SME Program funds which subsequently lends to SMEs or "projects". Intermediaries can be banks, investment funds, non-profit organizations, and other commercial and non-commercial entities. The word "Intermediary" is capitalized in the text when referring to the operations and structure of the SME Program.
Pilot Phase	The first phase of the IFC/SME Program, funded with US$ 4.3 million and lasting from June 1995 to July 1997.
Program Managers	The team of IFC managers responsible for the overall operation of the SME Program, this includes the Program Director and staff, as well as other staff of IFC' Environmental Projects Unit and the World Bank, who provide critical input to the SME Program operations.
Program-Level	The SME Program lends funds to Intermediaries, which, in turn, lend to sub-Projects. The Program-Level refers to the relationship between the SME Program and Intermediaries.
sub-Project	SMEs or other business activity, which is supported by funds from Intermediaries or from the IFC/SME Program directly. The word "sub-Project " is capitalized in the text when referring to the operations and structure of the SME Program.
SME	Small- and Medium-Sized Enterprises (SMEs) in the case of the SME Program are defined as enterprises with assets valued at less than $5 million.
SME1 & SME2	SME1 refers to the Pilot Phase of the SME Program, from June 1995 to roughly July 1997. SME2 refers to the SME Program thereafter, which was funded by the first 50% of the GEF replenishment.

FOREWORD

Method and Approach

Econergy International Corporation, Energy Ventures International, and EA Capital carried out this evaluation from May to September 1999. The Terms of Reference for the evaluation included:

1. evaluation of the Program structure in light of original objectives;
2. evaluation of the quality of loans at the Program level;
3. assessment of overall Program implementation and progress to date;
4. assessment of incremental cost and incremental risk mitigation at the Program- and sub-Project-level, as well as leveraging of other financing sources;
5. evaluation of Program impact in terms of biodiversity and climate change benefits; and
6. recommendations.

The evaluation consisted of three main components:

1. Review of documents (GEF, IFC, World Bank reports and studies, SME Program files);
2. Interviews with key individuals in the GEF, IFC and World Bank;
3. Field visits and desk studies to assess the structure and performance of Intermediaries and sub-Projects in the program.

Consultants traveled to Poland, Costa Rica and Egypt to meet with Intermediaries and review sub-Projects on-site in those countries. The field visits enabled consultants to gather key information, including hands-on evaluation of Intermediary capabilities and sub-Project performance, which contributed to a detailed analysis of the Program activity. Desk studies were conducted using IFC/SME Program files from IFC's Technical and Environment Department Headquarters in Washington, DC. This information was augmented by telephone interviews with Intermediary representatives.

Structure of Report

Section 0 of the Evaluation is the Executive Summary, presenting main findings and recommendations. Section 0 of this report consists of a detailed review of the SME Program, including an assessment of the structure, management, quality of use, fund placements (mostly loans) and use of innovative mechanisms to address incremental costs and incremental risks in the Program. Section 0 also includes a review of IFC mainstreaming issues for consideration by IFC and GEF management. Section 3 includes the Evaluation Team's expanded recommendations for the Program. Section 4 includes reviews of the three Intermediaries visited by the Evaluation Team, as well as desk studies of the nine remaining Intermediaries participating in the Program at the time the evaluation began. Annex I contains data collected during the evaluation of financings from the Program to the Intermediaries and from the Intermediaries to the sub-Projects.

EXECUTIVE SUMMARY

The intent of the SME Program is to promote global environmental benefits at the SME level in GEF eligible countries by providing concessional financing to Intermediary organizations, which invest in eligible SME sub-Projects. [1] To be eligible to receive the Intermediary funds, the sub-Projects must undertake activities that realize global environmental benefits in biodiversity and climate change. The Program is designed to address barriers to SME development and demonstrate that SMEs can generate global environmental benefits on a commercially sustainable basis. In addition to concessional financing, the SME Program also provides technical assistance and loan processing and monitoring fees to cover the costs of participating in the Program (see Section XX on incremental costs for further explanation).

Since its inception in 1995, the GEF and IFC have considered the SME Program to be experimental. An objective of the Program is therefore to gather information and gather best practices for the field of environmentally sound, commercially sustainable, SME project development. Of the 12 Intermediaries reviewed in this evaluation, the first seven came into the Program during the Pilot Phase (see Table 1).

IV. FINDING ON GENERAL STRUCTURE

The Evaluation Team finds that during the Pilot Phase (SME1) and initial phase of the second replenishment (first half of SME2), the Program has successfully demonstrated that the GEF can support global environmental SMEs with non-grant mechanisms and that these sub-Projects may become commercially viable over time.[2] The SME Program has achieved this without incurring undue costs (see Section XVII, "Cost Control and Efficiency", for more detail on administrative costs) because the structure of the Program enables Intermediaries in the respective host countries to identify, prepare and invest in project activities through a combination of conditional lending, management oversight and technical assistance provided by the SME Program Management.

The SME Program Management benefits from the Intermediary's in-country expertise and market knowledge, balancing the Intermediary's need for latitude in investment choices with negotiated risk-sharing arrangements between the Intermediary and the SME Program. This structure is valuable in terms of cost-effectiveness and rational risk assignment and mitigation.

[1] Concessionaliy includes 2-year grace periods and an interest rate of 2.5% per annum over 10 years, combined with debt forgiveness.

[2] In addition to activities in bio-diversity and climate change, the SME Program also funded "Short-Term Response" activities during the Pilot Phase.

At the time of completion of the Evaluation, well over 100 sub-Projects have been implemented and more than 15 Intermediaries are now participating in the Program.[3] Eleven Intermediaries are reviewed in this Evaluation, representing 113 sub-Projects. Two of the Intermediaries, FUNDECOR and el Sewedy, account for 61 and 31 of those sub-Projects, respectively, or 80% of the sub-Projects (see Table 14 through Table 17 for a list of Intermediaries and sub-Projects). Details on the performance of the Intermediaries to date are presented in Section XXI.

The Program has approved US$10.8 million in lending, with US$4.05 million disbursed and under management. Between US$70,000 and US$80,000 has been repaid to the SME Program (see Table 1).[4] Based on the results of this Evaluation, the Team expects that most of the loans to the Intermediaries will perform and the collection figure will increase significantly over the next two to three years as the loans begin to come due. The SME Program is the only GEF funded activity known to the Evaluation Team designed to repay GEF funds; several Intermediaries have begun repayment after completion of sub-Project implementation.

V. Finding on Goals and General Operation

The Evaluation Team finds that the SME Program has largely met its interim goals and objectives as originally identified. During the first replenishment phase, for example, 15 new sub-Projects were expected to come from existing Intermediaries, with some 50 new sub-Projects added to the Program through 10 to 12 additional Intermediaries.[5] To ensure loan quality, investment decisions cannot be driven by numeric targets and Program Management has flexibility in meeting these kinds of guidelines. Recognizing that fact, the Team considers the Program to be well on track. Please refer to Section 0 for further explanation and see Table 7 for a breakout of targets and actuals for portfolio diversification. The Team considers the Program to be progressing well in terms of qualitative (e.g. demonstrating that SME activity can succeed) and quantitative (diversification, funds under management) targets.

The strengths of the SME Program include careful selection of Intermediary institutions, good preparation of the Intermediaries with clearly defined commercial performance requirements, good monitoring of each Intermediary's financial and programmatic performance, good administrative cost control, and overall superior management and oversight of the Program.

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[3] A few Intermediaries are funding a large number of sub-Projects. Consequently, there are actually more than 100 sub-Projects in the Program. However, because they are often very small, weighting them equally in aggregate would misrepresent the impact of the Program. Please see Table 14 through Table 17 for a full list of sub-Projects reported during the Evaluation.

[4] The figure seems small and is attributable in part to two factors: (1) the early stage of the Program in terms of making investments and securing loan agreements that have not yet begun collecting interest and principal, and (2) the concessional terms of the loans.

[5] Global Small and Medium Enterprise Program Replenishment, Project Document, January 1997,

IFC. By June 1997, seven Intermediaries were signed up in the Program and 38 project loan agreements were in place, with more potential Intermediaries and potential projects in the pipeline.

VI. Finding on Loan Quality at the Intermediary Level

The Team finds the overall loan quality of the SME Program portfolio to be very good. The ability of Intermediaries to meet their debt obligations to the Program is based on their overall creditworthiness and on guarantees that are required as additional security in some cases, such as International Expedition. Intermediaries are carefully selected through a process that begins with referrals and ends with systematic review of proposals and substantive due diligence on the entity. At the same time, the risk of SME non-performance lies with the Intermediaries rather than with the Program, so the Intermediary could face default and subsequent damage to its credit standing among peer institutions if it did not meet its obligations to the SME Program. The Team reviewed the first 12 of 15 Intermediaries in the Program, as the last three were approved after the evaluation began in May 1999 (see Table 1).

Please refer to Tables Table 11 for a ranking of loan quality at the Intermediary level (loan from Program to Intermediary) according to categories provided in the Terms of Reference. Section XXI contains more detail on loan quality issues.

VII. Finding on Program Impact

The SME Program is still too young for conclusive findings about Program impact, both at the Intermediary level and the sub-Project level. Nevertheless, to the extent that empirical evidence is available, the Evaluation Team finds that the SME Program-level impact has been positive in terms of financial results and is making good progress in achieving the envisioned environmental results through Intermediary financing of SMEs. Good financial results include consistent disbursement of funds, initial collection of funds, and cost-effective administration. Good environmental results include recorded sub-Project implementation in biodiversity and climate change, as well as indications of increased knowledge base at the Intermediary level of GEF program activities and objectives.

All but two of the Intermediaries have invested funds without significant problems, and many more sub-Projects will be introduced in the coming months.[6] As the Intermediaries continue disbursing funds and record sub-Project-level performance over the next two years, more evidence will be available about the Intermediaries' long-term capability to seed SME projects that generate global environmental benefits.

A thorough analysis of sub-Project-level impacts is not practical given the limited amount of information currently collected on sub-Project activity. For example, project impact analysis of activity that falls under OP# 5 or #6 would require monitoring and recording of actual GHG reductions. This would not only be costly to the SME Program participants, it is also not required by the GEF to ascertain compliance with GEF criteria and objectives.

[6] EEAF did not invest all funds in time and returned 50% of its available loan. CARESBAC Polska has not been able to confirm GEF benefits from one project and another project has failed.

VIII. Finding on Leveraging

The Team finds that the Program is leveraging other sources of funding for sub-Project level activity. The simplest way to indicate leveraging is to assume that financing for the total costs are catalyzed by Program funds. On this basis, leveraging by the Program shows a sound and appropriate pattern (see columns on leveraging in Table 14 through Table 17). For more risky endeavors facing greater barriers, such as forest conservation in Costa Rica, leveraging is low, and for less risky, more commercially oriented activities, such as those in Poland, leveraging is higher. Leveraging of up to 90% characterizes some projects under this measurement, falling as low as 5% particularly small-scale, risky project endeavors.[7]

The Evaluation Team is also confident that the SME Program has successfully played a catalytic role in leveraging additional private investment in sub-Project activity because of the Program structure, including: (1) giving preference to sub-Projects that are co-financed with private sources and (2) introducing financial performance requirements to Intermediaries in the form of debt service obligations. Debt-servicing obligations create an incentive for sub-Project sponsors to pursue revenue-generating activities and identify other sources of capital, particularly equity. The Program structure therefore encourages investment by the Intermediaries in the sub-Projects.

IX. Finding on Country-Driveness

The Evaluation Team finds that the SME Program has made good efforts at securing country-approval. Because the sub-Projects are generally small in terms of capital cost and macro-economic impact, the Program sought a "no-objection" status from GEF focal points. Seventy-two of 129 countries contacted did not object and 57 did not respond.[8] To minimize costs and delays of ongoing attempts to contact the focal points, the Program Management adopted a practical approach to host-country approval, including a requirement that Intermediaries secure focal point approval for their activities in those countries that did respond to the first SME Program notification. The Team finds this approach is sound.

X. Finding on Financial Sustainability

The Evaluation Team finds that it is too early to make a clear determination of the financial sustainability of much of the SME Program activity at the Intermediary or sub-Project level. The lessons learned during the Program's Pilot Phase and since the first replenishment reveal a significant potential for Intermediary activity that is likely to perform commercially and environmentally, and others that may be eligible for additional SME Program funds.

[7] Measuring the catalytic effect of funding at the individual sub-Project level is beyond the scope of this Evaluation. It would be a difficult and costly process requiring extensive subjective interpretation of individual decision making over time.

[8] IFC memo to Lars Vidaeus; February 26, 1998.

The SME Program is designed to provide financial concessions to Intermediaries that in turn invest in sub-Projects at rates that the Intermediaries determine to be acceptable. While the Program Management does not control the Intermediaries' lending terms to the sub-Projects, the intent of the Program is that the sub-Projects would receive funds at market or near-market interest rates. Receiving commercial or near-commercial loans from Intermediaries would increase the sub-Projects likelihood of financial sustainability over time and improve their chances of securing subsequent financing from commercial sources by demonstrating an ability to meet debt obligations.

While it is beyond the scope of this study to determine actual commercial rates in each country relevant to each project, the Team nevertheless used rough estimations to assess commercial sustainability at the sub-Project level. Based on those assumptions, the Team finds that more than half of SME Program financing provided to the sub-Projects by the Intermediaries can be characterized as "concessional rate" financing and that most of the Intermediaries are passing on to the sub-Projects the concessionality that they receive from the SME Program.[9] In the long-term, concessional rate financing does not contribute to the financial sustainability of the sub-Projects, nor is it sustainable for commercial investors. Please refer to Section XIX for more detail on financial sustainability. This is in part due to the fact that the mechanisms for addressing incremental risk and incremental cost have been overly generous during the experimental, "start-up" phase of the Program, enabling Intermediaries to pass on concessions and still cover their costs and other barriers to implementation (see further analysis and findings on incremental cost and incremental risk below).[10] The Program Management is aware of the situation and is building on the lessons learned during the Pilot Phase by lowering the allowed debt forgiveness concessions on a negotiated basis. Instead of a flat 50% debt forgiveness for the original Intermediaries participating in phase one of the Program, incoming Intermediaries under Phase 2 face negotiations on the debt forgiveness percentage they will receive.

> **Recommendation on Financial Sustainability**
> In order to increase the likelihood that the Intermediaries will continue lending to small and medium-sized global environmental enterprises once the GEF and other grant funds are disbursed, Program Management should seek to reduce concessions provided to Intermediaries still further. It should therefore seek to attract Intermediaries whose sub-Projects are more likely to have a higher internal rate of return and who will be able to apply a loan rate for sub-Projects that is

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[9] For the purposes of this assessment, "concessional" is assumed as 4% to 8% annual interest rate and "at or above commercial rates" is defined as 11% to 20% annual interest rate.

[10] Incremental risks can be defined as those characteristics of a project which inhibit decision makers (both private and public) from undertaking environmentally-friendly projects with negative or low incremental costs, and which cannot be addressed with standard financial mechanisms typically found in conventional project development. Incremental risks are often apparent in the form of "financing gaps" in otherwise cost-effective and environmentally beneficial projects. High initial transaction costs, small project scale, weaknesses in domestic capital markets, perceived credit or technology risks and a lack of guarantees are just a few of the sources of incremental risks to projects which otherwise show potential economic viability.

closer to prevailing in-country commercial rates. Program Management should also negotiate other concessional features of the Program, such as the low interest rate currently applied to the Intermediary loans. Less concessional terms for IFC/SME Program loans overall (debt forgiveness, below-market rates and terms, fee structures) are likely to lead to a greater number of sustainable Intermediaries and a greater number of sustainable sub-Projects in the long-term.[11]

At the same time, it is important that Program Management exercise its own judgment on what is an appropriate level of concessionality based on their determination of incremental cost and incremental risk, as described below. Please also refer to Section XIX for more details on the Evaluation Team's recommendations in this regard.

XI. FINDING ON INCREMENTAL COST AND INCREMENTAL RISK

The incremental cost of GEF activity is defined as the difference between the cost of the base case – what would have occurred in the absence of the activity that achieves global environmental objectives – and the cost of the project case – the activity that achieves global environmental benefits.[12] In the case of the SME Program, incremental costs are only addressed at the Intermediary level and not the sub-Project level.[13] The incremental cost at the Intermediary level occurs in two instances. One is the cost of managing investments in SMEs that achieve global environmental risks (compensated with fees). The other is the incremental risk of using "own funds" in those investments since the Intermediaries must repay the loan (compensated by a concessional interest rate and additional risk incentive in the form negotiated debt forgiveness). The implementation of this incremental cost approach is reviewed in more detail in Section XX.

The Evaluation Team finds that incremental cost and risk are both addressed in innovative and valuable ways in the SME Program. The concept of addressing both the incremental cost of an Intermediary's management of global environmental SME investments (compensated with fees) and the incremental risk of the Intermediary's commitment of its own funds (compensated by low interest rate and partial debt forgiveness) is both novel and sound. To the extent that the incremental risk is represented by the amount of debt forgiveness provided to an Intermediary, and the debt forgiveness is a negotiated figure, it is not clear what factors contribute to a particular incremental risk level determination and how they contribute to it. These factors can be qualitatively identified, though quantifying incremental risk factors is impractical.

[11] Although the GEF objectives have proven problematic to quantify, it is the opinion of the Evaluation Team that more sustainable projects will overcome barriers according to GEF Operational Programs as a result of more stringent commercial criteria, ultimately demonstrating more measurable global biodiversity and climate change benefits.

[12] See, for example, GEF brochure on Medium-Sized Projects, p. 30.

[13] SME Program Project Document, January 1997, p. 14, para. 41.

First Recommendation on Incremental Cost and Incremental Risk
The IFC should continue with its current application of incremental cost and incremental risk in the SME Program and expand the negotiated coverage of incremental risk to include the interest rate and/or terms of the Intermediary loan.

Second Recommendation on Incremental Cost and Incremental Risk
The SME Program should promulgate a general approach to determining incremental risk (and thus the amount of debt forgiveness). The approach should not interfere with the Program Managers' flexibility in negotiating concessions, but should lay out the factors involved in arriving at a particular level of incremental risk in relation to different sub-Projects and/or sectors (e.g. explain why biodiversity preservation through change in local forestry practices receives more concessions than market development for eco-tourism).

XII. FINDING ON COORDINATION BETWEEN IFC AND THE GEF

The Evaluation Team finds that there is inadequate information flows and coordination on critical issues between IFC and the GEF Secretariat (GEFSEC) regarding the SME Program. This was also noted in the 1997 evaluation.[14] More frequent communications and periodic coordination on critical issues could resolve some of the issues the Evaluation Team was asked to examine.

For example, the issue of interpreting and applying GEF eligibility criteria within the SME Program remains unclear between IFC and the GEF. The SME Program's 1997 Project Document states clearly how GEF criteria should be operationalized and the Team finds that SME Program is in compliance with that document regarding sub-Project eligibility.[15] Determining GEF compliance at the sub-Project level can add significant administrative costs and delays to the program (e.g. analysis of incremental costs, determination of appropriate community involvement, etc.), so this issue should be addressed carefully and consensually. Currently, it is the policy of SME Program Managers to review all sub-Projects of the Intermediaries until they are convinced the Intermediaries truly understand the GEF criteria. The Program Managers have also rejected sub-Projects proposed by Intermediaries for not meeting GEF eligibility criteria.

Until late 1996, an Advisory Panel was consulted on GEF benefits and incremental cost calculations, as per the June 1996 Project Document. The Advisory Panel consisted of the Chief of the World Bank Global Environment Division and two GEF Scientific and Technology Advisory Panel (STAP) consultants. According to the SME Program Management, by late 1996, during the Pilot Phase, they had stopped conferring with the Panel because the STAP consultants could not provide up-to-date interpretations of GEF guidelines. In lieu of an Advisory Panel, the SME Program Management continued

[14] "SME Program Project Document", January 1997, "Environment Structure Review", p. xi, para. 33.
[15] SME Program Project Document, January 1997, p. 14, para. 41.

conferring with experts on climate change and biodiversity at the World Bank's Global Environment Division for guidance on GEF eligibility.[16]

> **First Recommendation on Coordination between IFC and GEF**
> An Advisory Panel to review issues critical to the GEF should be reestablished. A small, independent panel with the requisite expertise in current GEF programs, criteria and guidelines can provide dispassionate guidance to IFC and assurance to outside observers that a meaningful review process is in place. IFC should consult with the GEF on the composition of such a panel.

> **Second Recommendation on Coordination between IFC and the GEF**
> All Intermediaries, particularly new ones, should undergo training on GEF Operational Programs and eligibility requirements. Intermediaries routinely receive training on environmental impacts and the GEF training could be adopted and integrated into this activity. Alternatively, the training could be provided in conjunction with the regular SME Program "fairs" which are attended by the Intermediaries. For this purpose, the GEF and IFC should together generate concise and practical guidelines for implementation of GEF criteria.

> **Third Recommendation on Coordination between IFC and the GEF**
> IFC should review the SME project portfolio for opportunities to replicate activities with assistance of other GEF programs. While working towards commercial sustainability based on their own activity, some sub-Projects may be eligible for funds that help overcome barriers to replicating the sub-Project or disseminating information regarding selected sub-Project activity. At the same time, the GEF may be able to play a greater institutional role in garnering host government support for environmentally friendly sub-Project activity by communicating the benefits and results of SME Program directly to senior government counterparts.

XIII. FINDINGS ON SUB-PROJECT LEVEL ACTIVITY

The Evaluation Team reviewed 12 Intermediaries and their sub-Projects based on available information to reach preliminary conclusions and rankings of performance. Categories for ranking the sub-Projects were provided in the terms of reference. The ranking process was limited by a lack of clear indicators and some lacking information in the sub-Project files.

The Intermediary ranking on sub-Project activity in terms of GEF objectives is presented in Table 9 of the main text. Of the twelve Intermediaries and their sub-Projects assessed in the Evaluation, one Intermediary was found to be performing sub-optimally, six were too young to make a determination, and five were found to be performing well and likely

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[16] SME Program Project Document, June 1996, p. 13, para. 27 and 28. In addition, according to the 1997 SME Program Project Document, "The primary role of the Advisory Panel is the confirmation of the project GEF benefit." p.8.

to meet GEF objectives. For a more detailed explication of how these rankings were achieved, please refer to Section XIX.

In terms of the commercial viability of the sub-Project activity, the Team ranked the Intermediaries also according to the categorization provided in the terms of reference, in this case as applied to the SME to which the Intermediary is lending. The ranking is presented in Table 11. The Team found all of the Intermediaries to be neutral or above in this scale, with the bulk of the activity in the neutral plus category. A neutral ranking indicates that it is too early to determine with confidence how the sub-Projects will perform financially in the coming years. An above neutral ranking indicates that the Team believes sub-Projects are likely to become commercially sustainable. Please see XIX for further explanation and details of Intermediary ranking by commercial strength of SME activity.

XIV. FINDING ON MARKETING THE SME PROGRAM

The SME Program does not appear to be widely known. A low profile for the Program may have been beneficial during the Program's early years given that the Program has been experimental. Now that the concessions to Intermediaries are being negotiated downward, the pool of Intermediaries that can still profitably participate in the program is reduced. If other recommendations in this evaluation are followed, then there will be a need for the SME Program to seek out Intermediaries that can operate with even less debt forgiveness, higher IFC interest rates, and somewhat higher administrative costs as a result of addressing sub-Project eligibility.

> **Recommendation on Marketing of the SME Program**
> The SME Program should establish and implement a marketing strategy to increase the pool of potential Intermediaries. This strategy could involve the issuance of a competitive solicitation for a targeted technology, region or country. Whatever approach is used, it should involve a competition for participation in the Program, thereby helping to ensure that the Intermediaries selected are the most capable and the most likely to continue their global environmental lending on a financially sustainable basis without reliance on GEF (or other concessional) funds. The SME Program's current funding level may not be sufficient for a major marketing effort.

XV. FINDING ON MAINSTREAMING

In the 1998 GEF Corporate Budget, mainstreaming is defined as having two dimensions: first, increasing the number of GEF Projects with co-financing from the Implementing Agencies - in this case, IFC - and second, increasing the number of GEF-type Projects in the regular operations of the Implementing Agencies.[17] By this definition, the

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[17]Gareth Porter et al, *Study of the GEF's Overall Performance*, Washington, DC: Global Environment Facility, April 1998, p. 38.

Evaluation Team finds that the SME Program has not yet become mainstreamed at the IFC. The Intermediaries are not receiving co-financing from the IFC; and there is no increase in the number of GEF-type SME investments in regular IFC operations.

It is important to recognize that mainstreaming difficulties are not unique to the IFC. Mainstreaming the global environment has been problematic at all of the Implementing Agencies (the World Bank Group, the UNDP, and the UNEP), as detailed in the 1998 evaluation of the GEF's overall performance.

First Recommendation on Mainstreaming
Mainstreaming the SME Program at the IFC will take explicit effort on the part of SME Program management, the IFC's Environmental Projects Unit, and the GEF Secretariat. These parties should begin discussions that lead to the development of a plan for mainstreaming the SME Program at the IFC.

While the SME Program has not attracted normal IFC resources, other programs at the IFC that support small and medium enterprises have received IFC financial support. They could serve as models for mainstreaming the SME Program. There may also be some value in increasing the cooperation and coordination with them.

Ultimately, mainstreaming the SME Program may require organizational changes. Two precedents may be instructive. The Extending IFC's Reach program, which seeks to increase IFC's investments in smaller and riskier markets and which ultimately involves assisting small and medium-sized enterprises, will be mainstreamed by integrating it with each of the IFC's regional departments. These departments will receive extra investment funds earmarked for investments in the Reach Program's target countries. This could serve as a model for mainstreaming the SME Program. Likewise, the IFC's financial markets divisions are being reorganized so that one of their focal areas will be SME finance. Even if additional GEF or other concessional funds are still needed, they could be distributed to the regional departments or the financial markets divisions and earmarked for small and medium global environmental Projects or even global environmental Projects generally.

Please see Section XXII for more detail on mainstreaming and existing relevant activities at IFC.

Second Recommendation on Mainstreaming

IFC also presented the Evaluation Team with a concept for creation of a more conventional IFC fund modeled after the SME Program.[18] The Team agrees that this concept has merit and should be explored further. Under the plan, the costs of administration and management could be recovered from revenue derived from the difference in cost of funds provided by IFC and interest earned on funds provided to Intermediaries. This interest rate "spread" would be based on below-market or below-cost-of-funds from the IFC to the SME fund and would allow lending to Intermediaries at a concessional but still a higher rate than under the current SME Program (2.5%). GEF funds would play a significant role, but would not be lent directly to Intermediaries as they are under the current SME Program. Rather, GEF funds could be used to pursue specific environmental objectives (incremental cost and incremental risk mitigation) through intervention at the level of the Intermediary-to-Project lending.

[18] As of August 1999, this concept was introduced by and was being discussed among IFC/SME Program management.

Table 1: Summary Table of SME Program Loans

	Intermediary	Phase		SME Group (IFC) to Intermediary								
								Loan Terms				
				Loan Amount	Amount Disbursed	Receipt Date	Loan Lag Time	Loan Rate	Loan length	Principal Repaid	Interest Accrued	Amount Forgiven
1	EEAF	SME1	ngo	$ 400,000.00	$ 400,000.00	07/17/96	113 days	2.50%	10-12 years	$ 19,594.40	$ 1,655.78	$ 11,862.00
2	Caresbac-Polska S.A.	SME1	private	$ 600,000.00	$ 600,000.00	07/02/96	76 days	2.50%	10 years	$ 28,147.35	$ 1,745.31	$ 37,053.00
3	Fundecor	SME1	ngo	$ 500,000.00	$ 500,000.00	08/08/96	42 days	2.50%	10 year	$ 23,455.36	$ 479.55	$ 38,006.19
4	El Sewedy	SME1	private	$ 500,000.00	$ 500,000.00	10/18/96	121 days	2.50%	6 years	--	$ 21,970.14	$ 235,283.15
5	WWF	SME1	ngo	$ 500,000.00	$ 250,000.00	02/23/98	102 days	2.50%	10 years	--	$ 9,634.81	--
6	Grameen Shakti	SME1	financial	$ 750,000.00	$ 250,000.00	07/06/98	116 days	2.50%	10 years		$ 7,288.05	$ 16,877.79
7	Dessau-Soprin ADS	SME1	private	$ 800,000.00	$ 400,000.00	04/01/98	29 days	2.50%	10 years		$ 14,253.29	$ 12,000.00
8	Conservation Int'l. (1)	SME2	ngo	$ 1,000,000.00	$ 500,000.00	04/01/99	190 days	2.50%	10 years		$ 5,585.60	$ 4,472.00
9	FCG (3-4)	SME2	ngo	$ 500,000.00	$ 250,000.00	--	--	2.50%	10 years	--	$ 2,794.97	--
10	Selco Vietnam (1)	SME2	private	$ 750,000.00	$ 400,000.00	09/23/98	(5) days?	2.50%	8 years		$ 9,083.99	$ 4,696.48
11	Save Valley Wildlife (1)	SME2	private	$ 1,000,000.00	$ -	--	--	2.50%	10 years	--		--
12	Int'l. Expeditions (3-4)	SME2	private	$ 750,000.00	$ -	--	--	2.50%	10 years	--		--
13	Barclays Bank of Batswana*	SME2	financial	$ 1,000,000.00	$ -	--	--	2.50%	--	--		--
14	Peer Consulting*	SME2	private	$ 1,000,000.00	$ -	--	--	2.50%	8 years	--		--
15	PILCO*		private	$ 750,000.00	$ -	--	--		5 years	--		--
	TOTAL			$ 10,800,000.00	$ 4,050,000.00					$ 71,197.11	$ 74,491.49	$ 360,250.61
	*Not included in Evaluation											

PROGRAM LEVEL ASSESSMENT

XVI. ASSESSMENT OF SME PROGRAM STRUCTURE

Introduction

The Small- and Medium-Sized Enterprise Program (SME Program) is designed to provide loans from IFC to Intermediaries at concessional rates, which in turn lend to sub-Project developers at market-oriented or otherwise negotiated rates. The Intermediaries select and prepare sub-Projects and negotiate financing terms independently of SME Program Management. The SME Program retains the authority to determine the eligibility of the sub-Projects to participate in the Program. In addition to concessional loans, the SME Program provides debt forgiveness, monitoring fees, completion fees, and can provide certain kinds of technical assistance to Intermediaries and sub-Projects that advance Global Environment Facility's (GEF) objectives.

The SME Program is operationally concerned with moving investment funds at the Intermediary level; with a few exceptions, the SME Program does not lend directly to SMEs.[1] Instead, the SME Program encourages risk-based investments in the SMEs by the Intermediaries. The guidelines and requirements placed on the Intermediaries for the use of funds are intended to ensure that their activity realizes GEF objectives for overcoming barriers to project development while demonstrating the global environmental benefits.

By lending to SMEs that generate global environmental benefits, the Intermediaries enter two risk areas.[2] The first is the commercial risks inherent to lending to SMEs. The second is the risk of project performance associated with environmentally friendly activity, e.g. higher costs of management, monitoring, and compliance. To address the risk barrier of SME development, Intermediaries are offered low-cost funds from the SME Program and access to technical assistance. To address the cost and risk associated with environmental activity, the Intermediaries receive fees for monitoring projects (monitoring fees) and successful project closing (completion fees), and are rewarded for accepting the additional risks of eligible projects with a percentage of the principal loan amount (debt forgiveness).

[1] The exception to this rule is Intermediaries which are also Project implementers. See Section 0 for review of this category of Intermediary.

[2] The SME Program approves Project eligibility of Intermediaries' investments, but does not select, prepare or negotiate any terms with Projects. In this way, the SME Program maintains control over what kinds of Projects receive funding without taking on the risk of Project-level performance.

In terms of GEF eligibility and sub-Projects, the SME Program addresses both the incremental costs and risks that constitute a barrier to the development of climate change and biodiversity projects. The incremental costs are addressed by providing fees for monitoring and for completing the sub-Project activity. The incremental risks are addressed by a negotiated debt forgiveness of the amounts successfully placed in sub-Projects.

The use of non-grant mechanisms in the SME Program has evolved since the original SME Program Pilot Phase began in December 1995.[3] Non-grant mechanisms have been recognized in a study completed by the GEF and the World Bank as useful for addressing "incremental risks" of GEF eligible activity, particularly private-sector activity, as opposed to restricting GEF assistance to pay for "incremental costs" only.[4] The originally drafted term sheet was based on a convertible loan, which would become a grant if the Intermediary met several key objectives in its lending activity. This was discarded in favor of concessional loans and other more market-oriented tools and the Program shifted to an explicit "50% of principal" cash incentive in the Pilot Phase. More recently the Program adopted a negotiated debt forgiveness incentive to replace the flat 50% incentive.

Goals and Objectives of SME Program

The primary goal of the SME Program is to realize GEF eligible global environmental benefits through the mechanism of SME activity that is commercially sustainable. The Program is demonstrating that global environmental benefits of enhanced biodiversity and/or reductions in GHG emissions can be promoted at the SME level. An indicator of success is therefore increased lending by Intermediaries to SMEs which realize global benefits, directly or indirectly. Leveraging and engaging private sector participation in small- and medium-sized enterprise (SME) activity in countries that are eligible to receive funding from the IFC is an important sub-goal of the Program. The Program was conceived as an experimental exercise and has generated a large amount of valuable information and experience on the subject. The Program is now building on the experience of SME1 and the first half of SME2 to enter into a more operational phase.[5]

Because the IFC/SME Program is managing GEF funds it must meet the GEF's objectives and project eligibility criteria. The activity of private-sector SMEs are considered by GEF analysts and other experts to be a significant and growing threat to global biodiversity and climate stability, particularly in developing economies. "The intended result", according to the 1996 Project Document, "is the development of SME projects that address the GEF's objectives while at the same time demonstrating a commercially viable activity."[6]

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[3] See p.7 of 1996 Project Document for chronology.

[4] See "Contingent Finance as GEF Financing Modality: Part I"; World Bank; June 1999

[5] Small and Medium Scale Enterprise Program: Project Document; June 1996; p. 6.

[6] Ibid.

The Difficulty of Program Assessment with Dual Objectives

Determining the overall success of the SME Program in meeting its dual goals of realizing environmental benefits and financing commercially sustainable SMEs complicates the assessment and evaluation process. In this regard, the IFC has stated an underlying objective of the Program is, "to learn about the economic viability of SME investment in environmental activities that further the GEF's global warming and bio-diversity objectives."[7] IFC's and the GEF's interest in exploring the commercial viability of SMEs is therefore paired with the GEF's program parameters of funding only the incremental costs of project activity, one of several specific criteria for receiving GEF funds. Compounding the complexity of goals and criteria is a lack of standardized performance indicators for biodiversity project funding by the GEF.[8] At the same time, however, the IFC and the GEF share the objective of demonstrating that non-grant, concessional funding (concessional loans, guarantees and other market-oriented subsidies) can be used to leverage environmentally beneficial SME projects into the "mainstream" of IFC lending practices.[9]

Internal IFC and GEF memoranda from the time that the Program was initiated reveal the overall difficulty in assessing the success of the IFC/SME Program. A limited number of targets and goals were laid out at the beginning of the Program as guidelines for moving forward. However, the experimental nature of the Program activity precluded adopting fixed measures for success, and the determination was made to remain flexible with regards to numeric targets and milestones. For example, the SME Program draft term sheet dated February 1995 notes that during the pilot phase of the SME Program, a lack of track record would make it difficult to assess the Program at the Intermediary- level and impractical at the SME project- level.[10]

Consideration of Numeric Goals and Targets as Indicators

The February 1995 memorandum goes on to suggest several numeric indicators that in practice are difficult to interpret until Intermediaries gain a more credible track record. The indicators refer to technical capacity measures that may be required over time to determine if Intermediaries have acquired adequate capabilities, staff and capital to replicate the pilot phase activity. One suggested indicator was an increase in the number

[7] IFC Office Memorandum, May 16, 1995

[8] The GEF is currently developing performance and assessment indicators biodiversity projects. The project should be completed in 1999.

[9] "Mainstreaming" may also include eventual commercial bank participation in SME activity.

[10] October 3, 1995 Memo on Minutes to September 21 "Program Decision Meeting", p.4, states that first "term" of the program using the $4.3 million allocation will run for two years, from July 1, 1995 to June 30, 1997. This is the unofficial "pilot phase" of the SME program, not to be confused with the Pilot Phase of the GEF.

of technical and financial staff analysts employed by the Intermediary, and a measurable increase in revenues from other, non-SME Program funded activity (spillover effect). Another was an increase in working capital available to the Intermediary resulting from collection of interest on loans and conversion of the loan to a grant.[11]

Potential indicators were again discussed in the September 21, 1995 Program Decision Meeting. General targets were suggested at that time as follows[12]:

1. Number of SME projects financed and amount of financing provided to SMEs for GEF activities;
2. Confirmation of SMEs having met GEF objectives (climate change and biodiversity); and
3. Viability of financial structure between the Intermediary and the SME and the flow of GEF funds through Intermediaries to SMEs.

These discussions evolved informally as the Program gained experience during SME1. More specific indicators regarding quantity and geographic diversity of sub-Projects funded were suggested after the first replenishment. During the Pilot Phase, for example, early documents suggest several quantitative performance targets. These include:

1. Conclusion of five loan agreements with Intermediaries;
2. Identification of 100 projects through those Intermediaries (average 20 projects per Intermediary); and
3. Approval of 50 SME project loan agreements.

These performance indicators are laid out in the Project Document dated January 1997. The same Project Document also outlines an expectation that 15 new sub-Projects would come from existing Intermediaries, with some 50 new sub-Projects added to the Program through 10 to 12 additional Intermediaries.[13] Table 2 below contains the early targets and current figures on Intermediaries in the Program.

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[11] As opposed to concessional loans with partial principal debt forgiveness, the original instrument was conceived as a loan that would convert to a grant if the project succeeded, or a "contingent loan". This mechanism was later discarded as inappropriate for generating sustainable lending from Intermediaries.

[12] See IFC memo of October 3, 1995 for discussion of the September Program Decision Meeting.

[13] Global Small and Medium Enterprise Program Replenishment, Project Document, January 1997,

IFC. By June 1997, seven Intermediaries were signed up in the Program and 38 project loan agreements were in place, with more potential Intermediaries and potential projects in the pipeline.

Table 2: Number of sub-Projects by Region, Anticipated and Current

Intermediaries	Region	Target Number of sub-Projects	Number of sub-Projects as of October 31,1996	Number of sub-Projects as of June 30, 1999*
EEAF, Fundecor, FCG, Int'l. Expeditions, Conservation Int'l.	Central America*, South America and Caribbean	15	5	62
Barclays Bank of Botswana*	West Africa	5	0	0
Peer Consulting*, Save Valley Wildlife	South and East Africa	10	0	1
El Sewedy, Econoler, PILCO*	Northern Africa and Middle East	10	6	32
CARESBAC-Polska S.A.	Eastern Europe	10	4	5
Grameen Shakti	India, Pakistan and Bangladesh	15	0	0
Selco Vietnam	South East Asia*	10	0	2
WWF	Oceania	10	1	1
	China	15	0	0
	Total	**100**	**23**	**103**

*Please note that the large number of small projects for some Intermediaries, such as PV development by Grameen Shakti, are aggregated to avoid distorting total sub-Project counts.

Another initiative that was included with SME2 has not been fully realized. Of the approximately 75 new sub-Projects that were to be identified, the Program anticipated that 10 would be identified by the IFC's Project Development Facilities (PDFs) in Africa, the South Pacific region and south East Asia (see Section XXII on mainstreaming). According to Program rules, sub-Projects brought in through PDFs are eligible for direct lending from the Program, as opposed to through an Intermediary. The exception is justified based on the due diligence and preparation completed by the PDF managers, which would mitigate the risk of direct sub-Project lending.

As of June 1999, the SME Program (SME1 and SME2) was well on its way to reaching overall goals for the number of new sub-Projects under SME2. However, only one project was identified through coordination with the PDFs. The project was rejected upon further due diligence of the sponsor.

Targets and Indicators for Achieving GEF Benefits

Each application for disbursement of funds to a sub-Project must include identification and description of environmental benefits in terms of the GEF's Operational Programs.[14] This is a precondition for approval, and if a sub-Project does not meet that requirement or only realizes negligible benefits, the Program Managers will reject it.[15] Any *a priori* and/or *post facto* determination of GEF benefits is conducted in close coordination with qualified staff of the World Bank's Global Environment Division.

Once the determination is made that the project will achieve GEF benefits and the Intermediary begins financing/implementation, there are no standardized procedures for monitoring or measuring the positive results that are assumed at the outset. Monitoring and evaluating GEF benefits over the sub-Project's lifetime is generally considered too costly and burdensome for Intermediaries and/or project sponsors to complete. The Evaluation Team found this to be reasonable considering the quasi-commercial activity that is undertaken with the goal of becoming commercially sustainable. Asserting that SMEs achieve specific biodiversity benefits or measurable reductions in GHG emissions would require a capital outlay that would likely have a direct impact on the sub-Project's financial and economic performance.

The Intermediaries do receive a monitoring fee to cover the costs of assessing any negative environmental impacts as part of their compliance with IFC/World Bank financing requirements. These negotiated fees are also intended to cover the incremental cost of compliance with GEF eligibility criteria. In the future, the monitoring fees could help pay for the costs of monitoring and measuring biodiversity and/or climate change benefits.

Structural Analysis of the SME program

This section focuses on the three fundamental characteristics of the IFC/SME Program.
(1) Use of non-grant financing mechanisms
(2) Use of Intermediaries as a vehicle for financing projects
(3) Use of negotiated incentives to address incremental costs and risk

Use of non-grant financing mechanisms

[14] Short-term Response Measures are no longer pursued under the Program, although one project under the Intermediary CARESBAC Polska of Poland did successfully complete one in 1998-1999.

[15] One Project under the Intermediary CARESBAC was approved for funding but later judged as unable to meet any GEF objective. As a result, the Intermediary is responsible for the full amount of the loan and will not be eligible for principal debt forgiveness.

The IFC/SME Program represents one of the few uses of GEF funds as non-grant financing mechanisms.[16] Non-grant financing by the GEF has been discussed since its inception. Recent efforts by the Secretariat are aimed at identifying alternative ways to address the financial barriers to commercial activity in the form of incremental costs (new technologies, new capacities, new regulatory frameworks, etc.). In this context, non-grant mechanisms have been recognized by the GEF as more appropriate for addressing risk-related, financial barriers to investments in activities that demonstrate potential GEF benefits. One recent study by the World Bank notes that concessional non-grant mechanisms, such as contingent grants, contingent loans, and partial credit guarantees appear to be consistent with the policies of the GEF instrument.[17] "These modalities constitute potentially cost-effective approaches for overcoming financial barriers and other obstacles to otherwise viable projects benefiting the global environment, while at the same time leveraging mainstream private and/or public capital for investments in climate-friendly technologies."[18]

Insofar as the IFC/SME Program may be the only program to date that has collected re-flows of GEF funds through lending activity, it is an important experiment providing valuable information on how non-grant financing mechanisms may further GEF objectives. A total of US$10.8 million has been disbursed or authorized for disbursement and approximately US$78,000 has been repaid to the IFC/SME Program accounts. The figure of US$78,000 is relatively small compared to total funds under management. This can be explained by two factors: (1) the early stage of the Program in terms of making investments and securing loan agreements that have not yet begun collecting interest and principal, and (2) the concessional terms.[19] Based on the results of this Evaluation, it is expected that loans to the Intermediaries will be repaid and the collection figure will increase significantly over the next two to three years as the loans begin to come due.

Non-Grant Mechanism and Incremental Cost and Incremental Risk

The SME Program guidelines identify the incremental costs of Intermediary activity as the cost of processing and monitoring the loans to SMEs. These incremental costs are covered by "completion" and "monitoring" fees charged to the Program by the Intermediary. The fees are calculated as a percentage of the total SME project costs. During the Pilot Phase, these averaged 4% and 1% per year, respectively.

The monitoring fee is included in the IFC/SME Program as compensation for the incremental cost of monitoring environmental benefits and/or potential negative environmental impacts according to IFC and World Bank Group environmental criteria.

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[16] The IFC's Hungary Energy Efficiency Co-financing Program (HEECP) is another example.

[17] Ibid.

[18] See "Contingent Finance as GEF Financing Modality: Part I"; World Bank; June 1999; p.5

[19] Concessionaliy includes 2-year grace periods and an interest rate of 2.5% per annum over 10 years, combined with debt forgiveness.

The monitoring report for which it pays does not require reporting on GEF benefits or monitoring of continued compliance with GEF eligibility criteria. Nor does the GEF require monitoring of actual project-level environmental benefits to ensure eligibility. The monitoring report also includes information on commercial performance of the sub-Project. The sub-Projects meet the GEF eligibility threshold by demonstrating an ability to overcome barriers to development at the investment stage, not the operational stage, according to the GEF Operational Programs. Therefore, it is not clear how the fees to cover Intermediaries' costs of monitoring constitute compensation for incremental costs under GEF guidelines.

The IFC/SME Program is also structured to address the incremental risk that Intermediaries face in attempting to finance GEF eligible SME activity. The incremental risk refers to the financial hurdle to investing in SME activity, i.e., the risks associated with small, environmentally-friendly project activity that make the sub-Projects less than optimal from a financial return perspective. It is a component of incremental cost. Compensation for – or rather the incentive for – the Intermediaries' willingness to overcome this risk barrier is realized in the form of principal debt forgiveness of the amount the Intermediary must ultimately pay back to the IFC/SME Program (see discussion below on negotiated incentives).

Incremental Risk in Terms of Shifts in Internal Rate of Return (IRR)

During the Pilot Phase, the SME Program attempted to illustrate incremental risk coverage by comparing the IRR of sub-Projects before and after the loan from the Intermediary is disbursed. In theory, with the provision of the loan, the sub-Project IRR will improve to a level that is financially attractive on commercial terms. However, project IRRs provided to the SME Program by Intermediaries are often very approximate and this is no longer considered a valuable measure of how the Program addresses incremental risk.

As lenders, the Intermediaries are more interested in the credit-worthiness and risk to their loan than return on equity indicated by IRR. The lenders' incremental risk must be addressed first and foremost by specifying a dynamic risk-adjusted interest rate on the loan that reflects the lenders' confidence in the sub-Project sponsors' ability to meet debt obligations. Intermediaries are free to make these determinations regardless of the IRR calculations recorded at the SME Program level. For its part, the SME Program avoids the high costs of due diligence on numerous small sub-Projects by assigning the project-level risk to the Intermediary.

As the SME Program is structured now, the Intermediary carries the risk of loan non-performance by the sub-Project. The Intermediary should therefore still be motivated to calculate IRR and cash flows to determine debt coverage ratios and similar financial performance indicators. The debt-service payments from the sub-Project to the Intermediary triggers the debt forgiveness payment from the Program and to the Intermediary.

Leveraging of Commercial Funding

Some Intermediaries, such as CARESBAC Polska, Save Wildlife, Grameen Shakti and EEAF have contributed their own or other available funds -- for which they are responsible -- to the projects. An Intermediary's investment of own-funds in the sub-Project is a good indication of leveraging. Ideally, additional investment contributions from the sponsor and/or other sources indicate significant leveraging of commercial funds.

The type and nature of leveraging varies among projects. For example, one Intermediary, CARESBAC of Poland, is often a co-investor in the SME itself and is seeking additional value and risk mitigation related to the environmental benefits of the project. At the same time, this Intermediary is actively seeking Polish commercial bank financing so that it may expand the operations already seeded with the Program funds via CARESBAC. In this case, then, the SME Program has leveraged funds at both the Intermediary and sub-Project level. In terms of Program objectives, increased funding from the Intermediary is a good indicator of successful leveraging because it indicates greater capacity to finance SME activity.

Other sourced funds could be available on different terms (lower or no risk) but there is no way to know with confidence what the rate of risk sharing is among the total financing sources without a costly due diligence. Due diligence of this kind is not a good use of funds and contradicts the Program's use of Intermediaries. Using its own funds, together with the SME Program funds, the Intermediary becomes vested in project performance to recover its costs and to repay the SME Program. It should be noted that even when considering only Intermediary-sourced funds, it is still difficult to determine what the Intermediary is adding to the project. In the case of Conservation International's (CI) coffee project in Chiapas, Mexico, for example, the SME Program loan of US$50,000 covers 100% of the project, which is defined as getting the coffee to wholesale distributors. The same loan covers a much lower percentage of the total cost of introducing shade coffee farming practices to the region, which CI paid for from different sources.

The value of co-financing by Intermediaries was highlighted early on in the SME Program in a memorandum dated October 1995, which asked whether or not Intermediaries must put their own funds into projects. A subsequent decision was made that the Program would favor those that do in the application process.[20] There is no ratio target or fixed measurement for leveraged Intermediary funds that indicates successfully attracting commercial financing.

[20] October 3, 1995: Minutes to September 21 SME Program Decision Meeting

Use of Intermediaries

The primary purpose of using Intermediaries is to overcome local market barriers to SME development that demonstrates GEF environmental benefits. Intermediaries bring local or specialized capacity to the task of identifying projects, negotiating investment terms, and managing funds. These tasks are costly regardless of the cost advantages that in-country Intermediaries bring to the transaction, so their existence alone is not evidence that the SME development will achieve commercial sustainability without assistance from the IFC/GEF Program. The Intermediaries are also better equipped than the IFC/GEF Program Management to exploit niche market knowledge, in-country know-how and the capabilities of local entities, including knowledge of local capital market conditions. Thus, the Intermediaries can be more efficient and profitable – and therefore more sustainable – in moving funds into eligible sub-Project activity.

Of a total 12 Intermediaries participating at the time of this evaluation, two are financial entities of some type, such as CARESBAC Polska, four are NGOs, and six are independent businesses. Some observers of the Program have pointed out that teaching financial Intermediaries to operate under environmentally friendly parameters might be more effective than teaching environmental NGOs to operate under commercial parameters. In practice, the SME Program is following both paths, with a balanced mix of specialized commercial enterprises, non-profit and environmental financial investment firms, and non-profit environmental organizations. At the time of writing, for example, there are three financial non-government organizations, four environmental non-government organizations, and four commercial enterprises acting as Intermediaries.

The only under-represented group at this stage is for-profit investment firms, such as conventional banks, and the Program Management is working to increase their representation. Barclay's Bank of Botswana, for example, is a recent commercial bank that has joined the Program.

Table 3: SME Program Intermediaries
(as of May 31, 1999)

Intermediary (Month/Year of Approval)	Country	Type *	Proceeds Use#	Enviro. ## Benefits
EEAF ## (XI/1995)	Mexico, DR	FNGO	CO	CC/BD
WWF (II/1996)	PNG	ENGO	CO	BD
FUNDECOR (III/1996)	Costa Rica	ENGO	CO	BD
CARESBAC (V/1996)	Poland	FNGO	CO	CC/BD
Zaki el-Sewedy (V/1996)	Egypt	SME	CO	CC
Grameen Shakti (IX/1997)	Bangladesh	NGO	CO	CC
Econoler Int'l # (XI/1997)	Tunisia	SME	EI	CC
FCG (I/1998)	Guatemala	ENGO	CO	CC/BD
Conservation Int'l (I/1998)	TBD	ENGO	C/G	BD
SELCO Vietnam (III/1998)	Vietnam	SME	C/G	CC

Table 3: SME Program Intermediaries
(as of May 31, 1999)

Savé Valley Wildlife (IX/1998)	Zimbabwe	SME	C/G	BD
Int'l Expeditions (I/1999)	TBD	SME	C/G	BD
Barclay's Bank (IV/1999)	Botswana	FI	CO	CC/BD
Peer Consulting (V/1999)	South Africa	SME	C/G	CC

* FNGO: financial non-governmental organization (NGO); ENGO: environmental NGO; SME: small/medium-sized enterprise. # Proceeds use and structures: CO: Commercial onlending; EI: Equity investment; C/G: Loan collateral or guarantee reserves; VF: Vendor financing; PC: Performance contracting; ## CC: Climate change; BD: Biodiversity.
Source: IFC, Memo from DS/MB, re: SME Program-May, 1999, June 14, 1999.

Intermediary Selection Process

The selection of Intermediaries has been on a "deal origination" basis, with some exceptions. One exception has been the use of consultants to assist in identifying sub-Projects in the eco-tourism sector and additional project opportunities in Africa.

The process begins when project developers, IFC investment officers, and other individuals who know about the SME Program refer potential participants to the SME Program Manager, who then assesses the interested party for eligibility. This is a low cost and low risk method of selection based on an informal screening process at the early stage of deal identification. It is a typical management practice at funds that face a wide range of investment opportunities. The SME Program Managers only solicit applications and begin more formal due diligence for Intermediaries about whom they are knowledgeable and after they have determined general eligibility.

The disadvantage to the deal origination approach is that it limits the range of potential Intermediaries available to the SME Program. While the selection process is cost effective and relatively low-risk, the Intermediaries identified and selected through a passive referral process may or may not be optimal candidates to perform on the numerous objectives of the Program.

One alternative is a formal solicitation, evaluation, and award process.[21] Potential Intermediaries would present their explicit plans for achieving the Program goals in a response to a formal solicitation with specific award criteria. As a result, the SME Program would be able to choose Intermediaries from a wider, more representative selection and on a comparative, competitive basis. A solicitation would therefore be especially appropriate if fewer Intermediaries and sub-Projects were coming into the Program, perhaps as a result of offering less generous loan terms during the remainder of SME2.

[21] It is important to note that a formal solicitation will require planning and execution resources; significant administrative costs and/or outside consulting fees will be incurred.

Four recipients of SME Program funds are the sub-Project implementers. In these cases, the SME Program is essentially lending directly to the sub-Project. They are (1) Save Valley Wildlife; (2) Soprin; (3) SELCO Vietnam; and (4) Grameen Shakti. As such, these Intermediaries/SMEs receive funds at the Program-level concessional rate of 2.5% at 10-year maturity. Because directly lending to the SME in this way entails carrying the risk of the project performance itself, the SME Program has required additional guarantees from the Intermediaries, owners, or third parties.

According to the current Program structure, other sources of Intermediaries/SMEs that would receive direct loans from the Program level were to be identified by IFC's Project Development Facilities (PDF). The targeted PDFs included the Africa Project Development Facility (APDF), Mekong Project Development Facility (MPDF), and South Pacific Project Facility (SPPF).

Only one Intermediary/sub-Project has come into the SME Program from a PDF since this structure was identified for SME2 in 1997, and it did not pass due diligence. Some of the PDFs have shown interest and enthusiasm for the SME Program and one sub-Project introduced by the MPDF was considered but did not move forward after initial due diligence uncovered some problems with the proposed sponsor. Meanwhile, the SME Program Management has made several presentations to and corresponded with the PDFs. There is, however, no clear mandate from senior management at IFC that would give coordination with the SME Program a higher priority and profile. If the PDFs are also seen to be major sources of deal flow for the industry investment groups at IFC, then it is even more important to get the PDFs involved in the SME Program. This will help with the mainstreaming process by facilitating "cross fertilization" of projects between IFC/SME and conventional IFC investment projects.

The Evaluation Team recommends that the IFC enhance its internal communications between the PDFs and SME Program management, in order to highlight the great potential for attaining sustainable, environmentally beneficial SME activity in the PDF priority regions and sectors (see Section XXII "Mainstreaming at the IFC" for more information on this recommendation).

Findings and Recommendations on Program Structure

Goals and Objectives of SME program

The dual goals and objectives of the program – seeding commercially sustainable SMEs and achieving GEF environmental benefits through SME activity – are difficult to accomplish. The Evaluation Team found that the SME Program has been successful to date in not sacrificing one objective for the other. The Intermediaries have been carefully screened for their ability to invest in sub-Projects/SMEs with environmental priorities. When they have failed to achieve environmental targets, as in the case of a CARESBAC sub-Project in Poland, the funds incentives were disallowed. More importantly, the Intermediaries appear likely to continue financing SME sub-Projects after the Program funds are used up. For example, FUNDECOR, SELCO, and Econoler, for example, face many more sub-Project opportunities than can be financed by SME Program funds alone. If the Program-supported sub-Projects succeed, it is very likely that more resources will follow. Despite being confident that this will occur, the Team also recognizes that it is too early to be certain that Intermediaries will continue to support environmentally friendly SMEs on commercial terms.

Regarding numeric targets, the Evaluation Team found that the Program has been successful in meeting its numeric targets, recognizing that they are loosely set to accommodate the experimental nature of the Program's start-up years. The targets for number of sub-Projects funded, for example, have been met. On the other hand, the target for funds disbursed (see Section XVI) have not been met, but the Program is working to correct that. It is impractical to show causality between the provision of SME Program loans and measurable growth in capacity (e.g. staff) and resources (e.g. other capital inputs) at the Intermediary level. CARESBAC has grown, for example, but it is part of a larger undertaking with several sources of capitalization. Similarly, FUNDECOR operates several different Programs and shifts in resources would be very difficult to trace back to a single activity. Rather, determining the success of the Program at the Intermediary level is more easily based upon an overall ability of the Intermediary to continue lending to SMEs that generate GEF benefits after the SME Program loan has been disbursed.

Structure of the Program

The Evaluation Team found that the overall structure is sound, yet flexible. For example, Program funds have not been risked by sub-Project level failures (e.g. in the case of one CARESBAC investment), indicating the utility of the risk sharing structure of working with Intermediaries. The Program is also flexible in its willingness to lend directly to Intermediaries if the activity is particularly beneficial and the Program secures some additional security from the sponsors.

The Program's use of Intermediaries has been generally successful, confirming the expectation that they would reduce costs and generate greater deal flow. CARESBAC Polska, for example, has been actively screening project opportunities in Poland for several years and is very knowledgeable about the commercial viability of SMEs in that country. Similarly, FUNDECOR has an in-depth knowledge of local farming practices and has been a source of micro-deals with individual land owners that otherwise would have been prohibitively expensive for the SME Program to manage. It is not possible to evaluate the value of the Intermediaries in terms of the costs had they not been included. However, the Team is confident that the SME Program would not have been able to identify, assess and then manage investments in sub-Projects cost-effectively without a risk- sharing agreement with Intermediaries that is fundamental to the Program structure.

The Evaluation Team believes that the SME Program's ability to address incremental cost and incremental risk in accordance with GEF guidelines has also been successful, innovative and flexible. Fees for incremental costs and debt forgiveness for incremental risk are mechanisms that work within conventional banking and investing frameworks. The monitoring reports currently do not require monitoring of GEF benefits, but this may be useful in the future if it is not financially burdensome to the sub-Project.[22] If the Program seeks to gain more confidence in its contribution to GEF and global environmental benefits generally, the monitoring fees could later be used to pay for monitoring biodiversity and/or climate change benefits.

The Program has also shown a willingness and ability to adapt its approach to incremental risk and incremental cost to accommodate lessons learned. For example, the percentage of debt forgiveness to Intermediaries is now negotiated rather than fixed, reflecting the recognition that a fixed percentage approach may lead to an incentive that is disproportionately greater than the risk, particularly because the level of risk falls very quickly as soon as commercial viability is demonstrated. In other sections of this evaluation, it is noted that the mechanisms for addressing incremental risk and incremental cost have been overly generous during the experimental, "start-up" phase of the Program. Regardless, applying these two concepts to private-sector project activity remains a complex task, as many of the risks and other barriers to the Program are not easily quantifiable. [23]

<u>Recommendations</u>

The SME Program should consider a more stringent terms for access to funds, both in regards to the loan terms and the incentive to Intermediaries. The negotiated debt forgiveness is a cash incentive that accrues to the Intermediary to cover incremental risk as soon as the sub-Project begins paying back the loan. As such, the Intermediary can determine the lowest incentive ratio it will tolerate and keep that as a reference in negotiating with the SME Program managers. Regarding the terms of the loan itself, the IFC/SME Program should also consider negotiating this rate above the current 2.5% and shortening the 10-year maturity level.

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[22] See also the discussion of monitoring activity in Section 2.5.

[23] As noted in other points in the Evaluation, the SME Program now negotiates the debt forgiveness terms of it loans with Intermediaries, as opposed to providing a fixed 50% rate of forgiveness.

One potential reference rate and term would be those from local capital markets, from which the Program rate could be lowered and/or the terms relaxed to account for foreign exchange risk, SME risk, environmental characteristics and other risks as deemed appropriate by SME Program Management. As an illustration, assume the local market rate for a conventional project is 20% with 3-year maturity. With this reference, the SME Program may find cause for adjusting the rate downward by 5% for foreign exchange risk ($US-denominated loan to Intermediary), 3% as an incentive for SME activity, and another 3% for the environmental benefit risk/incentive. The result is a rate of 9% for the Intermediary, which may be supported further by a more favorable maturity term such as 7 to10 years. These figures are of course for illustration only and would need to be considered on a case-by-case basis.

In pursuing more commercial terms, SME Program Management should be wary of burdening each application process with "bottom-line" negotiations typical of much larger and more expensive transactions. Stricter negotiating terms may be less important, for example, for well-funded, global non-government organizations (NGOs) that may blend the SME Program funds with additional foundation and contributor resources. Larger, global NGOs may also be capable of eventually returning all the SME Program funding or re-utilizing funds, for example, by revolving the repayments into some form of longer-term fund under their own management. Therefore, assessing how far the IFC/SME moves towards local commercial rates may ultimately be a function of the number of non-financial Intermediaries entering the Program versus bank-type Intermediaries.

Although it is not directly related to incremental risk, the 4% IRR cut-off for eligible sub-Projects should also be raised, with certain exceptions.[24] A 4% IRR is extremely low in commercial terms. In practice, very few of the sub-Projects which reported IRRs are as low as 4%, again suggesting that this is not necessarily the best indicator for incremental risk (see **Error! Reference source not found.**). The SME Program could be more tolerant, for example, of low sub-Project IRRs that have a very high expectation of realizing GEF benefits, particularly in the biodiversity area. In sum, while the 4% minimum IRR for eligible project activity has not led to a flood of unsustainable projects into the SME Program, the cut off should be raised to a range closer to achieving commercial sustainability.

XVII. COST CONTROL AND EFFICIENCY

The projected administrative cost for SME2 is US$3.1 million over ten years. That constitutes some 18% of the US$17.5 million in total projected funds in the Program, or an approximate average of US$300,000 per year. In the fiscal year 1999, it was expected that the administrative cost of the Program would be some US$100,000 under budget.

[24] This is foreseen in the January 1997 Project Document.

As a percentage of the average size of its loan portfolio, the Program projected that it would bring down administrative expenses to 3% to 4% per year by 2001. The projection assumes that by 2001 the funds will all have been disbursed and most of the administrative fees will involve monitoring and fund repayment management.[25]

Current projections of the administrative cost in terms of average loan portfolio size, however, do not show these figures. This is mainly a result of overestimating the average loan portfolio size over time. For this year and the following three years, SME Program staff predict their average loan portfolio will not meet those calculated in the 1997 Program Document. The Program is currently running on an administrative budget based on these higher disbursement figures, which is causing their administrative expenses as a percentage of the average loan portfolio to be higher than expected, as shown by comparison of the column "Currently Forecasted" and "Schedule A" below in Table 4.

Table 4: Administrative Expenses As A Percentage of Average Loan Portfolio

	Administrative Percentage		Administrative budget		Average Loan Portfolio	
year	Forecasted	Realized	Currently Forecasted**	Schedule A	Currently Forecasted**	Schedule A
1998	20%	20%	--	$ 393,000.00	--	$ 2,000,000.00
1999*	10%	13%	$ 408,500.00	$ 470,000.00	$ 3,200,000.00	$ 3,900,000.00
2000*	7%	8%	$ 410,700.00	$ 498,000.00	$ 5,000,000.00	$ 6,120,000.00
2001*	4%	7%	$ 482,550.00	$ 44,000.00	$ 7,000,000.00	$ 8,500,000.00
2002*	3%	6%	$ 556,700.00	$ 452,000.00	$ 9,000,000.00	$10,300,000.00
2003	3%	N/A	N/A	$ 343,000.00	N/A	$11,100,000.00
2004	3%	N/A	N/A	$ 343,000.00	N/A	$ 9,900,000.00
2005	4%	N/A	N/A	$ 308,000.00	N/A	$ 7,200,000.00
2006	4%	N/A	N/A	$ 180,000.00	N/A	$ 4,200,000.00
2007	3%	N/A	N/A	$ 33,000.00	N/A	$ 1,300,000.00

* Fo these years the figures for the Administrative Budget labelled "Schedule A" used by SME program staff veried from the original Schedule A in Project Document.
**Columns labelled "Currently Forecasted were calculated by the SME staff for the latest budget approval

The Program Management has stated that it will seek to improve its disbursement rate, but must be wary of the trade off between quality sub-Projects and meeting performance targets. Costs are also expected to increase in fiscal year 2000 as a result of shifting consultants to employee status. The precise amount and impact of this event was not available at the time of writing.

The expense involved with finding new Intermediaries may cause the administrative budget to remain higher than projected with respect to the average loan portfolio in the coming years. Only when the fund disbursement process is completed will this figure decrease.

[25] Global Small and Medium Scale Enterprise Program Replenishment, Project Document, January 1997

Cost of Loan Disbursement and Operations

The Program's costs of operations and disbursement are kept low by passing most of the administrative burden of sub-Project-level money management to the Intermediaries. Intermediaries bear the cost of project pipeline development, project selection, ongoing management, and in the case of problem loans, project work out. Program costs are therefore relatively low. The financial structure of the Program – negotiated forgiveness of the loan principal to the Intermediary if their portfolio is well-managed and loans are collected – creates both a large risk mitigation incentive and additional reserve funding to cover any incremental management costs of sub-Project oversight.

During the first years of the SME, as it was proving its operating model, this type of cost allocation made sense. However, if the SME is to grow, or if mainstreaming is a significant goal, it might be prudent to move from a cost allocation model to more of a budgeting model. If more discretionary funding is available in the future, IFC/SME might want budget for a Program expansion that could be distributed to the Intermediaries. Three areas that would require additional overhead allocations include Intermediary selection, SME marketing, and investment screen development. The last of these is particularly important since the business areas regarding biodiversity and climate change have evolved since the SME was first conceived.

Monitoring and Communication in the Program

Dissemination of Program Progress and Results

Based on interviews and discussions held by the Evaluation Team with key stakeholders at IFC, GEF, and ENVGC, the SME Program appears to be doing well in communicating and reporting its activities and results. The Program Managers have also been soliciting feedback and ideas from experts and field staff within each of these organizations. For their part, the Intermediaries report that the SME Program has been rigorous, yet flexible in working and communicating with them.

The SME Program Project Fair of May 1999 was an excellent forum for sub-Project sponsors to share experiences and know-how, and for IFC, GEF, World Bank, NGOs and other entities and institutions to learn more about the SME Program. It would behoove the Program at this juncture to begin planning for a comprehensive publication on the SME Program. The wealth of qualitative and quantitative information is of great value to other efforts around the world with similar goals, particularly those that support environmentally friendly SME project activity.

In addition to making information on the Program more generally available, further programmatic coordination with IFC divisions outside of the Technical and Environment Department will become critical overtime if IFC is to become a mainstreaming conduit. Similarly, coordination and communication with the World Bank and any relevant small-and medium-enterprise support programs should be explored and formalized, if possible. Given the relative wealth of information on SME financing available from the Program's work to date, other Task Managers and or analysts are bound to benefit from the Program's experiences (see Section XXII for further discussion).

Record Keeping and Reporting

Record keeping on Intermediary and Program activity has been good and there is every reason to expect that it will continue as such. The Evaluation Team did find that some information was missing in the reports, as discussed below. This information was not absolutely critical to the Evaluators' work, however, the more complete and detailed the information recorded is, the more confident the Program will be in asserting its findings over time.

The absence of some information in the reports may simply reflect an outstanding task for the Program Management to aggregate available information into one place in an easily retrievable form. It appeared to the Evaluation Team that there is not yet a standardized process for monitoring and recording the Intermediaries' relationship with the IFC/SME. As a result, not all documentation is readily available for review. In some cases, Intermediary loan terms are not clear, in others, project portfolios are not well described. As the Program matures, it would be advisable to develop a package of standard terms and forms.

The SME Program Management has engineered a detailed reporting mechanism for potential new Intermediaries. They are required to provide the IFC with documentation on their qualifications and a description of the projects they are proposing for inclusion in the SME Program. These requirements are outlined in 'Memo No. 1'. Once an organization has been chosen as an Intermediary it is required to present quarterly reports detailing its activities and the activities of the sub-Projects under its management. Below is a table displaying all the documents required for inclusion in the SME Program.

Table 5: Reporting Requirements for inclusion in the IFC-SME Program.

Evaluation Template Report

A brief description of the SME
A description of the Project
The Proposed Financing
Evaluation Template Analysis Summary • Financial Viability • Contribution to GEF Objects • Leveraging of GEF • Environmental Review
Monitoring Reports
Completion/Progress Reports (quarterly)
Environmental Report (annually)
Bank Statements (quarterly)
Audited Financial Statements (annually)

Submitting an "Evaluation Template" is the first step to becoming an Intermediary. The procedure for submitting this report is outlined in 'Memo No. 1', which was provided to all potential Intermediaries. The Review Committee uses this report when deciding whether a sub-Project should be funded.

Based on the Team's analysis of the IFC Washington Office files, information was not present for some of the information required in the Evaluation Template. The most absent piece of information was the Internal Rate of Return (IRR), but this may largely be due to the fact that IRR reporting was not required after the Pilot Phase.

To evaluate further, the Team reviewed Intermediary FCG's Evaluation Report that was filed on July 18, 1997. This report did not contain the environmental review or the specific information on the GEF objectives. The missing information in this report may have been due to FCG's relative inexperience with work of this nature at the time. It was unclear, however, from the documents available whether this lack of data resulted in a request to FCG to re-file the information. Our reviewer noted that the loan agreement was not signed until late 1998, which may have given FCG time to report more information before it became an Intermediary.

Quarterly "Monitoring Reports" are required under the terms of the loan from the SME Program to the Intermediary. In exchange for this report the Intermediary is paid a prearranged "Monitoring Fee" that is negotiated between the Intermediary and SME Program Management, which accounts for part of the incremental cost of the GEF activity (see Section XX "Incremental Cost" for further information on this topic). SME Program Management distributed a memo to each Intermediary ('Memo No. 2') outlining the information that is required for this report. Intermediaries are required to complete these reports until the loan to the projects has been paid back or written off. The level of completion of these reports varied greatly; the Bank Statements and the Financial Statements were usually included, but Project Reports and Environmental Reports often only gave limited details.

EEAF, for example, was missing some information, but generally had a good track record of keeping up with reporting requirements. EEAF received SME Program funds on July 17, 1996 and has been managing the Soluz project since November of 1997. Based on these dates the Team expected to find seven Monitoring/Progress reports in the IFC files for the Soluz project, however, only three exist.

It was also noted that detailed requests for the Monitoring Fee payments were found, even when in some cases an Intermediary had not filed the appropriate reports with the SME Program. One possible reason for the lack of some documents may be attributed to the fact that they simply had not been filed in the IFC Washington Office File Room.

Speed and Timeliness of Disbursement

All loan funds allocated to Intermediaries must be on-lent within two years or they must be returned to SME accounts. This seems to have created a good incentive for Intermediaries to draw on their allocation in a time frame that is consistent with developing and managing a pipeline of projects. None of the Intermediaries that were interviewed felt that this requirement was onerous. EEAF returned US$400,000 in SME Program funds that were not invested in a timely fashion.

Once a relationship was established with the SME Program and a contract was in place for the loan program, Intermediaries responded that SME disbursements were made in a timely manner. See Table 6 for a comparison of the time required for loan disbursement and placement among the Intermediaries.

Table 6: Data on Intermediary Productivity

Intermediary	Number of Projects	Total Funding	Average Size	Time* Since Approval	Months Until Project**
EEAF	2	$135,000	$67,500	**43**	19
WWF	*1*	$100,000	$100,000	39	**35**
FUNDECOR	54	$366,521	$6,787	38	*3*
CARESBAC	5	**$532,500**	$106,500	36	8
Zaki el-Sewedy	34	$495,200	$14,565	36	11
Grameen Shakti	**311**	$205,611	$661	20	11
Econoler Int'l	*1*	$240,000	**$240,000**	18	12
FCG	0	$0	$0	16	--
Conservation Int'l	*1*	*$95,645*	$95,645	16	14
SELCO Vietnam	137	$203,350	$1,484	14	8
Savé Valley	0	$0	$0	8	--
Int'l Expeditions	0	$0	$0	4	--
Barclay's Bank	0	$0	$0	*1*	--

The high figure for each column is in bold, the low figure is in italics. * "Time" is defined as period of time from approval as Intermediary until May 31, 1999, rounded to nearest month. ** "Months until Project" is defined as period from approval as Intermediary to approval of first sub-Project.

XVIII. Portfolio Diversification and Risk Management Issues

The SME Program is largely experimental and hence the objectives of expanding coverage and gaining experience tend to outweigh more traditional objectives of investment risk management. Two underlying objectives of the Program are to gain experience with as many different types of sub-Projects as possible in as many countries as is practicable.[26] The document entitled "Project Summary for Decision Meeting" (revised as of September 27, 1995), identifies several issues relevant to risk and risk diversification for the SME Program. While the document specifically identifies only a few issues, it does outline three main risks as: country risk, project risk, and program risk considerations. For the purposes of this evaluation, these categories identified in internal memoranda are broken down in to three main risk categories: (1) portfolio level; (2) Intermediary level; and (3) Program level.

[26] SME Program Project Document, 1996.

Portfolio Diversification

The underlying objective has been to make SME Program resources available as broadly as possible. There are two major parameters for portfolio diversification for the Program: geographic coverage and diversity of project types.

Although the "Project Summary for Decision Meeting" document does not mention any specific objective in terms of geographical distribution, the Program clearly has sought to establish relationships with organizations operating in as many countries as possible in each of seven general regions (the summary notes that "there should be geographical spread…"). In practice, the Program has been relatively successful in establishing a balanced number of relationships with Intermediaries in each region, with Latin America in the lead, as demonstrated in Table 2. Where the Program appears to have made comparatively less progress is in Eastern Europe, Asia and Oceania.

Three major countries that are not yet covered but should be, given the size of their populations, economies, and potential for environmental degradation in the future, are China, Brazil and India. These are difficult countries in terms of a lack of political buy-in on international climate change and biodiversity programs. The Brazilian focal point for GEF activity has not supported the Program there, despite requests for approval on several occasions. As of May 1999, only one of these countries was represented by any of the potential Intermediaries under review.

In practice, more climate change-related projects have been supported than biodiversity projects. In terms of individual sub-Projects, the balance is skewed in favor of climate change, with 489 compared to 58 in the biodiversity area, because of the large number of relatively small climate change projects financed by Grameen Shakti, SELCO Vietnam, and Zaki el-Sewedy. Counting each sale of a photovoltaic unit for Grameen Shakti or SELCO as an individual project is not valid from a practical perspective. Even on the basis of total financing placed, however, climate change represents about 70% of the total placements made to date (see Table 7).

Table 7 shows the Intermediaries' investments by category of environmental benefit, either biodiversity or climate change. It includes a column showing the percentage of financing initially proposed by the Intermediary for that category which has actually been placed in projects. For example, CARESBAC Polska originally proposed placing US$300,000 in climate change related projects, but actually invested more than that amount, so its percentage is greater than 100% for that category.

Table 7: SME Program Loan Portfolio and Environmental Benefits
(as of May 31, 1999)

Intermediary	Project Region	Total Actual Financing	Projected Financing: Total Climate Change Solar PV	Projected Financing: Total Climate Change Other	Projected Financing: Biodiversity	Climate Change Actual	Climate Change Actual / Forecast	Biodiversity Actual	Biodiversity Actual / Forecast
EEAF	Latin America	$135,000	$75,000	$225,000	$100,000	$135,000	45.0%	$0	0.0%
WWF	Asia	$100,000			$500,000			$100,000	20.0%
FUNDECOR	Latin America	$366,521			$500,000			$366,521	73.3%
CARESBAC	Eastern Europe	$532,500		$300,000	$300,000	$352,500	117.5%	$180,000	60.0%
Zaki el-Sewedy	Middle East	$495,200		$500,000		$495,200	99.0%		
Grameen Shakti	Asia	$205,611	$750,000			$205,611	27.4%		
Econoler International	Middle East	$240,000		$800,000		$240,000	30.0%		
FCG	Latin America	$0			$500,000			$0	0.0%
Conservation International	Latin America	$95,645			$1,000,000			$95,645	9.6%
SELCO Vietnam	Asia	$203,350	$750,000			$203,350	27.1%		
Savé Valley Wildlife	Africa	$0			$1,000,000			$0	0.0%
International Expeditions	Latin America	$0			$750,000			$0	0.0%
Barclay's Bank Botswana	Africa	$0	$200,000	$400,000	$400,000	$0	0.0%	$0	0.0%
Peer Consulting	Africa	$0		$1,000,000		$0	0.0%		
Total		**$2,373,827**	**$1,775,000**	**$3,225,000**	**$5,050,000**	**$1,631,661**	**32.6%**	**$742,166**	**14.7%**

Source: "SME Program -- May 1999," June 14, 1999.

XIX. Assessment of Program Level Impact and Sustainability

Program Level Impact

The impact of the Program at the Intermediary level is reviewed in more detail in Section XVI "Assessment of Program Structure"). In short, the Program has been successful in identifying and seeding Intermediaries, which have in turn initiated sub-Project level activity that meets the GEF criteria. It is too early to determine the long-term sustainability of the Intermediaries in the Program, but they are all performing or expected to perform well in terms of meeting debt obligations to the Program. To the extent that the Intermediaries continue to fund environmentally friendly SMEs after the Program funds have been expended and/or returned, the SME Program will have demonstrated a very real and beneficial long-term impact. See Section XVI for a discussion of Intermediary quality and Section 0 for a discussion of how this activity may continue after the SME/IFC Program disburses all of its funds.

The Program's environmental activity has been approved by the GEF, and its success in meeting environmental objectives in terms of GEF Operational Programs is rated high, with one exception (see Section XXVI). Beyond the GEF's OP objectives and criteria, there has been insufficient program implementation from which to make conclusive determinations about the overall environmental impact of the SME Program. Even though there has been implementation – over 100 projects implemented to date – it is difficult to determine the aggregate global environmental impact because the Intermediaries are not required to systematically monitor their sub-Projects' global environmental impacts. Rough estimates of global environmental impacts can still be made based on assumptions about the individual projects. Ongoing monitoring would present an extra expense for the Intermediaries, and at least one has told the IFC that if assessments of carbon emission reductions are desired, then the IFC will have to pay the Intermediary to conduct them, since they are not part of its normal business operations.[1]

We therefore do not know, for example, if homeowners who purchase solar home systems are still using some carbon-producing kerosene, which the solar systems were intended to replace. Likewise, we do not have information on the extent of "snap back" in the energy-efficiency projects — that is, the increase in overall energy use in response to lower energy bills. And, we cannot tell in the case of the organic coffee cooperative if participation in the coop is helping with management of buffer zones around national parks or lessening pesticide loads in the local riverine ecosystem.

Since direct environmental monitoring of specific GEF benefits is not required, the only way to estimate the SME Program's environmental impact is to use the environmental projections contained in the SME Project Evaluation Reports that are submitted by the Intermediaries at the inception of each sub-Project. Even assuming the projections were

[1]Pierre Langlois, Econoler International, personal communication, July 1999.

calculated correctly, the Team has chosen not to rely on them because actual project implementation can vary widely from intended project implementation, and the Evaluation Team does not have information regarding the extent of that variance under the SME Program. In addition, according to changes in SME Program requirements, Intermediaries are no longer required to estimate the carbon savings from their projects.[2]

Ultimately, coming up with accurate estimates of an individual sub-Projects' global environmental impact may not be the most important indicator of the SME Program's success in terms of GEF requirements. According to a 1998 World Bank study of GEF project impacts, direct project impacts, at least in the climate change focal area, are much less significant than the project's indirect market impacts.[3] That is, a project's "ripple effect" on the broader market is far more consequential for the global environment than the project's level of carbon emission reductions. While information on market impacts has not been systematically collected by the SME Program, there is some anecdotal evidence regarding the Program's market impacts.

FUNDECOR is already having an impact on forest protection in Costa Rica beyond the impacts of its own projects. Likewise, in Vietnam, although SELCO is not on track to reach its goal of 12,000 solar home system (SHS) installations within two years, the SELCO operation appears to be establishing a market for SHS in Vietnam. Already, other solar companies are reportedly exploring potential opportunities in the Vietnam SHS market.[4] CARESBAC Polska's Symbio Impex project, like FUNDECOR, is beginning to have a significant impact on numerous farmers in Eastern Poland. On the other hand, the El-Sewedy Intermediary, despite its many implemented projects, does not appear to be having a significant impact on the market for energy efficient products in Egypt.

These preliminary observations must be tempered by the fact that the Intermediaries have only operated with SME funds for a short period of time. Their market impact depends largely on their continued operation beyond SME funding. These results will be more evident after financially sustainable operations have been recorded beyond five years.

While it is beyond the scope of this study to determine actual commercial rates in each country relevant to each project, the Team nevertheless used rough estimations to assess commercial sustainability at the sub-Project level. Based on those assumptions, the Team finds that more than half of SME Program financing provided to the sub-Projects by the Intermediaries can be characterized as "concessional rate" financing and that most of the Intermediaries are passing on to the sub-Projects the concessionality that they receive

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[2]Letter from Doug Salloum, IFC to Helen Chaikovsky, EEAF, February 14, 1997.

[3]Eric Martinot, *Monitoring and Evaluation of Market Development in World Bank-GEF Climate Change Projects Framework and Guidelines*, The World Bank, Environment Department Paper No. 066, December 1998, p. i

[4]Neville Williams, SELCO, personal communication, July 1999.

from the SME Program. [5] In the long-term, concessional rate financing does not contribute to the financial sustainability of the sub-Projects, nor is it sustainable for commercial investors. Please refer to the next section for more detail on financial sustainability. This is in part due to the fact that the mechanisms for addressing incremental risk and incremental cost have been overly generous during the experimental, “start-up” phase of the Program, enabling Intermediaries to pass on concessions and still cover their costs and other barriers to implementation (see further analysis and findings on incremental cost and incremental risk below). [6] The Program Management is aware of the situation and is building on the lessons learned during the Pilot Phase by lowering the allowed debt forgiveness concessions on a negotiated basis. Instead of a flat 50% debt forgiveness for the original Intermediaries participating in phase one of the Program, incoming Intermediaries under Phase 2 face negotiations on the debt forgiveness percentage they will receive.

Financial Sustainability

Financial sustainability refers to the ability of SME Intermediaries and their sub-Projects to thrive and expand without further GEF or other concessional funding. According to the GEF’s 1998 *Project Performance Report*, achieving sustainability of GEF projects generally, “. . . is proving to be much more difficult than expected. Most GEF projects [face] continued needs for external support.”[7]

The SME Program faces unique challenges in achieving financial sustainability because it is seeking to foster both enterprises contributions to global environmental benefits and small and medium enterprises. Each of these efforts face major difficulties attracting non-concessional financing. Combined, the difficulties are compounded. While the Intermediaries face these difficulties, the projects themselves generally receive fewer concessions. Thus, it is easier to determine the SME’s likelihood of sustainability than to determine the Intermediaries’ sustainability. This is a logical approach, because if the projects are proven viable, Intermediaries should continue financing them without concessionary sources of capital.

[5] For the purposes of this assessment, “concessional” is assumed as 4% to 8% annual interest rate and “at or above commercial rates” is defined as 11% to 20% annual interest rate.

[6] Incremental risks can be defined as those characteristics of a project which inhibit decision makers (both private and public) from undertaking environmentally-friendly projects with negative or low incremental costs, and which cannot be addressed with standard financial mechanisms typically found in conventional project development. Incremental risks are often apparent in the form of “financing gaps” in otherwise cost-effective and environmentally beneficial projects. High initial transaction costs, small project scale, weaknesses in domestic capital markets, perceived credit or technology risks and a lack of guarantees are just a few of the sources of incremental risks to projects which otherwise show potential economic viability.

[7] Global Environment Facility, *Project Performance Report*, 1998, p. 28

Sustainability of sub-Projects

In general, the projects that are achieving success in the near-term - i.e. servicing their debt, earning commercial or near-commercial returns, etc. - are more likely to achieve financial sustainability over the longer term. In this regard, the EEAF-supported projects - Soluz and EESM appear to be achieving financial sustainability. Some of the CARESBAC-supported projects are having success and FUNDECOR appears to making good progress.

Sub-Projects that are commercially successful may still not be sustainable over the long term because of difficulty in obtaining new debt. Restricted capital availability was one of the reasons for the establishment of the SME Program in the first place, and in many countries tight capital markets persist. The result is that many SME sub-Projects, despite their success, still cannot access domestic capital markets or multilateral development bank loans because of their small size. Even when they can gain access, they often cannot afford the exceptionally high domestic interest rates and short maturities. Thus, one indicator of project sustainability is the ability of projects to gain access to domestic and multilateral debt.

In this regard, one of CARESBAC's projects, the Symbio Impex organic farming project, may achieve financial sustainability. It has attracted the interest of regional development banks and is negotiating lines of credit and other financing for its current and future work. In some other CARESBAC projects, such as Agroplon and Jukan, domestic capital was at risk and lost during the project activity. This is most likely due to the relatively advanced stage of Poland's capital market development compared to other countries in that part of the world.

The el Sewedy projects enjoy favorable repayment periods and internal rates of return, but they face continued challenges in getting active participation from the local Egyptian banking sector. The sub-Project may be able to demonstrate success if local financing entities become more aware of the opportunity and capitalizes on it. Other sources of funding, however, may still be available for energy efficiency project development in Egypt.

In terms of the commercial viability of the Intermediaries' SME-level activity, the Team ranked the participants as follows according to the categorization provided in the terms of reference.

Table 8: Intermediary Ranking by Commercial Strength of SME Activity

Positive	*Neutral Plus*	*Neutral*	*Neutral Minus*	*Negative*
El-Sewedy	CARESBAC	FCG		
FUNDECOR	Grameen Shakti	WWF/PNG		
Conservation International	SELCO			
Econoler Int'l	Savé Valley			
	International Expeditions			
	EEAF			

In terms of meeting GEF objectives at the sub-Project-level, the Evaluation Team ranked the Intermediaries based on similar categorization provided by the IFC/SME Program. In this case the categories are defined as follows.

1. Positive: likely to meet GEF/OP objectives
2. Neutral plus: too early to judge but likely to meet GEF/OP objectives
3. Neutral: too early to judge likelihood of meeting GEF/OP objectives
4. Neutral minus: too early to make final determination, but concerns about meeting objectives
5. Negative: not likely to meet GEF/OP objectives

Table 9: SME Program Quality Assessment, GEF Environmental Benefit Criterion

Positive	*Neutral Plus*	*Neutral*	*Neutral Minus*	*Negative*
FUNDECOR				
Zaki el-Sewedy	SELCO Vietnam	Grameen Shakti	CARESBAC	
Savé Valley	EEAF	International Expeditions		
WWF/PNG	Econoler Int'l	FCG		
Conservation International				

For a more detailed explication of how these rankings were achieved, please refer to Section 0.

Sustainability of Intermediaries

The Intermediaries are receiving SME funds at a substantial discount from commercial terms - a 2.5% loan plus up to half of the principal forgiven. It is reasonable to ask if they could or would continue serving as financiers for small and medium global environmental enterprises without further concessional funds, whether from the SME Program or other sources of concessional money.

In some cases, Intermediaries are working in non-global environmental areas and may decide to discontinue global environment investing when the SME Program incentives end [e.g. El Sewedy, CARESBAC Polska]. Continuing to invest in global environmental projects may depend in part on the size of the GEF subsidy they are now receiving, and whether or not it is augmenting existing Program funds, as in the case of CARESBAC and their ability to replicate the activity with commercial financing.

However, most of the Intermediaries are working closely with businesses that benefit the global environment, and that are likely to continue their global environmental activities after their SME Program involvement ends. Many of these businesses will likely operate with concessional funds from other sources, where necessary. For example, EEAF has concessional funds from a number of donors, investors, and charities, which it allocates to various projects as its management and donors see fit. Similarly, CARESBAC is working with foundation grants and other concessional sources of capital.

Because the SME Program has not been in existence for long, the continued financial sustainability of its environmental investments cannot be conclusively determined. Some Intermediaries appear to have achieved (or are likely to achieve) commercial returns on their projects and will thus be more likely to continue supporting global environmental projects without further concessional financing. One Intermediary, CARESBAC, has had a difficult project and may be unable to continue global environmental investing without further concessional financing.

In general, the climate Intermediaries, such as Econoler International and SELCO, appear most likely to continue investing in global environmental projects without SME Program support and thus have the greatest prospects for financial sustainability. This is due in large part to the fact that their parent companies have made strategic decisions to pursue business in areas – energy performance contracting and solar home systems, respectively – which have beneficial impacts on the global environment, regardless of the source of their investment capital. In fact, both of these Intermediaries may be examples of free riders on the SME Program, although the Program has certainly lowered their parent companies' risks, thereby contributing to the decision to pursue business in riskier markets, in this case, North Africa and Vietnam.

Econoler International, though a year or more away from commercial success, appears to be heading, along with el Sewedy, toward eventual IFC or private loans for their energy-efficiency activities. Securing local financing has been a challenge for el Sewedy, but the success of the project may soon overcome that obstacle. On the other hand, Intermediaries with biodiversity investments, such as CARESBAC, appear to face the greatest challenge in achieving financial sustainability for their biodiversity investments. CARESBAC's problem loans — Agroplon and Jukan — make it less likely that they will risk further global environmental investing without additional concessional funds. However, there are exceptions, such as FUNDECOR's success at developing forestry businesses.

The renewable energy Intermediaries, such as SELCO and Grameen Shakti, fall somewhere in between the energy efficiency- and biodiversity-oriented Intermediaries. They operate on slim margins and have perceived high risks, but could become fully commercial depending on the terms of their lenders and the efficiency of their credit operations (i.e. maintaining low consumer default rates).

Capacity-Building Efforts at the Intermediaries

All Intermediaries are required to attend a training workshop on global environmental impact assessment. The workshops are intended to build the intermediaries' capacity to incorporate global environmental considerations in their investment practices. In general, the Intermediaries report that the workshops have been useful. In some cases, they have already had environmental impact training but find it useful to learn the GEF approach. However, the Team could not determine the extent to which the training has affected the type or quality or projects being supported by the Intermediaries. In addition, it is not clear if the GEF-related environmental training is distinct from the standard training required for World Bank Group environmental impact assessments. The conventional training is based on avoiding negative impacts on World Bank Group financed activities. To truly build capacity regarding GEF objectives, training would need to focus on climate change and biodiversity issues in particular.

At this time, Intermediaries receive training that focuses on environmental impact assessment. One Intermediary suggested that, in addition to the environmental training, the SME Program could provide training or technical assistance, to Intermediaries as well as project sponsors, on business management and financing.[8] The Team did not explore whether this suggestion should be acted upon. We note, however, that the IFC does provide such assistance to participants in the *Extending IFC's Reach* program (See Section XXII) and in its small and medium enterprise business advisory programs in Sub-Saharan Africa, the Mekong region, and the Pacific.[9] We also note that the World Bank's

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[8]Pierre Langlois, Econoler International, personal communication, July 1999

[9]These programs include the African Management Services Company (AMSCO), Enterprise Support Services for Africa (ESSA), Africa Project Development Facility (APDF), Mekong Project Development Facility (MPDF), and the South Pacific Project Facility (SPPF).

emerging approach to rural energy businesses (mainly solar photovoltaic project developers) is to emphasize the provision of business services over the provision of financial resources.[10]

Conclusion on Impact and Sustainability

According to the GEF Secretariat's Monitoring and Evaluation unit, in designing a GEF program, care must be taken to balance the provision of incentives with the ability of firms to operate sustainability under market conditions after a project ends.[11] In general, the larger the subsidy provided, the greater the doubt that the investment will become financially sustainable. However, the smaller the subsidy provided, the greater the possibility that the enterprise might have become sustainable without the subsidy. The challenge is thus to find investments that need assistance but "not too much" assistance.

Currently, the subsidies to Intermediaries are substantial. One way to improve the likelihood of Intermediary sustainability is to close the subsidy gap over time to commercial or at least near-commercial terms. That is, if the Intermediaries receive SME funds at a somewhat higher rate, it is easier to assess the SME Program's sustainability than at the current 2.5% interest rate (More than one Intermediary was astounded at the size of the incentive / debt-forgiveness windfall available by participating in the program). Likewise, if the principal reductions could be negotiated to a level not above 25%, and probably well below, the Intermediaries still wishing to apply for SME Program participation would be more likely to continue their global environmental investing once their participation is over.

Taking steps to attract stronger Intermediaries with backgrounds in the private sector is another important way to improve the chances for long-term sustainability. One way is to do this is to increase the pool of applicants, allowing the Program to identify more Intermediaries with the characteristics needed to ensure sustainable operations in the future. Another way is to use the IFC's Extend the Reach Program and regional Project Development Facilities (PDFs) as initial screens. In fact, this was already envisioned by the SME Program as a way to identify projects. Of the approximately 75 new projects that were to be identified during the Operational Phase, the Program expected that 10 would be identified by the IFC's PDFs in Africa, the South Pacific region, and Southeast Asia (and these would be eligible for direct SME Program funding, i.e. without Intermediary involvement). This approach has not been successful in generating any new projects, however (see Section XXII on "Mainstreaming" for further discussion of issues related to sustainability of the Program).

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[10]Damien Miller, 1999 white paper on World Bank's rural energy delivery efforts [Get full citation]

[11]Jarle Harstad, "GEF Lessons Note," GEFSEC, May 1998, No. 2

A third way to increase sustainability is to make the application process more competitive and require applicants to design robust on-lending programs. Increasing competition for SME Program funds will also generate a larger pool of Intermediaries to choose from. For example, the Government of Argentina, with World Bank assistance, set up a competitive bid program for providing rural energy services. The winning bidder was the one that requested the smallest subsidy. With lower subsidies needed, more of the SME funds could be used to provide business management-oriented technical assistance, which other IFC/SME programs tend to emphasize over financing, and which many Intermediaries could benefit from.

Finally, the process of determining the sustainability of the Program and SME-level activity could be enhanced with close monitoring of the case-by-case lending terms to the SMEs given by Intermediaries. The ability of the sub-Project to meet its obligations to the Intermediary, and the viability of the Intermediaries lending practices (spread on rates using IFC/SME Program funds as compared to other commercial sources), will be important measures of sustainability going forward.

XX. Assessment of Incremental Costs (IC) and Incremental Risks (IR)

Incremental cost approach between SME and Intermediaries

As explained in Section XVI, the incremental costs of the Program are identified as the cost of processing and monitoring the SME loans, which are paid for by “Completion” and “Monitoring” fees as a percentage of the total SME project costs. During the Pilot Phase, these averaged 4% and 1% per year, respectively. The Evaluation Team was not able to determine this figure for SME2 Projects.

The Evaluation Team believes the structure of accounting for incremental costs is appropriate for the type of costs incurred and it is conducive to the Program’s objectives. Incremental costs of well-defined projects are sometimes calculated in terms of a project case and baseline case, much like reductions in CO_2 are calculated for specific project activities. For example, the cost of a combined-cycle gas fired plant (project case) would be compared to the cost of a single-cycle plant (base case) to determine the incremental cost of that activity, with the difference being the additional cost of the beneficial activity. But projects under the SME Program are not nearly so well-defined. The additional activity that generates biodiversity and climate change activity is part of a general commercial undertaking. Additionally, the obstacles to development are not necessarily related specifically to technology or design, but rather to sustainable funding and operation of the activity. This reflects the fact that the Program as a whole is directed at helping Intermediaries overcome barriers to financing sub-Project activity; the activity itself must be additional or incremental to be eligible for Program funds. By providing fees for monitoring the sub-Project activity and a fee for completing individual loans to sub-Projects the SME Program is paying for the incremental cost of Intermediaries’ participation in the Program.

The monitoring reports are described in more detail in Section XVII. The Evaluation Team believes that these reports could be used to update and inform the Program and other interested parties on the GEF benefits at the sub-Project level. For example, the report could require an ongoing description of the initial activity may be growing, including descriptions of additional participants, resources, etc., coming into the activity. One result of this would be to continue building awareness of climate change and biodiversity benefits in Intermediaries and sub-Project sponsors. Another result would be a broader record of information on sub-Project-level benefits for reference by the GEF.

In the case of biodiversity projects, additional technical assistance may be justified in certain situations, in order to support the implementation of GEF indicators now being developed for analyzing biodiversity projects. [12] In lieu of this, an update and/or assessment of the biodiversity benefits that were initially projected in project monitoring reports would be useful to the Program and the GEF in terms of tracking the activity's overall environmental sustainability . In many cases, businesses that are integrally linked to biodiversity conservation must be evaluated annually or biannually by a third-party *certifier,* who assesses the project's or company's compliance with certification standards. Biodiversity issues are already a part of the regular reporting process for forestry projects and a similar type of third-party certifier might be subcontracted to assess the ongoing impacts of other types of projects as well.

Although the GEF does not require it, monitoring for climate change projects may include a status report and estimation of expected GHG emission reductions or sequestration. While units and cost of GHGs reduced or sequestered do not indicate barrier reductions according to the GEF Operational Programs, these estimates would be valuable in the evolving market for tradable emission credits. A simple assessment may suffice, such as a comparison of whether the project case as originally conceived is still operating against the originally identified base case. If the sub-Project activity intends to generate "real" reductions according to evolving international guidelines, additional sources of funding may be available from programs such as the Prototype Carbon Fund of the World Bank.[13]

Incremental Risk Approach

As noted in Section XVI and sub-section 2.5.1, the Evaluation Team believes that the SME Program addresses incremental risks in a way that is appropriate for generating sustainable, market-oriented activity at the level of SMEs. Under the Program's current structure, the incremental risk compensation is based on a negotiated percentage of the total principal loan amount. During SME1, this fee was fixed at 50% of total principal outlay, and was triggered when the first loan payment was transferred to the Intermediary.

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[12] Personal communication with Jarle Harstad, May 27, 1999, with reference to "GEF Development of Program Indicators for the Biodiversity Programs" now underway.

[13] The Prototype Carbon Fund (PCF) seeks to buy certified GHG reduction credits from World Bank project activity, and may be interested in eligible activity within the SME Program.

The Evaluation Team encountered significant anecdotal evidence that the debt forgiveness incentive is disproportionately high in relation to some Intermediary activity. The danger of providing too much incentive through this mechanism is that it may incite Intermediary investment approaches and, depending on how the incentives are passed on to the sub-Project, sub-Project activities, that are less likely to become commercial over time. Similarly, it opens the Program up to questioning about whether the activity overcomes significant barriers to development and financing.

Only time will reveal if these assertions are true. But three points are worth consideration in this context. First, the fact that an Intermediary or sub-Project profits by the Program is not necessarily an indication that it did not face significant barriers; commercially-viable activity is often overlooked by conventional market actors, and the Program is designed specifically to find those cases and demonstrate their profitability. Second, the SME Program is essentially experimental and can be adjusted to reflect lessons learned as it moves forward, particularly lessons learned during SME1. For example, during SME2, the percentage of principal retained by the Intermediary is negotiated, and has been coming in at or below 25%, depending on the nature of the Intermediaries' work and the estimated level of risk undertaken.

Finally, if the Intermediary passes the concessionality of its funds from the Program on to the sub-Project, this does not necessarily contradict the Program's sub-Project level objectives (e.g., commercially-sustainable project activity). In addition, the pilot nature of sub-Project activity and the volume of anticipated environmental benefits may compensate for concerns about near-term commercial viability. The best example of this, tempering the commercial model for determining adequate risk compensation is FUNDECOR's on-lending at 3% to 5%. This rate accurately reflects what that client can bear, in this case farmers in Costa Rica, and the potential downstream benefits in biodiversity conservation are very large.

Findings and Recommendations Regarding IC and IR

Incremental Cost

Although the monitoring and completion fees do not pay to measure GEF benefits specifically, they are components of the Program that pay for the incremental costs of the activity. The additional biodiversity and climate change activity is part of a general commercial undertaking, and the fees are an appropriate channel for compensating the commercial viability of that undertaking. However, the Team believes it would be valuable to both the Program and the GEF if more information were available about GEF benefits that are realized through the activity over time. This may be collected through the monitoring reports.

Monitoring of climate change activities should include a status report and some estimation of expected GHG emission reductions or sequestration, in order to justify compensation for incremental costs (fees). The Program should channel technical assistance into eligible biodiversity sub-Project activity to support testing of GEF indicators now being developed. In lieu of this, an assessment of the initial expected biodiversity benefits should be revisited in annual monitoring reports.

Incremental Risk
The Evaluation Team found significant anecdotal evidence that the debt forgiveness incentive of 50% during SME1, in combination with concessional loan terms to the Intermediary of 2.5% and ten-year maturity, may be disproportionate to the incremental risk of actual investments made by the Intermediaries. Depending on how the concessional terms are passed on to the sub-Project activities, this disproportionate incentive may also ultimately result in sub-Projects not moving toward commercial sustainability. There are significant caveats to this observation, as noted above in this section 2.5. In any case, incentives are now negotiated, demonstrating the ability of the SME Program to adapt to lessons learned during the Pilot Phase.

Nevertheless, the Evaluation Team recommends that the IFC/SME Program consider negotiating this rate above the current terms. One potential reference would be local capital markets or other appropriate market references for setting terms of the loan from the SME Program to Intermediary. Using that rate and term as a reference, Program Managers could negotiate with the Intermediary by lowering the rate and/or relaxing the terms as an incentive to account for foreign exchange risk, SME risk, environmental and other risks as deemed appropriate by SME Program management.

XXI. ASSESSMENT OF SME PROGRAM LOAN QUALITY

The Team assessed the Intermediaries by reviewing documentation, conducting interviews, direct interaction with Intermediary representatives and sub-Project sponsors during three field visits. The Evaluation Team reviewed the first 12 of 15 Intermediaries, the three exceptions having been approved after the current evaluation began in May 1999 (see Table 10). The Team found the Intermediaries to be well-established entities in their respective fields with good creditworthiness (see Table 11 below), primarily due to a careful selection process that begins with referrals and ends with a systematic review of proposals and substantive due diligence on the entity.[14] In instances where there is a perceived additional risk to the Intermediary because of the nature of the sub-Project activity, or because the Intermediary and sub-Project sponsor are the same entity, the SME Program seeks additional security through guarantees from the entity.

[14] The criteria for selection of Intermediaries includes (1) financial viability, (2) experience in working with SMEs, (3) financial structuring capabilities, and (4) environmental technical experience related to World Bank Group standard reviews and GEF benefits. See SME Program Project Document 1996, p. 11

Table 10: Summary Table of SME Program Loans (repeats Table 1)

				SME Group (IFC) to Intermediary								
							Loan Terms					
	Intermediary	Phase		Loan Amount	Amount Disbursed	Receipt Date	Loan Lag Time	Loan Rate	Loan length	Principal Repaid	Interest Accrued	Amount Forgiven
1	EEAF	SME1	ngo	$ 400,000.00	$ 400,000.00	07/17/96	113 days	2.50%	10-12 years	$ 19,594.40	$ 1,655.78	$ 11,862.00
2	Caresbac-Polska S.A.	SME1	private	$ 600,000.00	$ 600,000.00	07/02/96	76 days	2.50%	10 years	$ 28,147.35	$ 1,745.31	$ 37,053.00
3	Fundecor	SME1	ngo	$ 500,000.00	$ 500,000.00	08/08/96	42 days	2.50%	10 year	$ 23,455.36	$ 479.55	$ 38,006.19
4	El Sewedy	SME1	private	$ 500,000.00	$ 500,000.00	10/18/96	121 days	2.50%	6 years	--	$ 21,970.14	$ 235,283.15
5	WWF	SME1	ngo	$ 500,000.00	$ 250,000.00	02/23/98	102 days	2.50%	10 years	--	$ 9,634.81	--
6	Grameen Shakti	SME1	financial	$ 750,000.00	$ 250,000.00	07/06/98	116 days	2.50%	10 years		$ 7,288.05	$ 16,877.79
7	Dessau-Soprin ADS	SME1	private	$ 800,000.00	$ 400,000.00	04/01/98	29 days	2.50%	10 years		$ 14,253.29	$ 12,000.00
8	Conservation Int'l. (1)	SME2	ngo	$ 1,000,000.00	$ 500,000.00	04/01/99	190 days	2.50%	10 years		$ 5,585.60	$ 4,472.00
9	FCG (3-4)	SME2	ngo	$ 500,000.00	$ 250,000.00	--	--	2.50%	10 years	--	$ 2,794.97	--
10	Selco Vietnam (1)	SME2	private	$ 750,000.00	$ 400,000.00	09/23/98	(5) days?	2.50%	8 years		$ 9,083.99	$ 4,696.48
11	Save Valley Wildlife (1)	SME2	private	$ 1,000,000.00	$ -	--	--	2.50%	10 years	--		--
12	Int'l. Expeditions (3-4)	SME2	private	$ 750,000.00	$ -	--	--	2.50%	10 years	--		--
13	Barclays Bank of Batswana*	SME2	financial	$ 1,000,000.00	$ -	--	--	2.50%	--	--		--
14	Peer Consulting*	SME2	private	$ 1,000,000.00	$ -	--	--	2.50%	8 years	--		--
15	PILCO*		private	$ 750,000.00	$ -	--	--		5 years	--		--
	TOTAL			$ 10,800,000.00	$ 4,050,000.00					$ 71,197.11	$ 74,491.49	$ 360,250.61
	*Not included in Evaluation											

The loan quality at the Intermediary level (loan from Program to Intermediary) has been ranked according to categories provided by IFC, as follows:

Positive:	able to service principal and interest payments
Neutral plus:	too early to judge but likely to meet debt-servicing requirements
Neutral:	too early to judge ability to meet debt-servicing requirements
Neutral minus:	too early to judge but unlikely to meet debt-servicing requirements
Negative:	not likely to be able to meet debt-servicing requirements and losses likely

Table 11: Loan Quality Ranking by Intermediary

Positive	***Neutral Plus***	***Neutral***	***Neutral Minus***	***Negative***
CARESBAC	FCG			
EEAF	SELCO			
FUNDECOR	Savé Valley			
El-Sewedy	International Expeditions			
Conservation International	Econoler Int'l			
WWF/PNG				
Grameen Shakti				

Source: Econergy International Corporation

EEAF and CARESBAC Polska have already begun repayments of funds and therefore, meet the requirements for "positive". Both entities face very strong incentives to uphold their credit ratings with the IFC/SME Program as they are capitalized with bilateral and multilateral funds and other non-commercial investment sources. FUNDECOR is a highly sophisticated organization with extensive experience in the area of sustainable agriculture and forestry in Costa Rica, and was ranked very high overall by our Team's evaluator who visited the country. FUNDECOR is also highly dependent on official assistance and therefore faces a very strong disincentive to default on the SME Program loan. For these two reasons, as well as general credit-worthiness (Costa Rican Government backing), it receives a "positive" ranking.

El-Sewedy has already placed and recuperated all funds from the SMEs to which it provided loans for small, highly cost-effective energy efficiency projects. As a strong commercial entity in Egypt, it is very likely to meet its debt obligations to the Program. Similarly, Grameen Shakti has the backing of the Grameen Group in Bangladesh and boasts many years of successfully operating micro-lending in the country. There is little chance that a large, well-established entity of this kind would renege on an obligation to the IFC/SME Program.

Conservation International, like the World Wildlife Fund, is a large, well-established environmental non-profit with substantial foundation and membership support, and again, there is virtually no possibility that either organization would fail to meet its debt obligations to the IFC/SME Program.

Finally, FCG, Savé Wildlife, SELCO, and International Expeditions are ranked "neutral plus" because they are not as large and well-established as the other Intermediaries and because they have not yet established a firm track record of investing and administering funds with the SME Program. Similarly, Econoler is ranked highly by the Team's evaluator and has the backing of well-established international energy firms based in Canada, giving it a "neutral plus" rating. With that note, there is little reason to expect that these Intermediaries would not be able to meet their obligations. In the case of International Expeditions, a comparatively small, independent company, additional guarantees have been required from the company's owners/investors to secure the SME Program loan.

Intermediary Loan Performance in Terms of sub-Project-Level Activity

It is useful to review the loan quality with more current indicators of the Intermediaries performance regarding sub-Project-level activity, both financial and environmental. Providing a consistent set of criteria for evaluating the quality of the loans is difficult in part because the Program's procedures have changed between SME1 and SME2. In addition, in the early phase of the program more lending was done, whereas more recent activities have received equity investments, as well as reserves to provide collateral and guarantees.

With these caveats, the overall quality of loans in terms of current performance is also very good. Funds invested are performing within an acceptable range of failure and lag, given the difficulties of SME financing and the complexity of achieving sustainable business activity that foster positive environmental benefits.

Findings and Recommendations Regarding Loan Quality

The Intermediary ranking by loan quality presented in Table 11 is based on actual loan performance. Only two Intermediaries, CARESBAC Polska and EEAF, have actually made payments, according to their debt service obligations, to the SME Program. On the other hand, el Sewedy has essentially completed its projects, but is not obligated to pay back its loan until the grace period expires even though it has the resources in hand to do so. Still other Intermediaries have not yet entered into their period of debt servicing.

The contrasting status of the Intermediaries' loans illustrates that ranking the quality of loans according to current performance (repayments) is not very useful. Other factors, such as the strength of the Intermediary itself, the strength of organizations backing the Intermediary, and the rigor of the SME Program selection process, inform the ranking presented here. Based on its review of the Intermediaries, which includes these other factors, the Evaluation Team found the overall loan quality of the SME Program to be very good.

XXII. MAINSTREAMING AT THE IFC

One of the measures of the SME Program's success is the degree to which the IFC has "mainstreamed" its support for small and medium enterprises that have global environmental benefits. In the 1998 GEF Corporate Budget, mainstreaming is defined as having two dimensions: first, increasing the number of GEF projects with co-financing from the Implementing Agencies – in this case, the IFC – and second, increasing the number of GEF-type projects in the regular operations of the Implementing Agencies.[1]

By this definition, the SME Program has not yet become mainstreamed at the IFC. The SME Intermediaries are not receiving co-financing from the IFC and there is no increase in the number of GEF-type SME investments in regular IFC operations. The IFC had planned to co-finance a PV enterprise in Mongolia, but a financial disclosure problem unrelated to the Program design halted the investment.

According to some IFC staff, global environmental projects will never become mainstreamed at the IFC because the IFC is largely driven by business climate, opportunity costs of capital, and risk considerations. These analysts contend that the definition of mainstreaming should be broadened to include the extent to which the SME Program's projects are attracting private investment, not just IFC investment. Likewise, they believe it should include the extent to which global environmental small and medium enterprises *not* participating in the SME Program are attracting increased investment from private sources.

While the ability of SME Intermediaries and sub-Projects to attract private investment is indeed important, we believe that mainstreaming operations is more related to financial sustainability. We have addressed this in the section on financial sustainability (Section XIX), and have chosen to adhere to the GEF's more conservative definition of

[1]Gareth Porter et al, *Study of the GEF's Overall Performance*, Washington DC: Global Environment Facility, April 1998, p. 38

mainstreaming that includes a measure of financial involvement in, or commitment to, the Program by the administering institution, the IFC.

Although the SME Program has not yet mainstreamed its investments in small and medium-sized global environmental enterprises, it is important to recognize that mainstreaming difficulties are not unique to the IFC. Mainstreaming the global environment at all of the Implementing Agencies (the World Bank group, the UNDP, and the UNEP) has been problematic, as detailed in the 1998 evaluation of the GEF's overall performance. In addition, providing commercial resources for small and medium enterprises is generally quite difficult. The IFC has had to take explicit and costly steps to assist SMEs, as outlined below. Thus, attempting to mainstream both the global environment and SME assistance programs is far more difficult than attempting to mainstream either of the endeavors separately.

IFC's other SME Initiatives

While the SME Program has not attracted any IFC resources, other programs at the IFC that support small and medium enterprises have received IFC financial support. They could serve as models for mainstreaming the SME Program. There may also be some value in increasing the level of cooperation and coordination with them.

There are two broad areas of support for SMEs at the IFC: (1) technical assistance and business advisory services, and (2) financing. The technical assistance/business advice comes through the "Extending IFC's Reach" program and through several sub-regional SME programs:

- Africa Project Development Facility (APDF);
- Mekong Project Development Facility (MPDF);
- South Pacific Project Facility (SPPF);
- African Management Services Company (AMSCO) and;
- Enterprise Support Services for Africa (ESSA).

The financing comes through three sub-regional SME funds linked to several sub-regional technical assistance funds — Africa Enterprise Fund (AEF), Mekong Financing Line (MFL), Pacific Island Investment Facility (PIIF), the "Extending IFC's Reach" program's "Small Enterprise Fund", and through the regional financial markets divisions.

Extending IFC's Reach

Established in FY 1997, the "Extending IFC's Reach" Program promotes private sector investment in countries or regions which have not attracted significant IFC or private investment. The program does not target small and medium enterprises per se, but due to the smaller and higher risk markets it deals with, its investments end up being in enterprises that, from a global perspective, would be considered small and medium-sized.

With a US$18 million administrative budget, the "Reach" Program involves posting IFC staff in its target countries specifically for the purpose of identifying and preparing projects for the IFC and private investors. As part of the three-year program, a US$40 million "Small Enterprise Fund" (SEF) was established to invest in projects with total costs between US$250,000 and US$5 million. The SEF primarily provides debt financing but can also make equity and quasi-equity investments and provide local currency guarantees.[2] The funds are offered on a non-concessional basis, although the IFC is willing to provide up to 50% of the financing instead of the usual 40%,[3] and it is not strict about high IRRs, preferring instead to have good projects with good sponsors.

There is no outside source of funds to subsidize the IFC investments in the Reach Program, although appraisal fees are usually waived.[4] In addition, IFC's technical assistance trust funds, which are grant monies from donor countries, are used to help develop business plans, determine the best investment opportunities, provide management advice, and develop management information systems in the target countries. To date, this technical assistance has amounted to US$12 million, or roughly one-quarter of the IFC's trust fund expenditures.[5] IFC saves on administrative costs with the program compared to normal IFC investments because in most cases sub-Projects need only be approved at the regional director level instead of at the vice-president and executive board levels.

The Reach Program is moving toward being mainstreamed at the IFC. Under a proposed plan, after a period of time, it will no longer be a separate program. Instead, each regional department in the IFC will receive extra investment funds earmarked for investments in the Reach Program's target countries.

IFC's Regional Funds

The Africa Enterprise Fund (AEF) provides up to 40% of the financing for qualifying enterprises in Sub-Saharan Africa. AEF financing, usually in the form of loans, equity investments or a combination of the two, typically range between US$100,000 and US$1.5 million for projects usually averaging US$5 million in size. Funds are provided on a commercial basis, and recipient enterprises must conform to IFC's standard investment criteria. Since its creation in 1989, AEF has provided a total of US$142 million for 232 projects in 30 African countries. Projects are appraised, processed, and supervised by IFC's representatives in Africa.[6]

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[2]World Bank homepage, http://www.worldbank.org/html/extdr/business/sme.htm, and IFC Annual Report - 1997, "Report on Operations - 'Extending IFC's Reach' Initiative," http://www.ifc.org/AR97/html/box2-1.html

[3]World Bank Nepal Office, News Release No. 35 RMN98RMN98, "International Finance Corporation Brings Extended Reach Program To Nepal," November 23, 1998, http:/www/worldbank.np/worldbank/news/inter.html

[4]Richard Rutherford, IFC, personal communication, July 1999.

[5]Rajiv Kochar, IFC, personal communication, July 1999

[6]IFC web site: http://www.ifc.org/abn/aef/aef.htm

The US$5 million Mekong Financing Line (MFL) and the US$6 million Pacific Island Investment Facility (PIIF) are IFC lines of credit that provide debt financing to SMEs in the Mekong and Pacific island regions, respectively. They work closely with their regional project development facilities -- the Mekong Project Development Facility and the South Pacific Development Facility (See section immediately following) -- which identify and appraise projects, and work with potential applicants to ensure that their applications meet the credit facilities' guidelines. Loans are provided on a commercial basis, although, as with the Reach Program, there is some flexibility on the required internal rate of return. Both facilities can provide financing of up to 40% of project cost, 50% on an exceptional basis. The MFL invests in the US$50-750 thousand range per project, and up US$1 million in exceptional cases. It has invested in four projects to date. The PIIF invests in the US$100-500 thousand range, and up to US$750,000 on exception. It has so far invested in five projects. [7]

IFC's Project Development and Advisory Services

Several multi-donor regional programs exist to assist in the development of small and medium-sized businesses and to provide technical assistance. IFC either manages or participates in them. Project development support is provided by the Africa Project Development Facility (APDF), Mekong Project Development Facility (MPDF), and the South Pacific Project Facility (SPPF). The business advisory services are provided by the African Management Services Company (AMSCO) and Enterprise Support Services for Africa (ESSA). In reality, there is some overlap between the project development facilities and the business advisory services. Both tend to provide advice and assistance in attracting investment to the enterprises.

Although the programs do not provide financing themselves, they do work with their client businesses to attract local and offshore investors. The three project development facilities plus AMSCO have together helped small and medium-sized enterprises mobilize approximately US$600 million in project finance.

[7] IFC, *1998 Report to the Donor Community: IFC Donor-Supported Technical Assistance Programs*, (Washington DC: International Finance Corporation, 1998) p. 54, and David Clark, IFC, personal communication, August 1999.

IFC's Financial Markets Divisions

Each of the IFC's regional departments contains a financial market division, which provides financing to financial intermediaries such as leasing companies and commercial banks. It also establishes new financial intermediaries in the form of private equity funds. Some of the funds have a country focus, some have a line-of-business focus, and some focus on both, such as the investments dedicated to equity and venture capital in India. Many of the regional departments' investments target small and medium-sized intermediary institutions, and many of its equity funds target SMEs. The financial market divisions are currently undergoing a reorganization, after which they will focus on seven business fields, one of which will be small business finance.

Findings and Recommendations on Mainstreaming

Mainstreaming the SME Program at the IFC — that is, increasing IFC co-financing of SME Program Intermediaries/sub-Projects and increasing the number of SME Program-type projects in the regular operations of the IFC — will take some effort on the part of SME Program staff, the IFC's Environmental Projects Unit, and the GEF Secretariat. The most likely avenues for mainstreaming will be through other SME programs and IFC's financial markets divisions, even though they are limited to specific countries and sub-regions.

Discussions about coordinating the SME Program with the financial market divisions have been ongoing since 1996. But, coordinated implementation has been difficult because the IFC's financial market divisions do not consider SME Program Intermediaries to be eligible for conventional financing. The Intermediaries have been viewed as either having an insufficient track record of good appraisal and credit management or as having insufficiently strong ownership or management.[8] This situation may change as the Intermediaries develop more of a track record in credit management, particularly in collecting funds, and a greater understanding of the biodiversity and clean energy businesses.

There are potential synergies between the SME Program and all of the specialized funds, particularly the "Extending IFC's Reach" Program. The main advantage of the "Reach" Program is its large pool of IFC field staff whose function is to identify, appraise, and assist potential applicants to the Reach Program's Small Enterprise Fund (SEF). These staff could potentially, cost-effectively do the same for global environmental enterprises. The regional funds - Africa Enterprise Fund, Mekong Financing Line, and Pacific Island Investment Facility - likewise employ IFC field staff, but they are far fewer in number.

Given the fact that the SME Program's Intermediaries provide financing to projects at commercial or near-commercial terms, there is certainly scope for closer coordination, if

[8] Hany Assaad, IFC, personal communication, August 1999.

not co-financing, with the IFC's funds on the sub-Project level. It may be more difficult for them to co-finance the Intermediaries directly given the gap between the funds' need for commercial returns and most of the Intermediaries' need for concessional financing. Still, there may be exceptions, such as the non-intermediary Intermediaries like Econoler International and SELCO, that could qualify for co-financing. In fact, SELCO, a U.S. company, originally approached the Mekong Project Development Facility and the Mekong Financing Line for commercial debt but was reportedly told that foreign companies could not qualify for assistance from the Mekong facilities.[9]

One of the most noteworthy aspects of IFC's specialized funds is their heavy reliance on project preparation and business advisory services. Although the funds themselves provide few or no concessions in their financing terms, they offer these services to help potential applicants improve their prospects for financial success. There may be an opportunity for the SME Program's sub-Projects and even Intermediaries to link up with the business assistance programs - the Mekong Project Development Facility, South Pacific Project Facility, Africa Project Development Facility, African Management Services Company and Enterprise Support Services for Africa. Such a linkage could help improve the prospects for financial sustainability of SME Program Intermediaries and sub-Projects, which in turn could help them qualify for regular IFC financing in the future.

The special SME funds and services, particularly the Extending IFC's Reach Program, enjoy strong institutional support from IFC management. Coordinating and collaborating with these programs would not only help SME Program Intermediaries and sub-Projects but could also benefit the overall SME Program by increasing its visibility and support from IFC management. SME Program staff have already made some attempts to coordinate with the special funds and services, including presenting the program at an internal IFC SME symposium in June 1998 attended by representatives of all the special funds and services, but they report little success, at least with IFC headquarters staff.

The Evaluation Team had limited contact with the headquarters staff from the funds and services, which revealed that they had some familiarity with the SME Program and an interest in learning more about it. The staff of the Mekong and Pacific facilities seemed most knowledgeable about the program. In one case, there was nearly a co-financing arrangement between the SME Program and the Pacific Island Investment Facility. However, the investment, an ecotourism project in Papua New Guinea called the Mount Gahavisuka Lodge, did not go forward for reasons unrelated to the efficacy of the project.[10]

There does not appear to have been a concerted or sustained effort to market the SME Program to the IFC's special funds and services. There may be insufficient resources for

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[9]Neville Williams, SELCO, personal communication, July 1999.

[10]David Clark, IFC, personal communication, August 1999.

such an effort, mainly because the chief objective of the SME Program is to help the Intermediaries become commercially viable regardless of the source of the investment. Since the Program seems indifferent about whether investments come from the IFC or private investors, and since some IFC staff regard attracting private investment to be a priority, attracting IFC co-financing is regarded by some as a relatively low priority.

On the other hand, a less formal effort to bring the SME Program's activities and results to the attention of main IFC department heads and others within the institution may be a good first step towards "mainstreaming." The Technical and Environment Department and the SME Program Manager should seriously consider this opportunity.

Ultimately, mainstreaming the SME Program may require some organizational changes. As mentioned, the Reach Program will be mainstreamed by integrating it with each of the IFC's regional departments, which will receive extra investment funds earmarked for investments in the Reach Program's target countries. Likewise, the financial market divisions are being reorganized so that one of their focal areas will be SME finance. This could serve as a model for mainstreaming the SME Program, perhaps in the form of funds earmarked for global environmental or SME investments. Even if additional GEF or other concessional funds are still needed, they could be distributed to the regional departments or the financial market divisions and earmarked for small and medium global environmental projects or global environmental projects generally. The Evaluation Team did not explore the viability of this approach in detail, but it would likely require a concerted effort to disseminate the results of the SME Program and to harmonize GEF financing procedures with IFC's normal investment practices.

RECOMMENDATIONS

XXIII. PROGRAM LEVEL

Recommendations for Program Level Structure

Since its inception in 1995, the SME Program has been considered an experimental undertaking that would gather information and develop best practices for environmentally friendly, commercially sustainable, SME sub-Project development. The SME Program has been successful in demonstrating that multilateral funds can be channeled to promote commercially viable SME activity that will also generate global environmental benefits. The outlook is good for the remainder of the Program and the Evaluation Team expects additional successes with the remainder of the GEF funds under the next replenishment.

The success of the program to date is due to the following characteristics:

1. Careful selection of Intermediaries based on strong relationships developed over time, combined with clearly defined commercial requirements from participants (financial viability, sound business practices);
2. Good preparation of Intermediaries to meet their performance obligations (e.g. careful explanation of obligations and planning to meet them);
3. Good monitoring of Intermediary progress in identifying, preparing and financing projects; and
4. Flexibility of the SME Program Management in ensuring Intermediaries meet their Program requirements, without sacrificing Program objectives.

Based on the general success of the Pilot Phase and ongoing progress of SME2, the SME Program can now pursue a more aggressive risk/return approach by introducing measures to identify and incite more commercially viable Intermediaries and SMEs. The goals of this more commercially-oriented approach are threefold: (1) a greater likelihood of sustainability at the Intermediary and SME level over time; (2) a more conventional use of funds to bring projects nearer to mainstream financing more quickly; and (3) more secure realization of GEF benefits over time.[11]

[11] Although the third objective is difficult to quantify, it is the opinion of the Evaluation Team that more projects overcoming more barriers according to GEF Operational Programs, and ultimately demonstrating more measurable global biodiversity and climate change benefits.

The following recommendations are related to the commercial sustainability of Intermediary and SME investments.

- Pursue more sub-Projects (through Intermediaries) with a higher IRR at a rate closer to commercial rates, while retaining flexibility to go well below that rate if the GEF or other benefits are deemed particularly valuable.
- Reduce the portion of principal debt forgiven as an incremental risk incentive, establish a range for the amount forgiven and relate it more closely to the incremental risks that Intermediaries take on through their project-level investments, and negotiate the debt forgiveness incentive with Intermediaries.
- Instead of a fixed 2.5% rate over 10 years, use local capital market references or other appropriate market references for setting the terms of loans from SME Program to Intermediaries. From that reference rate and term, lower the rate and/or relax the terms to introduce incentives to account for foreign exchange risk, SME risk, environmental characteristics and other risks as deemed appropriate by SME Program Management. As an illustration, assume the local market rate for a conventional project is 20% with 3-year maturity. In this environment, the SME Program may find cause for adjusting the rate downward by 5% for foreign exchange risk, 3% as an incentive for SME activity, and another 3% for the environmental benefit risk/incentive. The result is a rate of 9% for the Intermediary, which may be further supported by a more favorable maturity term. These figures are of course for illustration only and would need to be considered on a case-by-case basis.
- Continue pursuing a flexible approach to financing mechanisms that are suitable for the SME-level activity in question. For example, short-term working capital loans such as those provided to Conservation International would be appropriate for other types of SME activity. Wherever appropriate, this type of financing should be provided in combination with technical assistance to develop business management skills so that short-term credit facilities may be replicated by Intermediaries or solicited by SMEs from commercial sources.[12]

Please refer to Section 0 for a more detailed discussion of commercial criteria for selecting Intermediary and sub-Project level activity.

XXIV. RECOMMENDED NEXT STEPS ON "MAINSTREAMING"

Mainstreaming the SME Program at the IFC is understood here as increasing IFC co-financing of SME Program Intermediaries/sub-Projects and increasing the number of SME sub-Projects in the regular operations of the IFC. Other programs at IFC that support SMEs have received IFC financial support. They serve as models for

[12] The SME Symbio Impex project under the Intermediary CARESBAC Polska essentially learned the need for short-term lines of credit as part of its business development and is seeking them from Polish banks and clients now. This could be replicated with assistance of SME Program for other SME's via the respective Intermediaries.

mainstreaming the SME Program into a formal activity of the IFC. In the meantime, there is value in increasing cooperation and coordination between these programs and the SME Program.

Relevant Existing Programs at IFC
The IFC's regional Project Development Facilities (PDFs) and their associated financing divisions have synergies with the SME Program that could be cost-effectively exploited to advance the GEF'S goals. Please see Section XXII for a more detailed discussion of these programs. In addition, IFC's "Extending IFC's Reach" Program promotes private sector investments in countries or regions that have not previously attracted significant IFC or private investment. Extending the Reach is not targeted towards SMEs per se, but due to the smaller, higher risk markets in which the program operates, the investments end up supporting enterprises that from a global perspective would be considered small and medium-sized.

The IFC is working to mainstream its Reach Program. Rather than operating it as a separately budgeted, experimental program, each regional department in the IFC will receive additional funds that are earmarked for investments in the Reach Program's target countries.

Finally, each of the IFC's regional departments also contains a financial market division, which provides financing to financial intermediaries, such as leasing companies and commercial banks. The financial divisions also establish new financial intermediaries in the form of private equity funds. The funds have a country focus, a line-of-business focus, or a combination of the two, as in the case of the investments in India. Many of the regional departments' investments target SME intermediary institutions, and many of its equity funds target SMEs. The financial market divisions are currently being reorganized to focus on seven business fields, one of which will be small business finance.

Next Steps on Mainstreaming
Mainstreaming will take some effort on the part of SME Program Management, the IFC's Environmental Projects Unit. The most readily available avenues for mainstreaming are through the IFC's financial market divisions and IFC's other SME programs, even though they are limited to specific countries and sub-regions.

Given the fact that the SME Program's Intermediaries provide financing to projects at commercial or near-commercial terms, there is a need for closer coordination with the funds and perhaps co-financing on the sub-Project level. However, the need for commercial returns makes it more difficult for the funds to act as co-financiers with SME Program Intermediaries. The SME Program should explore new project opportunities with any Intermediaries that may soon qualify for mainstream co-financing. One example is the Intermediary/SME SELCO (SELCO is acting as the Intermediary to its own SME activity, thereby assuming greater risk of project performance). SELCO, a U.S. company, originally approached the Mekong Project Development Facility and the

Mekong Financing Line for commercial debt but was reportedly told that foreign companies could not qualify for assistance from the Mekong facilities.[13]

One of the most important aspects of the specialized funds is their heavy reliance on project preparation and business advisory services. In lieu of stipulating concessions in their financing terms, these services are targeted to improve the recipient's prospects for financial success. The SME Program's sub-Projects and Intermediaries could benefit from linking up with these business assistance programs, including the Mekong Project Development Facility, South Pacific Project Facility, Africa Project Development Facility, African Management Services Company and Enterprise Support Services for Africa. Such a linkage could help improve the prospects for financial sustainability of SME Program Intermediaries and sub-Projects, which in turn could help them qualify for regular IFC financing in the future.

IFC's special SME funds and services, particularly the "Extending IFC's Reach" Program, enjoy strong institutional support from IFC management. Coordinating and collaborating with these programs not only would help SME Program Intermediaries but could also benefit the overall Program by increasing its visibility and support from IFC management.

Mainstreaming the SME Program may ultimately require organizational changes. The Reach Program is an example of how that might occur. The Program is going to be integrated with each of the IFC's regional departments, which will receive extra funds earmarked for investments in the Reach Program's target countries. This could serve as a model for mainstreaming the SME Program, using its funds for environmental or SME development.

The financial market divisions of IFC are also being reorganized so that one of their focal areas will be SME finance. If any additional GEF or other concessional funds are needed, they could be distributed to the regional departments or the financial market divisions and earmarked for global environmental projects or SME development. The Evaluation Team did not explore the viability of this approach in detail, but it would likely require a concerted effort to disseminate the results of the SME Program within IFC and to harmonize GEF-eligible, SME project financing procedures.

XXV. SUGGESTIONS FOR CONTINUATION OF THE SME PROGRAM

- Strong performers in the SME Program portfolio are already considered for mainstream IFC funding windows such as the REEF and the Terra Capital Fund. IFC should consider establishing a dedicated "SME Graduation Program" using IFC funds to place commercial debt and equity investments in SMEs that have been seeded in the IFC/GEF SME Program.

[13]Neville Williams, SELCO, personal communication, July 1999.

- Explore creation of a self-sustaining IFC fund modeled after the SME Program. The fund would cover costs of administration and management with the difference in cost of funds provided by IFC at the rates provided to Intermediaries. This interest rate "spread" would be based on below-market or below-cost-of-funds loans from the IFC to the SME fund; and on-lending to Intermediaries would still be concessional, but at higher rates than under the current SME Program (2.5%). GEF funds would play a significant role, but would not be lent directly to Intermediaries as they are under the current SME Program. Rather, GEF funds could be used to pursue specific environmental objectives (incremental cost and incremental risk mitigation) through intervention at the level of Intermediary-to-Project lending.[14]
- Issue a competitive solicitation for a targeted technology, region or country. The objective would be to generate an additional tier of potential Intermediaries based on the responses. The solicitation should be used as a tool to identify medium-sized potential Intermediaries with an ability to invest in sub-Projects with capital costs in the range of US$5-50 million. Larger "medium-sized" Intermediaries will be better equipped to use a broader range of financial mechanisms for financing SME sub-Projects (i.e. leasing, guarantees) and thereby achieve GEF benefits of a higher magnitude and scope. More administrative costs and/or outside consulting fees will be incurred by implementing this recommendation.
- Look to the SME Program portfolio for projects that may be eligible for further assistance in monitoring or expanding their activity to increase GEF related benefits (i.e., funds to overcome barriers to replicating project activity or disseminating lessons learned). GEF may be able to play a greater institutional role in garnering host government support for environmentally–friendly SME activity by communicating the benefits and results of SME Program directly to senior government counterparts.
- Publish Intermediary and SME summaries and make more information on the SME Program available on Internet.

Other Suggestions Regarding Administration and Procedure

- Use technical assistance funds or monitoring fees to document positive environmental benefits as part of the incremental costs of SME activity. Technical assistance may be an appropriate means of introducing biodiversity indicators that are now under development at the GEF.[15] This would be a useful tool for capturing the environmental benefits of project level activity as revenue streams (e.g. Certified Emission Reduction's as established under the CDM of the Kyoto Protocol, that justify a price premium for SMEs in those Operational Program areas).

[14] As of August 1999, this concept was introduced by and was being discussed among IFC/SME Program management.

[15] See "GEF Development of Program Indicators for the Biodiversity Programs"; Task 3 – Framework of Project-Level Objectives, DRAFT, February1999.

- Require Intermediaries to develop an outreach program that will identify and prepare SMEs/sub-Projects for financing;

If funds are available, make greater use of investment officers or consultants to identify and prepare more Intermediaries/sub-Projects in underrepresented sectors or regions. Additional staff time, based on available resources, for project identification and selection would increase the quality and number of projects.

FIELD VISITS & DESK STUDY REPORTS

The Intermediaries el Sewedy, CARESBAC Polska, and FUNDECOR were chosen for site visits because they have been in the Program for longer periods than the other Intermediaries and because as a group, they represent a good distribution of type, ownership structure, management, and other characteristics. The field visits enabled the Evaluators to see first-hand how IFC funds are being used at the sub-Project and Intermediary level. The Team paid special attention to those attributes of the Intermediary that could not be evaluated by reviewing paper work. The Team was able to get better insights into the functioning of each Intermediary and often was given information more candidly than through formal reporting.

The Intermediaries that were not visited were reviewed as desk studies. The information used to evaluate these Intermediaries came from the IFC/SME project files, interviews with key personnel at the Intermediary and IFC, and other sources familiar with the projects. The Team tried to use the interviews to gather information that was not available in the files and to include anecdotal evidence of the Program's workings.

The sub-Projects below have been ranked according to GEF benefits and commercial viability, similar to the rankings for Intermediaries provided in Section 0. The categories for GEF benefits are as follows.

Positive:	likely to meet GEF/OP objectives
Neutral plus:	too early to judge but likely to meet GEF/OP objectives
Neutral:	too early to judge likelihood of meeting GEF/OP objectives
Neutral minus:	too early to make final determination, but concerns about meeting objectives
Negative:	not likely to meet GEF/OP objectives

Commercial ranking categories have been provided for this exercise, as follows.

Positive:	able to service principal and interest payments
Neutral plus:	too early to judge but likely to meet debt-servicing requirements
Neutral:	too early to judge ability to meet debt-servicing requirements
Neutral minus:	too early to judge but unlikely to meet debt-servicing requirements
Negative:	not likely to be able to meet debt-servicing requirements and losses likely

XXVI. CARESBAC POLSKA S.A. (FIELD VISIT)

Among the spectrum of the IFC/SME Programs Intermediaries, CARESBAC Polska S.A. (CARE Small Business Assistance Corporation) is a conventional financial institution operating on a commercial basis. CARESBAC was created to provide commercial debt and equity to small business enterprises in Poland, so the overall likelihood of commercial sustainability of IFC/SME Program funds invested by CARESBAC is good. Almost all of CARESBAC's funds are invested and performing, indicating a well-managed operation overall. However, CARESBAC's performance record in its use of the SME Program funds has not been consistent with this overall expectation. Of the five loans awarded, two have proven problematic, one having failed and another is under restructuring and threatens to fail as well.

CARESBAC has been operating in Poland since 1991 and signed its loan agreement with the IFC/SME Program in April 1996. CARESBAC only invests in small- and medium-sized enterprises. The Polish government defines an SME as a business with up to 250 employees, but does not set a criterion for sales volume. For its own purposes, CARESBAC also defines an SME as an enterprise with a maximum of 250 employees and maximum annual revenues of US$10 million. In practice, CARESBAC's criteria for support is whether the SME can acquire 25% to 49% of the total equity with an investment of US$50,000 to US$500,000. These parameters were decided on in coordination with USAID and the European Bank for Reconstruction and Development (EBRD), two of three original investors in CARESBAC. In addition, the fund may only invest in majority Polish-owned enterprises. There are exceptions to the 49% maximum ownership rule, such as Symbio Impex, an organic farming company of which CARESBAC now owns 70%.[16] According to CARESBAC's covenant with the IFC/SME Program, no investment of IFC/SME funds may exceed US$180,000 per project.

CARESBAC has US$16.1 million under management, broken out as follows.

USAID	US$9.5 million
EBRD	US$5.0 million
Ford Foundation	US$1.0 million
IFC/SME Program	US$0.6 million

CARESBAC was approved in April 1996 for a loan of US$600,000 at 2.5% interest and a 10-year maturity from the IFC/SME Program during the Pilot Phase. CARESBAC received US$300,000 in July 1996 and another US$300,000 was approved in July 1997 and disbursed in March 1998. At the time of writing, CARESBAC has disbursed a total of US$14.5 million from its available funds to SMEs in Poland, including all but US$100,000 of the IFC/SME Program loan. The remainder of the US$1.1 million in undisbursed funds consists of the Ford Foundation grant listed above.

[16] CARESBAC has latitude to make exceptions to the guidelines based on its management's opinion. In the case of Symbio, the company was in need of working capital cash flow, which CARESBAC felt comfortable providing in return for majority ownership. Personal communication with Steve Sperelakis, Director, CARESBAC, July 12, 1999.

CARESBAC has invested IFC/SME funds in five projects:

1. Agroplon – sustainable agriculture: US$135,000
2. Jukan – manufacturer of energy efficient windows [Jukan is currently facing liquidation proceedings and CARESBAC's equity investment and part of debt financing are a loss.]: US$150,000, with US$100,000 retrieved before liquidation
3. Triada – switch from coal-based to gas-fired heating system: US$17,500
4. Symbio Impex Polska – sustainable agriculture: US$180,000
5. Polkat – wood briquette manufacturing: US$50,000 [and additional US$70,000 in technical assistance]

The total invested funds are therefore US$532,500.00, with the balance US$67,500.00 comprised of completion and monitoring fees. The fees collected by CARESBAC thus constitute some 11% of total funds from the program.

The Agroplon SME sub-Project

Agroplon is a cattle farm of 1,100 hectares owned by International Farm Resources LLC, CARESBAC, and several individuals. CARESBAC has a US$500,000 equity stake in the project, constituting an ownership share of about 25% of the US$1.9 million project. The project is financed on an approximate 52/48 equity-to-debt ratio. The equity breaks down into three largely equal shareholders and one minority investor. The three main equity owners are CARESBAC, International Farm Resources LLC, and Mr. Ludwik F. Zon.

Agroplon's debt is broken out among a commercial bank loan, a line of credit, shareholder loans, and the IFC/SME Program loan. Of the total financing, the IFC/SME Program loan constitutes some 7-8%.

The IFC/SME Program loan to Agroplon is for US$135,000 and covers four measures: (1) hedge planting, (2) tree planting, (3) water system management improvements, and (4) flax cubing to generate fuel for hot water and heat. The first three measures have been submitted as biodiversity activities (GEF OPs 1-4) and the third is climate change (OPs 5-7). The IRR for the project before the IFC/SME loan was estimated at 21%, and after the loan 24%.

As of July 1999, tasks (1) and (2) were completed and (3) was close to completion. Task (4), however, was sidetracked when severe flooding nearly wiped out the livestock and derailed the farm's growth plan. The financing problems that ensued led the farm's management to use the remaining SME Program funds to purchase new livestock and continue operations, unfortunately constituting a potential violation of the loan covenant regarding the use of IFC/SME funds.

CARESBAC has been closely monitoring the situation and is working with Agroplon to restructure in such a way that keeps the flax cubing project within financial viability. At this time, CARESBAC is seeking an outside strategic investor and is pursuing vertical integration of the cattle farm with a beef processor in which CARESBAC also has an equity position. The Polish beef processor's key customers include TGI Fridays and Burger King, two U.S franchises with significant operations in Poland. Burger King of Poland has stated it will only buy Polish beef. The financial problems now facing Agroplon appear to be the result of two circumstances: (1) flooding and (2) an underestimation of the start-up and working capital requirements of an agricultural enterprise of its type and scope. The current difficulties are not insurmountable, though it will require significant effort on the part of CARESBAC's managers. Given CARESBAC's stake in both the farm and the beef processing plant, all parties appear to be sharing the risk of performance appropriately as the project goes forward.[17]

Ranking According to GEF Objectives:

The first three measures of the Agroplon project appear to be relevant to Operational Programs 3 (Forest Ecosystems) on biodiversity and the fourth, flax cubing, to Operational Program 6 (Removal of Barriers and Implementation Costs to Renewable Energy) on climate change. According to an October 28, 1998 memorandum, the IFC/SME Program Managers have decided to not to approve any loan forgiveness for Agroplon because the flax cubing project has not moved forward and it is the only measure with clear GEF benefits. Although there are immediate and general environmental benefits to tree and hedge planting and sound water/irrigation management, the Agroplon project does not appear to have strong GEF-relevant biodiversity benefits through the first three measures. Tree and hedge planting alone does create a carbon sequestration benefit, but there is no delineation of GEF biodiversity goals, such as conservation or *in-situ* protection, nor sustainable use of forest products with beneficial local impacts. There is also no record of a national park or other conservation land contiguous to the farm and therefore no provision of buffer zone preservation benefits.

Agroplon's ranking in terms of GEF objectives is "Neutral minus." The project design did not have clear biodiversity benefits according to an ecosystem approach as laid out in the GEF objectives regarding OP No. 3. Further, the success of the flax cubing project remains in question given the Agroplon's financial strain. A more detailed price/cost analysis of the farm's fuel and energy use has not been completed, so the economic utility of flax cubing and burning remains uncertain.

Ranking according to commercial viability

Agroplon's ranking in terms of commercial sustainability is "Neutral." The farm has faced a significant setback from the loss of head from flooding beyond its control. However, the overall market for beef in Poland is strong. The CARESBAC plan of

[17] Personal communication with Steve Sperelakis, Director, CARESBAC, July 12, 1999.

integrating Agroplon with the beef processing plant is a sound approach and the beef processing plant now has strong customers in U.S. franchise restaurants, among others. Therefore, though financial performance has not been good to date, it is still too early to tell if the project will become sustainable on a fully commercial basis.

The GEF focal point for Poland is one of the focal points that approved a blanket waiver for CARESBAC lending activity.

As a relatively small scale, private agricultural enterprise, there are few significantly harmful social or environmental effects of Agroplon's operations. The project has been rated as Environmental Category B by the IFC, whereby impacts are site-specific and few (if any) are irreversible. In most cases, mitigation measures can be designed for the project more readily than for projects that fall under Category A. Though the site was not visited for the purpose of this Evaluation, the project descriptions and documentation indicate that this is an accurate ranking of the project. Given the review process required by IFC and the attention paid to environmental issues by CARESBAC's management, the probability is low that CARESBAC's investments of IFC/SME Program funds will lead to significant negative environmental impact. In most cases, CARESBAC's investments should result in significant local benefits accompanying the recorded GEF-eligible benefits. In Agroplon's case, tree and hedge planting and water system improvements may not lead to verifiable GEF benefits according to OP No. 3, but those measures are mitigating the negative environmental impacts of cattle farming and grazing on the local environment.

Given the difficult economic and social restructuring which Poland has been undergoing for the last 10 years, Agroplon could make significant beneficial economic and social development impacts in the southwest region of Poland. To the extent that the farm can become commercially viable in the near- to medium-term, it will have a positive impact on employment in the area.

Leveraging

As noted above, the IFC/SME Program loan to CARESBAC constitutes about 7-8% of the total project financing, and about 16% of all debt financing. All of the equity financing was in place before the IFC/SME Program loan became available. The IFC/SME Program loan makes up proportionately about 26% of all non-individual or shareholder-sourced debt financing, although the CARESBAC terms of 5% interest over five years is below commercial rates in Poland. The IFC/SME Program loan is, therefore, a significant overall portion of the total project financing, particularly outside, institutional debt financing. On this basis, it is reasonable to assume that the leveraging effect of the IFC/SME Program loan was significant, but this has not been confirmed through discussions with other lenders.

The Jukan SME sub-Project

Jukan S.K. manufactures energy efficient, PCV windows. The Jukan project is currently in liquidation proceedings and is no longer actively on CARESBAC's IFC/SME Program project list. The project failed due to weaknesses in management. Jukan's manager broke a loan covenant, separate from the IFC/SME loan covenant, by not enabling direct debt service payments from sales revenues. CARESBAC committed US$150,000 of IFC/SME loan funds to the project and disbursed US$50,000 before the project failed, thereby recuperating US$100,000 of the committed funds.

The total cost of the Jukan project was approximately US$1.25 million. The IFC/SME Program loan of US$150,000 constituted 12% of the total project costs. The financing was a 41/59 percent equity-to-debt ratio. The owner-manger of the firm and CARESBAC were the only equity shareholders, providing 60% and 40% of the total equity portion, respectively. The debt participants in the project included the Polish Development Bank, the BGZ bank (regional development bank), CARESBAC and the IFC/SME Program funds.

The project IRR shifted from 22% before the IFC/SME Program's involvement to 24% after receiving the loan. In terms of leveraging, the 12% figure of total financing is probably less indicative of what might have resulted without the IFC/SME Program loan. The loan was for development of an extensive marketing and expansion plan, which would have enabled Jukan to overcome barriers to using energy efficient technology in Poland as well as to achieving commercial viability.

Conclusion

Jukan failed as an investment and therefore ranks as "negative" for both GEF benefits and commercial viability. The project offers important lessons as a failed activity in the IFC/SME Program pipeline. The SME Program does not carry the risk and associated costs of the Jukan failure – CARESBAC is still responsible for paying back the loan to the SME Program – so GEF funds are still intact. The failure is explained largely as a function of the risk of small enterprise development in Poland. The owner and manager of Jukan was unable to manage the administrative responsibilities of the firm and broke the covenant on the loan, a major debt holder. More due diligence may have alerted CARESBAC to the possibility of default, but beyond that assertion, the project displayed good fundamentals and was manufacturing with modern German equipment.

The Triada SME sub-Project

The Triada sub-Project is an example of a successful short-term activity financed by the GEF with complete recovery of funds. The project financed the replacement of a coal-fired furnace at a small printing facility with a gas-fired unit.

The terms of the loan were 6% at one-year maturity. The total amount of the loan was US$17,500.00. Sixty-percent of the financing was covered by savings from fuel efficiency and maintenance and operations. Bank financing at the time the GEF loan was awarded was 35%, with onerous collateral requirements for small businesses.

The carbon factor of coal versus gas in generating heat energy is very high. Therefore, while the actual reductions have not been quantified, there is every reason to be confident that the projected reductions were achieved. Ancillary benefits include reductions in harmful particulate, SO2 and NOx emissions on the site. The owners report that the lack of coal dust and ash has improved the quality of their product significantly, enabling them to gain new clients. The factory serves as a model for other small enterprises in the area.

The Symbio Impex SME sub-Project

Symbio Impex is an organic farming project that is in its second year of operation. The total project cost to date is approximately US$250,000, based on a valuation of in-kind equity presented by one of the project managers. In practice, the IFC/SME Program investment of US$180,000 made the project possible and it is unlikely that Symbio Impex would have been able to raise funding from other sources at such an early stage of development. Of the US$180,000 investment, US$20,000 is equity and US$160,000 is debt. The debt terms are 10% for 1.5 years, intended as a start-up loan to be paid off as soon as other commercial financing became available. However, it will be several years before Symbio Impex can repay the loan, so CARESBAC intends to relax the payment schedule to accommodate the company's slower that predicted growth in cash flow.[18]

In addition, CARESBAC is administering US$70,000 in technical assistance to help Symbio Impex become certified as a domestic organic farming entity . The main barrier in this regard is that three years of organic farming experience is required under European Union law for agriculture products to qualify as fully organic. The project must therefore operate under development for three years on limited cash-flow before it can capture the full benefit of the premium attached to organic berry production.

Symbio Impex currently has 150 small farms under contract to produce organic berries. Several buyers are entering into fixed price agreements for purchasing from Symbio in its second year of operation. This is an improvement over the first year of operation during which a major single buyer reneged on a "variable price, plus premium" contract. Symbio was able to sell the product, but at a much lower price than originally anticipated. In practice, wholesale buyers and sellers of berries are more comfortable with fixed price agreements that allow them to manage shifts in market prices through commodity and source diversification. Therefore, cash-flows should be more predictable in this second year of operation for Symbio Impex.

[18] Personal communication with Steve Sperelakis, Director, CARESBAC Polska, July 23, 1999.

Commercial Sustainability Ranking

Symbio Impex is several years away from full-scale operation and profitable operations. However, the prospects for success are still good. Symbio has begun to garner the interest of regional development banks (BGZ) and is negotiating lines of credit or other financing to assist with cash-flow demands during the growing and buying season. Currently, buyers are paying 50% upon delivery of products to warehouse/freezer stations and the remaining 50% upon sale in the market. This helps with short-term cash flow needs, as Symbio must otherwise front all of the costs of the berry purchase until the wholesalers deliver to the market. The banks that are engaged in discussions with Symbio would likely assist with its short-term cash-flow requirements.

On a macroeconomic level, the prospects for organic farming are also good. Growth in demand for organic products is strong. Poland's two million farmers are gradually adapting to new production methods as new markets for organic produce open up within the newly competitive market place. These factors all contribute to Symbio Impex's commercial sustainability ranking of "neutral".

Ranking According to GEF Objectives

The organic farms are in National Park "buffer zones" as defined by the Dutch biodiversity certification and research firm, IUCN. In this regard, they meet the conservation objective of OP No. 3. To the degree that they also displace the growth of consolidated and automated farming enterprises that use chemical fertilizers and other high-impact farming methods, the farms will have a generally positive effect from a biodiversity perspective. Thus, the ranking in terms of GEF objectives is "positive".

The Polkat SME sub-Project

THE POLKAT SP. (WHAT'S SP.?) HAS BEEN PRODUCING FIBER-BOARD WOOD PANELING AND FURNITURE PARTS SINCE 1992. THE MANUFACTURING PROCESS GENERATES WOOD CHIP WASTE THAT IS A POTENTIAL FUEL SOURCE FOR LOCAL COMMERCIAL AND RESIDENTIAL USE. THE PROJECT INVOLVES PURCHASING MACHINERY THAT CONVERTS THE WOOD CHIPS TO BRIQUETTES THAT CAN BE BURNED IN COAL FURNACES AT LOCAL FACTORIES AND RESIDENCES, DISPLACING COAL-FIRED ENERGY GENERATION. THE SME PROGRAM LOAN COVERED THE PURCHASE AND INSTALLATION OF THE EQUIPMENT, TRAINING FOR POLKAT STAFF, AND LOCAL MARKETING EFFORTS. ORIGINALLY, ALL OF THE BRIQUETTES PRODUCED WERE TO BE SOLD, BUT SOME ARE BEING USED IN THE FIBER BOARD MANUFACTURING. THE BRIQUETTES USED WOULD DISPLACE COAL-FIRED ENERGY GENERATION.

The loan amount is US$50,000 at 10% per year for a four-year term. Based on assumptions about the price and volume sale of briquettes, the IRR on the sub-Project is 19%. The CARESBAC loan makes up about 2% of the total project financing, and

CARESBAC has both an equity and debt investment in the sub-Project, totaling about 25% of the total financing. Of the US$50,000 loan, US$20,000 pays for machinery, US$10,000 for installation, US$10,000 for staff training, and US$10,000 for marketing. Polkat has requested additional financing for installation of a second machine.

Ranking by Commercial Sustainability

Polkat has not yet shown a profit, but should break even this year, according to CARESBAC. The firm is well-managed with new machinery and equipment and sells a high quality product to Western European buyers. A direct risk of the project is that local demand for the briquettes may not take hold. Indirect risks include, the firm's ability to maintain cash-flow and the availability of affordable input from suppliers (changes in weather can significantly affect supply availability and price). Given the favorable outlook for the firm and the strength of its operations, the commercial rating is "neutral plus", despite its not yet being profitable.

Ranking According to GEF Objectives

The climate change benefits of the sub-Project are twofold: (1) elimination of methane and CO_2 from natural decomposition of the unused wood chips (2) displacing coal-fired heating in the area with wood chip-fired, which comes from a renewable resource. If the timber supply to the Polkat factory is harvested according to sustainable forestry practices, then the use of the briquettes may represent a "closed loop" renewable fuel supply that is displacing fossil fuels. The Evaluation Team did not investigate the practices of Polkat's suppliers.

Polkat address GEF Operational Program No.5. "Removal of Barriers to Energy Efficiency and Energy Conservation", in particular "inter-fuel substitution" of coal contained in OP 5.7 and 5.6 on market barriers. If the timber supplied to the process is in fact harvested sustainably, then the project would also be eligible under OP #6, "Promoting the Adoption of Renewable Energy by Removing Barriers and Removing Implementation Costs." Eligibility under OP6 would have to be confirmed through investigation of Polkat's suppliers. Based on this review, the GEF ranking of Polkat is "neutral plus".

XXVII. ZAKI EL-SEWEDY (FIELD VISIT AND DESK STUDY)

Summary of the sub-Project Activity

The SME Intermediary Zaki el-Sewedy and Co. is an electrical supplies manufacturer and distributor based in Cairo, Egypt. The company has been in business for 50 years, and now has 160 employees with an annual turnover of about £E 70-75 million (about

US$22 million). The company, along with two others controlled by Zaki el-Sewedy, is largely run by Zaki's two sons. The two sister companies are:

- ElectroMeter, with 150 employees and turnover of £E 20 million (US$5.8 million), specializing in electric meters for distribution companies; and
- El-Sewedy SI, with 45 employees and £E 2.5 million in sales (about US$750,000), specializing in electrical panels, and performing projects for Zaki el-Sewedy Co.

The el-Sewedy family also has an interest in Arab Cables, based in 10th of Ramadan City outside Cairo, which has 1,000 employees and an annual turnover of about US$100 million. The company sells to the Egyptian Electricity Authority (EEA), and seven distribution companies (until recently, they were separate from EEA, but are now subsidiaries), and exports to other utilities and electric companies throughout the Middle East, especially the Persian Gulf.

Zaki el-Sewedy used the US$500,000 loan from the SME Program to provide vendor financing for the CFLs that it normally sells, thereby enabling it to execute a series of energy efficiency projects at hotels, stores, and educational and government buildings. Funds were disbursed in two tranches of US$250,000, the second of which was disbursed only when the total amount of first tranche had been used up.

Funds from the first tranche, which was disbursed in 1997, helped finance 21 lighting projects at hotels (including facilities operated by Hilton, Marriott and Mövenpick). The clients were hotel management companies, not the owners, which are usually local investors and/or banks. Funds from the second tranche, disbursed in in 1998, helped finance 10 projects in shops, department stores, the American University in Cairo (AUC), and the Ministry of Foreign Affairs, among others. (See Table 13 for a detailed listing of the projects.) Another three projects were approved during the first quarter of 1999.

The repayment record for the 31 loans has been good, with all but three of the loans from 1997 completely paid off, and with delayed payment in only about 20% of the total financing provided. In an interview, Emad el-Sewedy said that his brother had handled the client evaluation work, but he noted that the company offers financing only to companies that they trust, since there is very little protection afforded to suppliers whose customers don't pay. These tended to be larger or more well-known companies, such as the hotel management companies.

Under the agreement with the IFC, Zaki el-Sewedy would pay IFC 4% interest on the unused portion of the funds allocated to the project, or 2.5% on the portion of funds that were allocated. The company, in turn, charged customers an extra 4% of the sale for the financing, whereby it received a margin on the value of the sale equivalent to 1.5%. The term of the IFC financing is six years, with all disbursements to be made in two to three years. If the entire loan were disbursed, el-Sewedy would be liable for only 50% of the total loan amount, after deducting a completion fee of 6% of the total financing disbursed.

The 50% loan write-down extended to Zaki el-Sewedy would help the company absorb any financing risks during the life of the loan. In addition to the collection risk, the risk of currency fluctuations would also be covered in this way. The collection risks were certainly real, and were controlled by el-Sewedy through careful client selection. However, it is less clear how much of a risk currency fluctuations really posed. Since 1995, the official rate for the Egyptian pound has changed very little, from £E3.39/USD to £E 3.4005/USD. While the actual exchange rate faced by a company such as el-Sewedy may be different depending on market conditions, anecdotal evidence suggests that the black market premium was not all that large, nor prone to wild fluctuations during the period covered by the loans. This observation does come after the fact of course, and certainly the risk of exchange rate volatility was very real during the difficult weeks and months after the Luxor killings.

Success in Meeting GEF OP Objectives

Given the assessment presented here, the Zaki el-Sewedy loan merits ranking in the "positive" category with respect to achieving the GEF OP objective No. 6, the removal of price barriers for energy efficency technology.

The successful implementation of the el-Sewedy's energy efficiency projects suggests that the environmental objectives set by the SME Program for this project were achieved. An evaluation of a hotel project in Sinai, performed by Bechtel Consulting with USAID funds, confirmed that these projects would generate environmental benefits by reducing electricity consumption in areas served primarily by fossil-fired generation stations.

Egypt's electric power system has installed generation capacity of about 13,300 MW, of which only 2,805 MW or 21% is provided by hydroelectric facilities in the south, most notably the Aswan High Dam (2,000 MW). Thermal capacity provides the balance, and over the last decade the share of thermal capacity provided by natural gas-fired generation stations has increased steadily. The breakdown of total generation between hydro and thermal power is identical to that of capacity, indicating that Egypt relies on thermal capacity for a large share of its baseload requirements, especially in winter given the downturn in hydro availability at the Nile dams and barrages. At present, natural gas provides almost 70% of total energy consumed by the thermal stations, which are located primarily in the northern and central regions of the country. Future plans call for an almost two-fold expansion of generation capacity to meet demand growth, with natural gas-fired facilities providing the bulk of the new power. Some renewable capacity is contemplated, including wind power along the Red Sea coast. Egypt and Jordan recently completed an interconnection that crosses Sinai and the Gulf of Aqaba. Virtually all generation capacity in Jordan is thermal.

Given rapid demand growth and the heavy reliance on thermal generation stations, there is little doubt that reductions in demand and consumption provide tangible environmental benefits in regions not served by hydropower. This reflects the fact that, with one exception, the el-Sewedy projects have been executed in regions of the country served by thermal generation stations for baseload and peaking requirements, or at minimum, peaking requirements.

Although hydropower is an important part of the electricity supply for Cairo, it seems very likely that thermal capacity is needed to meet peak load requirements during the evening. Although working hours at ministries and universities are skewed towards daylight hours (government offices are generally deserted after 3 PM), it is likely that lights are used anyway. Even if an adjustment is made to reflect reduced emissions savings from theese projects, the overall impact on environmental benefits from the el-Sewedy project portfolio is minimal (less than 1%).

Based on these observations, EIC has prepared a preliminary estimate of the carbon emissions reductions attributable to the el-Sewedy projects, based on energy savings data provided in el-Sewedy's project reports, and summary information on fuel consumption and electricity generation from the Egyptian Electricity Authority (EEA). These data indicate that the projects are generating savings of almost 109 tons of carbon per month, yielding a cumulative emissions reduction of approximately 1,376 tons of carbon through June 30, 1999. (See Table 12.)

This estimate is conservative, given several limitations in the data used, including incomplete information on the dates when the projects became operational, and details on the operation of the Egyptian national electricity grid. For the purposes of this analysis, it is assumed that: (1) only isolated generation stations are available to serve the resorts on the Red Sea coast where some of the hotel projects were undertaken (Hurghada); (2) all projects that received funding in 1997 became operational on January 1, 1999; and (3) all installations financed in 1998 became operational on January 1, 1999. Data from three projects approved in the first quarter of 1999 were not available, and hence the savings generated by them are not included in this evaluation.

Table 12: Estimate of Carbon Emissions Reductions from el-Sewedy sub-Projects

Generation Region	Number Projects	Energy Savings (kWH/Month)	Share of Total Energy Savings (%)	Carbon Emissions Factor (Tons/MWH)	Emissions Reductions (Tons/Month)
Cairo	18	274,736	59.15%	0.18	48.36
Canal	5	44,798	9.64%	0.16	7.28
Canal (Red Sea)	7	143,791	30.96%	0.37	53.05
South Upper Egypt	1	1,176	0.25%	0.00	0.00
Totals	31	**464,501**			**108.69**

Estimate of Cumulative Carbon Emissions Reductions from Projects
As of June 30, 1999

Region	Effective Date	Months in Operation	Cumulative Reductions
Canal	Jan-98	18	131.06
Canal (Red Sea)	Jan-98	18	954.85
South Upper Egypt	Jan-98	18	0.00
Cairo	Jan-99	6	290.18
Total			1,376.08

Ranking by Commercial Sustainability

Given the client's good track record of repaying Zaki el-Sewedy, the applicable Intermediary credit rating should be "positive".

El-Sewedy's clients enjoyed very favorable repayment periods and internal rates of return, suggesting that they would be commercially viable, regardless of the fact that they obtained credit from local financial institutions. Once the difficulty of obtaining credit in Egypt is considered, however, the viability of the projects taken by themselves is diminished. Without access to credit, the clients would probably downgrade the urgency of investing in efficient lightingin favor of other, higher-return investments using scarce resources. At the same time, el-Sewedy noted that the risk involved in offering vendor financing was substantial, making it unlikely that they would offer financing using internal resources exclusively.

Since only banks are authorized to make loans in Egypt, and banks have not and are not expected to provide credit for energy efficiency projects, Zaki el-Sewedy used the SME loan to provide vendor financing. El-Sewedy required the client to provide it (or one of the other group companies) with four postdated checks, which would then be collected over the financing period (one year). El-Sewedy applied the IFC funds only to the second through the fourth payments, absorbing the financing cost implicit in giving customers credit equivalent to the first payment. Clients received the vendor financing at 4% interest annually over one year.

The 4% interest rate over a year is unlikely to have been a substantial deterrent to clients during the SME Program. It remains to be seen, however, whether customers will be willing to pay higher interest rates for a commercial line of credit for vendor financinng arrangements provided by Zaki el-Sewedy in the future if the company is granted a straight commercial line of credit by the IFC. .

Leverage

El-Sewedy provided the first three months payment for the vendor financing it provided (the first 25%), and used the SME funds to cover the 75% of the project cost financed. The project reports submitted to the IFC by el-Sewedy indicate that the total amount financed by el-Sewedy was 133% of the total SME financing provided (US$495,200), confirming a 3:1 leverage ratio.

Assessment of Public Participation

There does not appear to have been any public participation in the development or implementation of the el-Sewedy projects.

Sustainability of sub-Project Level Activity

The sustainability of the project activity has been questioned in some quarters, due to a perception that el-Sewedy obtained a substantial subsidy. One observer familiar with the Egyptian market for energy efficiency products and services commented that after the project is over and the loans repaid, little remains in the country to help sustain the provision of goods and services. This observer seemed to be suggesting that the clients would regard their energy efficiency upgrades under the program as a windfall and would not seek similar arrangements from el-Sewedy or other vendors. This may be true, but the energy efficiency measures at the customer level were paid for on a commercial basis, so basic demand was not distorted. If the concessions which el-Sewedy's received from the SME Program were directly passed on to the customer, the risk that no activity will be replicated would be higher.

Given el-Sewedy's success in generating projects that repaid the SME loans quickly, it seems likely that new financing offered by the IFC under straight commercial terms could be placed successfully by the company, with good prospects for the sustantainability of the vendor-financed sales of efficient lighting. Emad el-Sewedy did report that he had discussed the possibility of "graduating" from SME and obtaining credits from the IFC on straight commercial terms. According to Doug Salloum, the biggest obstacle to ensuring that Zaki el-Sewedy does indeed graduate to commercial IFC financing has been a lack of follow-through on the part of the in-country IFC staff.

Project Level Impact in Development Context

It is not clear yet whether the project has had a significant or lasting impact in the Egyptian market. It did demonstrate, of course, that the vendor financing model could be made to work in Egypt in principle, but it did not provide information that would allow the SME Program or el-Sewedy to gauge the highest interest rate that the market would bear for this sort of financing. In the future, if el-Sewedy takes on IFC credits on commercial terms, it will have to raise the financing charge on its sales, thus, more information will be obtained as to the market's ability to bear higher rates.

Assessment of Financing Effectiveness

There seems to be little question that the SME financing enabled el-Sewedy to close numerous sales successfully. Whether or not the financing provided helped stimulate the market for energy efficiency services and create sustainable demand for them, is another question. Some observers of the Egyptian energy efficiency market have argued that the program has not really "left anything" in Egypt. However, the Zaki e-Sewedy experience seems to indicate that with the right financing package – on commercial terms – providers of energy efficiency services and equipment could make a substantial impact in certain sectors of the Egyptian economy. The major limitation to broader impact in this sector – concerns about the creditworthiness of Egypt's vast population of smaller businesses – is shared by numerous other providers of goods and services. This is a pervasive, structural problem in the country's economy, and is not particular to the energy efficiency market.

Ability to Identify and Target Prospective sub-Projects

El-Sewedy has demonstrated that it is capable of generating a steady flow of projects for SME Program financing, even under adverse conditions. Initially, el-Sewedy targeted hotels in Egypt's tourist destinations. After the tourist killings in Luxor in November, 1997, Egypt saw a sharp drop in tourist business, and hotels began avoiding any non-essential investments; el-Sewedy redirected marketing from hotels and still generated demand for US$220,000 in SME Program financing.

Lessons Learned and Best Practices

In retrospect, the SME Program was a tremendous money-maker for el-Sewedy, given the relatively good repayment record that the company achieved with the vendor financing arrangements they offered. The rapid repayment of the outstanding invoices permitted el-Sewedy to repay its loan ahead of schedule, thereby enabling it to avoid servicing the loan while still collecting outstanding invoices and incurring financing costs without any collecting additional revenue from reissuing vendor financing with the proceeds of the earlier sales. Even in this situation, the loan represented an very attractive deal for el-Sewedy.

It seems, however, that tighter conditions would have been entirely sustainable for el-Sewedy and beneficial to the SME Program. Among other approaches, the SME

Program might have considered requiring el-Sewedy to reuse the reflows for further financing, thereby generating more continued financing in the sector.

Table 13: Projects Executed and Financed by Zaki el-Sewedy, 1997-1999.

Client	Number	Region*	Savings kWH/month	New installation Consumption kWh/month	New installation Cost USD/month	Quantity lamps	Investment (USD)	Existing installation Consumption kWh/month	Existing installation Cost** USD/month	Savings (USD/month)
Arabia Beach Resort (Hurghada)	97-1	Canal RS	41,878	11,652	$ 719.68	3950	$ 42,036.76	53,530	$ 3,971.44	$ 3,251.75
Giftoun Beach Resort (Hurghada)	97-2	Canal RS	34,128	9,312	$ 575.15	3050	$ 32,477.94	43,440	$ 3,182.16	$ 2,607.01
Kanzy Hotel (Giza)	97-3	Cairo	6,216	1,406	$ 86.85	445	$ 5,558.53	7,622	$ 560.51	$ 473.66
Bell Air Resort (Hurghada)	97-4	Canal RS	19,056	5,184	$ 320.19	1700	$ 18,227.94	24,240	$ 1,771.84	$ 1,451.65
Palmera Beach Resort (Hurghada)	97-5	Canal RS	27,744	7,536	$ 465.46	2450	$ 26,139.71	35,280	$ 2,576.77	$ 2,111.31
Fayrouz Hilton Resort (Sharm el-Sheikh)	97-6	Canal	12,157	3,529	$ 217.99	1634	$ 23,123.02	15,686	$ 1,183.87	$ 965.87
Hilton Residence Resort (Sharm el-Sheikh)	97-7	Canal	5,758	1,698	$ 104.86	711	$ 9,753.57	7,456	$ 558.98	$ 454.12
Hurghada Hilton Resort (Hurghada)	97-8	Canal RS	9,873	2,866	$ 177.04	1327	$ 13,330.50	12,739	$ 961.44	$ 784.40
Marriot Resort (Sharm el-Sheikh)	97-9	Canal	13,766	2,602	$ 222.50	1370	$ 13,762.46	16,368	$ 1,220.61	$ 998.11
Mövenpick Elgouna Resort (Hurghada)	97-10	Canal RS	5,880	1,320	$ 81.53	500	$ 6,114.71	7,200	$ 532.43	$ 450.90
Mövenpick Airport Hotel (Cairo)	97-11	Cairo	3,720	1,080	$ 66.71	500	$ 6,842.65	4,800	$ 362.26	$ 295.55
Mövenpick Hotel (Cairo)	97-12	Cairo	7,818	2,248	$ 138.82	977	$ 14,433.51	10,066	$ 796.24	$ 657.42
Mövenpick Resort (Luxor)	97-13	SUE	1,176	264	$ 16.31	100	$ 1,561.76	1,440	$ 106.49	$ 90.18
Mövenpick Resort (Sharm el-Sheikh)	97-14	Canal	6,013	1,629	$ 100.64	721	$ 11,147.93	7,642	$ 601.76	$ 501.12
Nuweiba Hilton Resort (Sinai)	97-15	Canal	7,104	1,776	$ 109.69	740	$ 10,563.17	8,880	$ 662.07	$ 552.37
Safir Hotel (Cairo)	97-16	Cairo	2,369	655	$ 40.47	210	$ 2,109.57	3,024	$ 223.62	$ 183.15
Safir Hotel (Giza)	97-17	Cairo	7,727	2,137	$ 132.00	685	$ 6,881.23	9,864	$ 729.42	$ 597.42
Semiramis Intercontinental (Cairo)	97-18	Cairo	5,062	1,598	$ 98.72	370	$ 4,007.97	6,660	$ 484.38	$ 385.65
Sol Media Resort (Hurghada)	97-19	Canal RS	5,232	1,488	$ 91.91	600	$ 7,485.29	6,720	$ 503.22	$ 411.31
American University in Cairo	97-20	Cairo	7,680	1,920	$ 118.59	400	$ 4,705.88	9,600	$ 663.53	$ 544.94
Mövenpick El Gouna (El Gouna)	97-21	Cairo	3,072	528	$ 32.61	200	$ 2,470.59	3,600	$ 253.24	$ 220.62
AEDCO / Lighting Div.	98-1	Cairo	60,000	15,000	N/A	5000	$ 43,382.35	75,000	N/A	$ 2,892.00
Pyramisa Hotels & Resorts	98-2	Cairo	-	N/A	N/A	N/A	N/A	N/A	N/A	N/A
El Sewedy Light Division	98-3	Cairo	-	N/A	N/A	N/A	N/A	N/A	N/A	N/A
El Sewedy Light Division	98-4	Cairo	-	N/A	N/A	N/A	N/A	N/A	N/A	N/A
El Sewedy Light Division	98-5	Cairo	-	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Ministry of Foreign Affairs	98-6	Cairo	26,624	6,656	N/A	2100	$ 29,380.12	33,280	N/A	$ 1,634.81
El Sewedy Light Division	98-7	Cairo	21,949	6,472	$ 359.53	1427	$ 17,488.82	28,421	$ 1,578.93	$ 1,219.40
El Sewedy Light Division	98-8	Cairo	50,360	12,828	$ 712.67	2568	$ 32,514.44	63,188	$ 3,510.47	$ 2,797.80
El Sewedy Light Division	98-9	Cairo	54,715	11,914	$ 661.88	2637	$ 32,849.97	66,629	$ 3,146.07	$ 2,484.19
SEGA Energy & Environment Co.	98-10	Cairo	17,424	156,816	$ 8,712.00	6050	$ 19,900.00	174,240	$ 9,680.00	$ 968.00
( )	99-1	?								
( )	99-2	?								
( )	99-3	?								
Totals			464,501				$438,250.39			$29,984.71

* Location is by service territories of the seven regional generation and distribution regions. The seven include: Canal (encompasses all of Sinai and the Red Sea coast; Cairo (metropolitan Cairo); SUE (
In the case of the Canal region, this is subdivided into the Canal region proper, encompassing Sinai, and Canal Red Sea or Canal RS, encompassing the Red Sea coast, since this area is served by isolate
** Electricity plus replacement lamps.

XXVIII. FUNDECOR (FIELD VISIT)

Summary of Organization

The Foundation for the Development of the Central Volcanic Range's (FUNDECOR) mission is to promote the conservation and sustainable use of the Central Volcanic Range and its natural resources. It was created with a US$10.6 million trust funding from the Costa Rican Ministry of Environment and Energy (MINAE) and the United States International Development Agency (USAID) as a non-governmental service organization.

Advanced Wood Purchase sub-Project Review

This project gives plantation owners up-front funding in exchange for a percentage of their future harvest if they follow certain sustainable forest management techniques. In exchange for these harvest futures, owners get funds to perform the sustainable practices required under the program. FUNDECOR normally receives the rights to a maximum of 20% of the total harvest, leaving substantial reserves to be sold by the farmer on the open market.

FUNDECOR's management program involves careful identification of specific trees for harvesting in order to minimize damage to the forest. This change from free-growing techniques to plantation-style also enables a better quality harvest. FUNDECOR gives technical assistance to the plantation owner throughout the life of the timber, to insure that sustainable practices are used. The plantation owner is paid on a sliding scale, which is dependent on the age of the plantation (present value of the future payments is higher for older trees). The timber is required to meet strict quality standards, which on average are estimated to take 15 years to obtain. If the trees are not ready at this point, the plantation owner is required to add 5 % more timber each year that they do not deliver. This penalty could give the landowners an incentive to use non-sustainable methods in order to make the 15-year deadline. .

One of FUNDECOR's major contracts under this Program is Industria Agropecuarias. FUNDECOR paid US$75/ha for 100 hectares worth of harvestable forest. This land was first cut 25 years ago and was replanted with primarily Almond trees. The second cutting (which involved FUNDECOR's management techniques) was in 1997. Agropecuarias has already paid back its loan to FUNDECOR with interest.

Reforestation sub-Project Review

FUNDECOR has also established a reforestation program to help small and medium sized landowners reforest their land. They try to specifically target lands that have been cleared prior to 1992, to avoid actually supporting deforestation. Energia Global (a local hydrological company) is contributing US$10 per hectare per year, through the Costa Rica National Forestry Fund (FONAFIFO), to these landowners if they agree to use low-impact reforestation methods on their property. This investment represents approximately US$30,000 per year in payments. FONAFIFO then pays individual property owners US$40 per hectare (US$30 from the national government). The overall goal of this project is to sustain the forests and insure that the watershed is protected for use by a local hydroelectric operator. Unfortunately there are no funds left for this project, all funding is currently going to the other mature forest management programs.

Ranking by GEF Operational Program Objectives

The ranking of FUNDECOR in terms of GEF objectives is “Positive”. FUNDECOR projects promote Operational Program #3, the conservation and sustainable use of biological diversity, and the use of endemic species while not harming the area for future growth. These programs also contribute to the increased absorption of carbon dioxide, which is related to the GEF’s climate change objectives.

Numerous long-term environmental benefits could potentially arise from these programs. This project contributes to the protection and use of sustainable management practices in the buffer zone surrounding a unique biologically diverse area, The Central Volcanic Range Conservation Area, and its watershed. These contributions will likely lead to long-term educational improvements among the farmers in the region. The successful farmers in this program could potentially educate people in the surrounding regions about the usefulness and profitability of sustainable forestry management practices. Turning environmentally-sound forestry practices into financial returns (by labeling wood ‘green’ using the Qualifor Green Seal) will clearly have educational repercussions down the road.

Substantial risk remains, however, due to the fact the many of the wood-futures FUNDECOR receives do not come to maturity for many years (in some cases as long as 17 years). The landowners’ contracts allow them to sever the contract if they repay all advanced funds with 11% interest. Not only would this represent a decrease in future cash-flows from the sale of timber, but also the farmer could then abandon the sustainable forestry practices.

Ranking by Commercial Sustainability

The ranking of FUNDECOR in terms of commercial sustainability is “Positive” (likely to meet debt-servicing requirements). There is some uncertainty as to whether landowners will “opt-out” and pay back the loan before their contract is complete with FUNDECOR. This would represent a loss of capital to FUNDECOR. At present this has only happened once, so it is unlikely that this will occur under present conditions.

The return on harvested wood can be very profitable following the methods advised by FUNDECOR. Generic indigenous wood species sold at the local market can range in price from US$160-350/$m^3$, while “high-quality” wood can fetch prices of US$500-600/$m^3$. For most of these sub-Projects the internal rate of return before IFC financing is approximately 25% and 50% after financing. These are some of the best rates of return in the SME program (next to el-Sewedy). For many of the landowners, this represents long-term returns that could not have been possible under normal forestry methods.

Demand for up-front financing for reforestation programs is currently very high. This type of financing makes sustainable forestry practices possible for people who normally could only afford the most rudimentary management techniques.

FUNDECOR does not have experience with the financial structuring of long-term projects of this nature. However, this does not currently appear to be adversely effecting the program. They have been well advised by IFC staff and appear to have worked out any problems attributable to a lack of financial management skills. FUNDECOR also acts as the government's representative in the field of sustainable forestry in this region. FUNDECOR also benefits from a trust fund and from government incentives for landowners engaged in reforestation that prepare forest management plans, so it does not depend on revenues for day-to-day operations.

Leverage

In many cases, FUNDECOR's loans to landowners represent a large portion of the funds used to manage the land. Landowners also receive technical assistance that is paid for with the revenues from the harvest. These landowners would not be able to afford to manage their land without this up-front capital. FUNDECOR's contract with the IFC requires that they not buy more than 50% of the expected harvest.

Public Participation

FUNDECOR currently has agreements with landowners that control more then 25% (32,000 hectares) of the total forested area in the Central Volcanic Range Conservation Area. At present, over 80% of the possible participants have signed up for the program. This represents 60 landowners who have signed up for SME loans and another 412 under contract for technical assistance. This is due in part to the fact that landowners with small-scale forestry projects previously had little bargaining power when it came to negotiating price terms and removal methods. The advanced payment system also gives landowners the up-front capital that is needed to start new projects.

Another important incentive to participate in this Program is the formal recognition of land ownership. Most of the landowners in the Central Volcanic Range and surrounding areas have not legally registered the land in their name. FUNDECOR has developed procedures that allow these people to formalize their land ownership by taking part in the Program. These contracts are placed in the public register of land holdings. This added incentive has been taken advantage of widely.

Review public participation requirements

With most of FUNDECOR's work done at the individual landowner level, there are few significant harmful local environment or social effects. The sustainable forestry practices are designed to provide for the long-term prosperity of the forests and its owners. Given the technical assistance and the review process required by IFC, there is very low probability that the money invested by the IFC would be used in a manner that results in negative environmental impacts.

Assess sustainability of project level activity

Social Sustainability of the sub-Projects

The key for sustainability is keeping the economic incentive in place. The FONAFIFO governmental Program only goes for five years, after this period ends, there is little certainty that the positive economic/environmental benefits will remain sustainable. If, however, the projected revenues are realized, the landowners will have an incentive to continue the practices they began during the first growth and harvest periods. These sustainable harvest methods will likely have a positive economic and social impact on this part of Costa Rica. The optimal outcome is dependent on the landowners reinvesting some part of the IFC funds and their revenues from the harvest back into the next crop of trees.

Project Mainstreaming

Presently, no plans for mainstreaming have been made. Mainstreaming would have to occur at the Intermediary level of this project if it were to occur at all. The IFC could not give the project enough individual attention to manage it successfully; the projects are simply too small. Successfully mainstreaming FUNDECOR's activities into the normal lending section of the IFC is highly probable.

Assessment of project level impact in a development context

This project helps the rural farmers/landowners increase the sale value of their product and improve the overall sustainability of their harvesting process, earning them the Qualifor Green Seal of approval. This added value allows them to get better then average prices when it comes time to sell the harvest. If this increased value can be sustained, the local farmers/landowners can slowly move up the supply curve by offering better products, and ultimately improving their income and quality of life.

These sustainable management techniques offer a side benefit in addition to the sale of wood products. The population of Costa Rica currently depends on this area for 50% of its water supply and the National Park system does not control a majority of the watershed region, so independent private projects like this become very important to insure the continued quality of the watershed. This is one more reason for the continued cooperation of the landowners. The project also benefits Costa Rica as a whole. If landowners are not convinced that sustainable forestry practices are in their best interest, they may turn to traditional logging companies to harvest their property and the quality of the watershed could be diminished.

Assessment of the effectiveness of the project financing

This project appears to have opened up the market for sustainable forestry practices in this part of Costa Rica. Many of the landowners have no other method of financing available to them. They do not have any assets to use as collateral (except their landholdings, which normally have already been leveraged), which makes them ineligible for normal commercial loans. Due to the long-term nature of the forestry industry it is unlikely that those that do possess collateral could even get loans because of the long payback period. Also a lack of technical know-how has restricted the landowners from branching very far from traditional forestry methods.

FUNDECOR's method of loaning money in exchange for wood futures could cause some problems for them in the future. On average, FUNDECOR has to wait eight to twelve years before the timber is harvested. IF they had to wait this long to cash-in their futures they could have serious cash-flow problems, due to their funds being tied up in futures. The only way to get around this is to sell the futures on a secondary market, freeing up their assets and allowing them to finance projects in the future. However, the downside is that FUNDECOR would not get the full net future value of the wood future if they sell them early on a secondary market. If cash is needed, they may have no other alternative.

Identification of lessons learned and best practices from project activity

FUNDECOR's system of sustainable forest management is very good and could serve as a model to other Intermediaries. Specifically, other Intermediaries should take note of FUNDECOR's methods of document and data management, which is probably one of the best systems of tracking and organizing documentation and loan paperwork that has been seen. They currently have 60 clients, but have the infrastructure set up to handle a much larger load. Their system of tracking landowner loans and their use of a geographic database to manage timber resources represents a level of efficiency well above most programs of this nature. Tying the program to legal recognition of property ownership should also be mentioned as an impressive incentive mechanism for getting landowners to sign up for the program. FUNDECOR could be a successful model for other regions of the world where the international community wishes to promote sustainable forestry management techniques.

Assessment of deal flow

The project is currently only being implemented in the Central Volcanic Range Conservation Area, which means that they have a limited number of potential clients to work with. This should not impede FUNDECOR in meeting the GEF objectives, but could be a constraint to them when looking for new commercially viable landowners. It maybe necessary to recruit landowners that are less experienced with managing their land and could represent greater financial uncertainty. This could potentially be addressed by increasing technical assistance and monitoring.

FUNDECOR has undertaken the task of building a geographic database of all the landowners that are currently taking advantage of their services. Through this technology they will be able to easily pinpoint potential new clients by looking for regions that are not in the database. They can also locate landowners in close proximity to a current client to minimize the costs of transportation, monitoring, and road construction (when necessary).

Assessment of risk management procedures

As in any futures market, estimating the worth of forest products many years down the road can be difficult. The FUNDECOR team sees this risk as being one of their greatest concerns. FUNDECOR tries to minimize the risk of over- estimating the value of wood-futures (and promising to pay an amount greater then the real value) by initially only agreeing to pay 80% of the expected value. If, at the time of sale, they did not over estimate the value of their timber-rights FUNDECOR pays the remaining 20%.

Underestimating the future value of timber can also create risks. Landowners may begin to use the exit clause to get a better price for their harvest. Because of the relatively generous nature of this exit strategy, the landowners theoretically could wait until the year of harvest, take a loan from a traditional lending institution or entrepreneur (using the soon to be harvested timber as collateral), pay-off FUNDECOR, sell the harvest (including FUNDECOR's old share) at a larger-than-expected profit, and pay-off the second loan. If this is seen by the landowners and the outside lenders as a viable alternative, FUNDECOR could find itself in a difficult situation. Further, if FUNDECOR plans to sell their 'wood-rights' on a secondary market, the previous hypothetical situation could be a deal breaker for many potential buyers. We suggest that FUNDECOR address this issue before concluding further contracts.

The risk of defaulting on loans is believed to be minimal because a lien is placed on the landowner's property. Costa Rican law holds these liens in high regard, which should make landowners hesitant to disregard their contracts.

Potential risks could increase if FUNDECOR neglects their monitoring and technical assistance program. Monitoring is very important in this project because it is very easy for landowners to cut corners and use standard logging methods or harvest the trees before the designated harvest year. With a weaker monitoring system wood could be illegally harvested and flood the market, which could bring prices to an artificially low level.

XXIX. SELCO VIETNAM (DESK STUDY)

The Solar Electric Light Company of Vietnam (SELCO) received a SME loan of US$750,000 in late 1998 and to date US$400,000 has been disbursed. It has used the SME loan in two ways: (1) to guarantee local financing from the Vietnam Agricultural and Rural Development Bank (VARDB) for homeowners to purchase 20-60 Wp solar photo-voltaic home systems; and (2) as collateral to secure financing for SELCO Vietnam's operations. SELCO's partner is Vietnam Women's Union (VWU), a large politically-connected non-governmental organization. SELCO provides, installs, and maintains the solar systems, while VWU markets the systems and the credit for buying them. The VWU also certifies each borrower for a VARDB loan. The VWU, like the VARDB, has branch offices throughout Vietnam. SELCO negotiated a 30% principal subsidy with the IFC, which it shares with the VMU at a ratio of 70:30 for SELCO and VMU respectively.

The project originated as a small demonstration project with a revolving solar fund sponsored by the non-profit Solar Electric Light Fund (SELF). Neville Williams, the founder and former president of SELF, later left SELF to establish and run the for-profit SELCO, which has used the relationships established during the demonstration project to launch its project. The project's goal is to install 12,000 systems within three years of the first SME disbursement.

SELCO first learned about the IFC/SME Program through the IFC's Mekong Facility in late 1997/early 1998. The SELCO application was rejected by the Mekong Facility because it does not accept foreign companies. In the process, Tom Davenport of the facility told SELCO about the SME Program.

Ranking by GEF Operational Program Objectives

SELCO-Vietnam merits a ranking of "neutral-plus," (still to early to tell, but likely to meet GEF operational Program requirements) with respect to achieving the GEF Operational Program requirements. SELCO's project activity promotes GEF's Operational Program No. 6, removing barriers and reducing the implementation costs of renewable energy. SELCO was given this rating mainly bacause of its efforts to remove barriers and the long-run commercial viability of the project. The general economic environment in Vietnam is slowly progressing in a positive direction, which leads us to believe that this program will preform better then similar projects in other regions of the world.

Ranking by Commercial Sustainability

SELCO-Vietnam merits a ranking of "neutral-plus," (likely to meet debt-servicing requirements) with respect to its commercial viability. SELCO had an initial goal of selling 12,000 systems within three years of opening its doors. However, SELCO is not currently on track to meet this goal. The main problem, according to SELCO, was with the VARDB. The VARDB, took an inordinately long time to approve its participation in the program and then inform its branch offices that no collateral would be required by borrowers. As a result, only a few hundred systems have been installed to date. Another issue is that the VARDB insists on charging a higher interest rate (15%), rather than the 9.7% preferential rate it charges for other rural activities. Many potential solar borrowers decide not to borrow because of the high rate. While this interest rate issue persists, the overall viability of this project seems strong.

The Internal Rate of Return (IRR) for SELCO has not been calculated at this time, but the long-term sustainability of the project looks strong. If the relationship with the VARDB holds, SELCO could be a solid implementation model for rural development projects in the future. The SME Program funding was instrumental in establishing relations and getting the loan program off the ground.

In future years, SELCO could be a prime candidate for mainstreaming into the normal IFC lending program. SELCO does not really need concessional money (the original application to the IFC was on a non-concessional basis with Mekong facility). If the Vietnam Agricultural and Rural Development Bank would lower the interest rate it charges solar buyers from 15% to the preferential 9.7% that it gives for some other rural activities, then according to the company, it would return the SME Program funds to the IFC. A possible next step to ensure financial sustainability is lobbying the VARDB to allow the solar systems to qualify for the preferential interest rate.

Leverage

The basic question to ask when examining the role of IFC-SME leveraging is: would SELCO be able to finance this project without the aid of the IFC. While it initially appeared that they would not be able to proceed with out some type of IFC loan, it is unclear whether they needed funds at a concessional rate.

Public Participation

SELCO has just a few staff in Vietnam and the Vietnam Women's Union has hired and repositioned staff for marketing and loan certification. However, if the project is successful, then it will lead to domestic solar home system assembly and greater local employment potential. SELCO's agreement with VMU stipulates that any manufacturing/assembly done in Vietnam will employ 50% women.

Project Level Impact

At the current interest rate, the cost of these photovoltaic cells may still be out of reach for many in the poorer communities in Vietnam. The customers of SELCO most likely would not come from this population, but rather from a more affluent rural middle-class or lower middle-class. With this in mind, the technology could still be spread through the population.

Effectiveness of the sub-Project Financing

If the VARDB were to lower their current interest rate to SELCO customers, making it easier for them to pay back loans in a timely manner, then SELCO could expand their customer base throughout Vietnam.

SELCO is an example of an Intermediary that is also the SME/project.. The SME loan goes only to SELCO, not to a financial Intermediary that could on-lend to SELCO as well as other solar development companies, and thus spur competition. Because the Intermediary and sub-Project are the same, the risk is higher to the SME Program and the potential gain to the sub-Project is greater; the sub-Project is receiving the full concessional loan normally awarded only to the Intermediary. In return, the SME Program requires a guarantee from the SELCO's corporate sponsor.

The SELCO model of "Intermediary" may have worked (lending of funds directly to a sub-Project versus having a financial Intermediary). BP (spell out) and others may now be looking for deals and financing in the future, which leads us to believe that this form of "seeding" may be a viable method. It is difficult to enter the Vietnamese market with new technologies and this seed loan appears to have stimulated interest.

Risk Management Procedures

One method of risk mitigation for SELCO has been its agreement with VARDB (Vietnam Agricultural and Rural Development Bank). This agreement gives the Bank, rather than SELCO control over the loan to the customer purchasing the PV unit and frees up SELCO's cash flow to reinvest in the marketing and sale of more units in different regions. In exchange, the VARDB receives part of the principal subsidy from the IFC.

XXX. ECONOLER (DESK STUDY)

Summary

Econoler International (formerly called Soprin ADS) is based in Quebec City and has been in the ESCO business for at least 15 years, although most of its ESCO operations have been in Canada. It is owned by two Canadian firms - Hydro Quebec with 49% of the equity, and Dessau Soprin (a large engineering firm) with 51%. Econoler was formerly a division of Dessau Soprin. Econoler first became aware of the IFC/SME program from colleagues during a business visit to Washington DC.

Under the SME Program, Econoler received US$800,000 (with a negotiated 30% principal subsidy) to help establish ESCOs in Tunisia, Morocco, and Algeria. To date US$400,000 has been disbursed. It can allocate no more than US$250,000 to any one ESCO, and so far it has done so only for an ESCO in Tunisia. The Tunisian ESCO is called STGE and is capitalized by Econoler with 51% of the equity, plus three Tunisian banks and one Tunisian entrepreneur, who together own 49%. There is no debt except on a project basis. But even on a project basis, debt will be owed by the end-users, not by STGE.

Ranking By GEF Operational Program

Currently, we rate this project's compliance with the GEF's Operational Programs as "Neutral" (too early to judge the ability to meet debt-servicing requirements). We believe that this project will eventually contribute to the Operational Program No. 5, removal of Barriers to energy efficiency and energy conservation.

One of Econoler's staff members attended a 2-day IFC training seminar on how to assess environmental risk, which they already have experience managing. Econoler prepared and submitted an environmental assessment for STGE and is planning to examine the environmental impact of each project.

Econoler has not attempted to calculate the level of Carbon reductions that are expected to result from their activities. They currently do not have the financial capacity to do so.

Ranking by Commercial Sustainability

Currently we rate this project's commercial viability as "Positive" (likely to meet debt servicing requirements).

Local banks lending to ESCOs provide project financing on a client-by-client basis at about 10-12%, which is relatively competitive with market rates. To date, there have been no investments made by the Tunisian ESCO, so we cannot evaluate the debt-servicing ability of the ESCOs that Econoler is proposing to fund.

In the business plan for the STGE activity, Econoler predicted an IRR of 40% over 5-6 years. Currently, it is zero because Econoler does not yet have any clients. As mentioned above, Econoler expects that to change shortly.

Econoler is so focused on getting the first STGE projects going that it has not focused on the post-SME Program period and there has been no thought given to where additional financing will come from. If STGE is successful, financing should not be difficult to find. Hydro Quebec (one of Econoler's owners) can always provide financing, and additional equity will be available from the local banks that are the current partners.

Public Participation

Local employment impacts of the activity are somewhat minimal; currently STGE has two employees. With the first contracts, an additional two will be hired. By the end of the year, Econoler anticipates having a staff of 10 in place, all Tunisian.

Assessment of the effectiveness of the project financing

The structure of the IFC-SME funding in this case is in the form of an equity investment, not a loan. The IFC determines whether an Intermediary receives its principal subsidy payment based on successful debt-servicing by project sponsors, which would not apply in this case. In this instance, IFC bases its principal subsidy determination on STGE's overall performance. Econoler has agreed to provide STGE's balance sheet, which has been approved by an auditing company, to measure their success.

Econoler has to cover most of its operating costs itself. They do have a zero-interest US$50,000 loan from the Quebec government. It covers things like plane tickets and other local costs. If the Tunisia project is successful, Econoler has to pay the loan back. Otherwise, the loan is forgiven (The opposite incentive from the SME Program's principal reduction subsidy).

Lessons Learned

Whenever Econoler starts up the next ESCO, it will wait to sign contracts with clients before fully establishing the local company. They have realized that much time and many resources were lost on projects, which did not move forward.

Second, the training that's needed in Tunisia (and probably in other countries) for local ESCO employees is a lot greater than anticipated. The cost of training is high, partly because people must be trained overseas. In the future, Econoler will try to get grant money from CIDA or another development agency to pay for such training.

Third, Econoler originally stressed the technical approach with potential clients. Now, financial structuring will be front-loaded. In Tunisia, Econoler is using non-recourse financing, which is new to the country and takes a long time to set up and, may even be impossible in some countries. Econoler will stress financial approaches more in future business plans and will place a lot less emphasis on the technical aspects of the business.

In addition to these suggestions, Econoler could benefit from financial training for both project sponsors and the Intermediaries themselves. This would allow them to better manage their business and insure that the funding is used in the most efficient manner.

Deal Flow

Econoler has been actively trying to recruit local partners for ESCOs. Due to the long-term nature of these contracts a substantial time commitment is needed to organize a contract. Two years ago Econoler signed an agreement with the Algerian electricity/gas company, but no one wanted to go to Algeria at the time because of the political instability and violence. Now conditions are better. Last week Econoler signed a new agreement with the utility to prepare the business plan, which will take 6-9 months to complete. The utility will share the cost of developing the business plan (total cost about US$150,000). In Morocco, Econoler approached the local utility, ONE, but it declined, so Econoler has had to pursue other partners. (In Tunisia, the national utility, STEG, said yes. STEG was originally going to be an equity partner but later decided not to add new ventures as restructuring and privatization loomed). ONE will still help Econoler in other ways but will not be a partner in an ESCO. Econoler is still waiting for final commitment from other potential partners.

Progress has been very slow for STGE. It has 10 proposals outstanding with various facility owners. Part of the problem is the lack of history of ESCOs in Tunisia and almost no history of non-recourse financing. Another problem is that, in general, business in the country moves very slowly. Econoler has had to do a lot more up-front preparatory work than originally anticipated. So far, there have been no ESCO deals signed, although the first one is expected shortly.

Econoler does quite a bit of consulting around the world, but currently the three SME-funded ESCOs are the only ESCOs in which Econoler has a stake. Although Econoler, in a joint venture agreement with Hydro Quebec, began work on these ESCOs before hearing about the SME Program, Pierre Langlois had not really thought about how he would come up with Econoler's share of the equity. He thought he would have to use Econoler's own funds or go after some risk capital from Quebec investors. As it turns out, Econoler has needed additional cash for STGE beyond what the SME Program is providing, and has received it in the form of a US$20-30,000 loan from Dessau Soprin.

Risk Management

A major problem for Econoler is foreign currency risk. The Tunisian currency has been devalued heavily in the last several years. Econoler's original investment in STGE, which ended up totaling US$280,000, is now worth about US$250-255,000. Econoler took the full foreign exchange risk because IFC wouldn't take any of it, and the amount was too small to insure.

XXXI. FCG GUATEMALA (DESK STUDY)

Summary

Fideicomiso para la Conservación en Guatemala (FCG), or Guatemalan Environmental Conservation Trust signed its US$500K loan agreement with IFC/SME on November 20, 1998, and its grant agreement on December 15, 1998. It has drawn down on its first disbursement of US$250K, but has not extended any financing as of the time of this writing, although they have a pipeline of approved project profiles totaling US$605K. Until they have actually signed projects, it is not possible to assess the leverage. Reviewers met with María José González, Executive Director, Juan Mario Dary, Treasurer, and Leonor Rodríguez, Loan Officer. Leonor Rodríguez, a new member of the staff, was recently hired using funding from a technical assistance grant from the IFC (US$30,500). It should be noted that the Evaluation Team was only able to make preliminary judgments on FCG because it is too early to come to any real or accurate conclusions. With that said, the preliminary indications point toward a positive outlook for FCG.

Ranking by GEF Operational Program Objectives

The ranking of FCG in terms of GEF objectives is "Neutral" (too early to judge the likelihood to meet debt-servicing requirements) because the project is simply not at a stage yet where they can be evaluated for this objective.

From the limited information provided about the project pipeline, it would seem that the vast majority of FCG financing will fall under the GEF's Operational Program No. 3, Forest Ecosystems. FCG's projects will promote the conservation and or sustainable use of biological diversity and endemic species. Three proposed projects, which can be incorporated under this OP are: sustainable fishery (i.e. F.D.N. Tilapias), organic agriculture (i.e. Fincas Organicas), and ecotourism (i.e. Promoción Ecoturistica). One loan profile is for a geothermal project (GEOTEC, S.A.) project.

Ranking by Commercial Sustainability

The ranking of FCG in terms of commercial sustainability is "Neutral" (too early to judge the likelihood to meet debt-servicing requirements). However, all indications are that FCG will be a success.

The FCG loan interest rate is 7% p.a. in US$. This is considered to be very competitive with similar loan rates in local currency (Quetzales, or Q), which are 25% p.a. and inflation is currently 12% or so.

As of the date of this Evaluation no projects have received IFC funds, so it is too soon to tell if mainstreaming is an option.

Leverage

As of the date of this Evaluation no projects have been loaned IFC funds, so information is not available on the sustainability of projects.

Public Participation

FCG has a number of NGO "members" such as FUNDAR, Tropical Forestry Research Institute, Defensores de la Naturaleza (EDF affiliate), FUNDE/MABV, WWF, TNC and others. There are two agencies of the Government of Guatemala (GOG), CONAMA (National Environment Commission) and CONAP (National Protected Areas Commission). These two have no direct input into loan credit decisions, but do have some influence in grant-making decisions. Overall, the GOG influence in FCG activities appears to be moderately low. Members also include the financial advisor mentioned above, Mr. Castellaños.

Assessment of project level impact in a development context

As of the date of this Evaluation no projects have been loaned IFC funds, so information is not available on the project level impacts.

Effectiveness of the sub-Project Financing

FCG has created a committee to evaluate potential projects. The Credit Committee is made up of five members plus the loan officer, who introduces the projects to the Committee. Members include Juan Mario Dary, Treasurer FCG, María José González, Exec. Director FCG, and three outside members, Messrs. Movil, Castellaños and Obiols. Simple majority is required for a project to be approved. Mr. Castellaños is a well-known banker in Guatemala and serves as a Director of FCG as well.

From the information provided by FCG, it appears that the loan application procedures are well thought out and presented in a cogent, simple manner. Project profiles are not to exceed six pages in length, and the Loan Officer at this stage makes sure that the GEF's OP objectives are being met by the proposed project. Loan applications for firms and individuals are reasonably simple and firms provide financial statements, whereas individuals provide statements of "patrimony" or net worth.

FCG will require one of three kinds of guarantees from a potential loan recipient: a) "hipotecaria", i.e. mortgage-backed assets such as homes and other collateral; b) "fiduciary", i.e. personal guarantees , in these cases, a cross-guarantee from a known entity or individual as a third party; and c) "prendaria", or pledges on the underlying assets to be financed.

Lessons Learned

As of the date of this Evaluation no projects have been loaned IFC funds, so FCG is not at the stage where they can comment on lessons learned.

Deal Flow

FCG's target is to disburse the full US$250K of the first tranche by March 2000. This would imply approval of five loans at US$50K each. It appears that this goal is highly achievable. FCG notes that a critical success factor and at the same time, one of the major barriers is preparing a project for FCG financing.

FCG currently has 18 projects in its pipeline for a total of US$846K (see Annex 1), which averages approximately US$47K per project, very close to the US$50K average financing discussed with SME. Eleven (11) project profiles have been preliminarily approved with a US$55K financing average. For these approved profiles, full loan proposals have been requested by FCG. After loan proposal requests have been received, they are reviewed again by the loan officer and presented to a Credit Review Committee. After a positive appraisal by the Committee, it is forwarded to the independent external evaluation, and after a final Credit Review Committee meeting, a loan request is submitted to SME for approval and loan contracts are subsequently drafted. Please see Annex 2 for a graphic representation of FCG's loan process.

Risk Management

No information was available pertaining to FCGs risk management procedures.

XXXII. GRAMEEN SHAKTI (DESK STUDY)

Summary

Grameen Shakti (the sole project of Grameen Bank) has established four divisional offices in Bangladesh to market and sell Photovoltaic cells for home electrification. Disbursements to date total US$250,000 of an authorized US$750,000 loan from the IFC. The plan calls for the sale of 5,400 units over the first three years of the project. The target population is the 20 million households in Bangladesh without access to electricity, 5% of which are estimated to be able to afford the PV packages. The current plan entails a small mark up on the packages and 12- to 24-month financing. Preferred terms are offered to individuals who are current customers of Grameen Bank.

Grameen Bank has operated in Bangladesh at the local rural community-level for many years. The Bank is committed to delivering credit to the rural poor who normally would not be able to qualify for conventional bank loans. Currently the Bank has 2.3 million borrowers, 94 % of which are women. The Bank has removed the need for collateral and created a banking system based on mutual trust, accountability, participation and creativity at the local level. The Grameen Bank is the keystone in a family of companies that operate on the principal that their business practices should help improve the social and economic conditions of Bangladesh’s rural population.

In addition to Grameen Shakti, the Grameen family of companies also has additional experience delivering distributed technologies in rural areas via their Telecommunications Company. The network also includes several companies that specialize in helping certain industries in Bangladesh to promote and market their products around the world. This group of affiliated companies has given Grameen Shakti a network of personnel and experience that they have been able to call on to help them open this new market.

Ranking by GEF Operational Program Objectives

The ranking of Grameen Shakti in terms of GEF objectives is “Neutral” (too early to judge the likelihood of meeting GEF/OP objectives). Grameen Shakti projects promote Operational Program #6, removal the financial barriers. The project promotes the installation of photovoltaic cells in the relatively poor and remote regions of Bangladesh. Grameen was given a “neutral” rating due to the difficulty the Evaluation Team feels Grameen Shakti will face in removing price barriers.

For most of the rural poor in Bangladesh, the high cost of electrification makes implementation at the household level impossible. Being able to offer financing through Grameen Bank has made electrification a possibility for many poor households. This technology would also replace the need for kerosene lamps in rural homes. The rate of increase the in production of greenhouse gases (GHG) and the depletion of forested areas would be minimized if a large enough number of households in Bangladesh converted to PV cells. For these reasons this project would normally be considered for inclusion under Operation Program #7 (reduction of greenhouse gas-emitting energy technologies), but it appears that households are using the PV cells for new uses (Cellular phones, TVs, etc…) as opposed to reducing the use of technologies that contribute to GHG levels.

Ranking by Commercial Sustainability

The ranking of Grameen Shakti in terms of commercial sustainability is “Neutral-Plus” (too early to judge but likely to meet debt-servicing requirements). This is only evaluating Grameen Shakti’s ability to meet debt services, and not Grameen Bank (Grameen Shakti can use the Banks funds, if necessary to meet debt-service requirements). The directors of Grameen Shakti originally wanted to sell the PV packages without any markup. IFC provided a consultant to review Grameen Shakti’s business plan and offer advice pertaining to the sale and distribution of its product. Once the consultant's review was complete, Grameen Shakti reworked their business plan to be more sustainable over the long-term. The current plan has a selling price of US$518 for a 50 Wp unit, which represents a gross margin of 17%.

Leverage

The IFC/SME loan to Grameen Shakti currently makes up approximately 60% of the total project cost. While it is very clear that Grameen Bank was interested in this program from the start, it is not clear whether they would have been able to proceed without IFC funding. Grameen's commitment to the rural poor of Bangladesh leads us to believe that they may have been willing to go ahead with the project on a smaller scale with other funding (or their own). The IFC/SME funding however did cause Grameen Shakti to change their business plan substantially from one that was relatively preliminary to a more long-term sustainable outlook.

At the project level, the leveraging was closer to 75%. It was very clear that the families purchasing these PV cells would not be able to come up with the money on their own. These cells (average cost: US$500) cost more then the price of a normal rural home in Bangladesh. In order for a household to qualify for financing they must be able to make a 25% down payment on the PV cell. They are then given a loan for the remaining 75% of the purchase price. The current interest rate is 12% and they hope to be able to increase the rate to 18% when the public is more aware (and more interested) in purchasing PV cells for home electrification.

Public Participation

No market analysis of the demand for rural electrification was available to the Team at the time of this review. A general desire for electrification seems acceptable and understandable, and it is safe to assume that the public of Bangladesh have identified this as a high priority.

Sustainability of sub-Project Level Activity

If Grameen Shakti can keep providing financing at a relatively low rate, it could be very possible for this organization to continue well after the SME loan has been repaid. With approximately one million families able to afford this product, the customer base is not likely to dry up anytime soon. The first several years of the business plan are mainly focused on opening up the market and making the public aware of this product's potential. By opening several regional offices across the country, with each office controlling smaller units in the rural countryside, they should be able to provide the local level support and advertising required for a project of this scale.

Social Sustainability of the sub-Projects

A service arrangement is in place that benefits both the user and Grameen Shakti, with the further advantage of promoting long-term, sustainable use of PV cells in Bangladesh. Representatives visit the purchasers monthly to inspect and repair each unit and collect the monthly payment. This service is performed until the debt is paid off. Grameen Shakti has trained approximately 200 local men and women to act as independent service representatives who can replace batteries and repair units after the service contract with Grameen Shakti is complete. This is an effort to insure that the units are kept in good working order after the debt is repaid to Grameen Shakti.

Project Mainstreaming

When asked if they would be interested in mainstreaming into the normal funding arm of the IFC, Grameen Shakti responded that the cost of such funds were too great. They feel that the current interest rate at which they are receiving funding is more then they would like to be paying. With a 10% to 12% average de-valuation of the Bangali Taka (currency) annually, Grameen Shakti is under substantial potential foreign exchange risk. So future integration of Grameen Shakti into the mainstream IFC funding mechanism is unlikely.

Project Level Impact

It remains to be seen whether this project has had a lasting effect on the development of a market for PV cells in Bangladesh's rural regions. The price of the PV cells (even though they are substantially discounted) will likely remain a barrier to the poorest people of Bangladesh. Perhaps the several PV cell programs occurring in Bangladesh presently will have a cumulative positive effect on the market.

Effectiveness of the sub-Project Financing

Grameen Shakti's original business plan did not go into detail about the operation of the project beyond the initial subsidized phase. After reworking the plan, they have tried to make the project more self-sufficient. Grameen Shakti's long-term plan is to increase the interest rate on loans to equal the current market rate. This should allow them to repay the IFC loan and build the company up enough to continue. Increased interest rates have not been applied yet because they are still building a customer base and are hesitant to increase interest rates until their product is more commonly known.

With the 'family' nature of the Grameen network of businesses, Grameen Shakti has transferred some costs to Grameen Bank when necessary. This appears to be how Grameen Shakti plans to slowly become a self-sufficient, profitable business. The only concern with this practice is the possibility of cost being transferred back to the Bank if they begin to run less profitably.

Concerns have been raised related to the presence of several other organizations operating in Bangladesh in the PV market that offer better terms then Grameen Shakti is offering. Many of these other organizations have grants from other countries that do not require them to generate a profit. In theory, these programs may be unsustainable and could potentially distort the market.

Due to the relative poverty of Grameen Shakti's client base, there is a substantial risk of clients defaulting on loans. Widespread flooding recently occurred in Bangladesh, which has caused many people to loose their livelihoods and, thus, their ability to pay back their loans to Grameen Shakti. Sales and loan repayment revenues fell in the final quarter of last year due to this flooding.

This type of risk is not going to decrease overtime for this project. Grameen Shakti hopes to account for this problem by increasing the volume of sales. This method may not be an adequate solution to *'force majeure'* problems. If they are wrong, they will increase their losses dramatically.

Lessons Learned

This project is well suited for SME funding; it is high risk with little hope of attracting commercial investment otherwise. While Grameen Shakti may have been willing to go it alone, it is doubtful that they would have been able to succeed with a project of this scope. While questions still remain as to whether all the loans will be repaid, the project has succeeded in decreasing, if not removing, the barriers and reducing the implementation costs (GEF Operational Program No. 7) of providing PV cells to the rural poor of Bangladesh.

Deal Flow

Grameen Bank Intermediary status is different from other organizations in that they only have one official 'project,' Grameen Shakti. Grameen Shakti sells their product to individual households who are able to pay 25% of the cost of the PV cells. They have set up a network of offices in the countryside to be closer to their client base. At these offices they have installed examples of the PV systems so that potential buyers can see the product in use. They have estimated that one million households can afford and have a need for the cells. With the widespread community awareness of the Grameen Family of businesses, potential customers should have no trouble finding out about this product.

Risk Management

Grameen Bank appears to be able to manage any potential risk of financial failure. The current holding of this organization should be more then enough to ensure all of Grameen Shakti's debts are covered. This was a stipulation by the IFC in agreeing to the loan to Grameen Shakti in the beginning. Presently, we believe that Grameen Shakti will be able to service its debt to the IFC, and will not require Grameen Bank help. This could change should the Taka be devalued higher then the current rate or *'forces majeure'* evens occur.

XXXIII. Environmental Enterprise Assistance Fund (Desk Study)

Summary

Environmental Enterprise Assistance Fund (EEAF) was the first Intermediary selected by the IFC/SME Program, and it received US$400,000 on July 17, 1996. Currently it is funding two projects; US$75,000 to Soluz Inc. for a solar home system project in the Dominican Republic; and US$60,000 to EESM for energy-efficiency performance contracting projects in Mexico (Econergy is involved in this project). It also plans to provide SME loans to a charcoal manufacturer in Costa Rica and a sugarcane bagasse cogeneration project in El Salvador. EEAF has already provided loans to both of these projects, but in the Costa Rica case it is applying retroactively for SME funds, and in the El Salvador case is applying to SME to cover some cost overruns.

EEAF manages a number of funds and therefore has the flexibility to choose which funds under its control are the most appropriate for a given project. At the time the SME Program started up, EEAF had a large grant from U.S. AID to on-lend to small and medium enterprises. This money was easier to use than the SME money (due to EEAF's unfamiliarity with GEF rules) and also came with project development funds, which the SME loan did not. And, like the SME money, the AID money had to be spent before a certain deadline, so, EEAF concentrated on investing its AID money instead of the SME money. As a result, EEAF did not meet the two-year limit on SME fund commitment. It returned half of the original US$800,000 to the IFC and received an extension on the remaining funds, which it hopes will be almost fully disbursed if the charcoal loan (US$150,000) and bagasse loan (US$100,000) are approved.

Ranking by GEF Operational Program Objectives

The ranking of EEAF in terms of GEF objectives is "Neutral-Plus" (too early to judge but likely to meet GEF/OP objectives). The Soluz project falls under the removal of barriers to energy efficiency and energy conservation GEF Operational Program No. 5, while the EESM project will fall under Operational Program No. 6: promoting the adoption of renewable energy.

Ranking by Commercial Sustainability

The ranking of EEAF in terms of commercial viability is "Neutral-Plus" (too early to judge, but likely to meeting debt obligations). EEAF has extensive experience managing the finances of environmental projects. They are well trained and able to determine the commercial viability of their projects. It is safe to assume that EEAF would not get involved with a project if it were not likely that they would be able to service their debt requirement.

For both sub-Projects, EEAF reported that the Internal Rate of Return, was tantamount to the interest rate it charged borrowers. For Soluz, this was 12%. For EESM, it was 13%. EEAF would have lent to EESM at 16% if it were not for the availability of free AID money.

The IRRs of the borrowing companies are not immediately available. The post-loan IRR on EESM is 27% but that is dependent on EESM getting additional financing. It may still be somewhat optimistic.

Leverage

The SME funds represented 20% and 38% of the total funds used by Soluz (total funding, US$375,000) and EESM respectively (total funding, US$217,450), of which US$60,000 was provided by SME. EEAF has provided debt for this project but not through SME. Based on this leveraging, the IFC funding appears to have made a difference to the projects.

Econergy International Corporation provided additional sources of funding and technical assistance support. EEAF is able to decide what percent of the total project cost will be provided.

Sustainability of sub-Project Level Activity

The long-term goal for both projects, as it is for all EEAF projects, is commercial self-sufficiency and in the case of these two projects, the immediate timetable is the term period of the loan (5 years). But EEAF will likely stay involved in both projects, providing additional capital, though not necessarily through SME. It is too soon for an exit, particularly for EESM, which is profitable and will likely become more so as it enters into more performance contracts (it only has two at the moment).

EEAF is not really taking any provisions to ensure that the Soluz project continue after SME funding is completely disbursed, because the SME funds are only a small portion of the total financing. But, even though Soluz is not operating at financial break-even, EEAF has enough confidence in the sustainability of Soluz that it is seeking debt from CFA (a Central American fund set up by EEAF) for Soluz's operations in Honduras.

For EESM, EEAF funds are a significant share of the total financing. Given its profitability, however, EESM's continued success after SME funds are disbursed is not an issue. Although it is too soon now, additional capital could eventually come from either a line of credit from a Mexican commercial bank or potentially a cash infusion from a buy-out by a larger company. Since EEAF is providing money to EESM at non-concessional rates, the question of whether additional concessional money may be needed is moot.

Project Mainstreaming

Soluz is currently applying for a regular IFC loan, and will possibly apply to Triodos solar fund, the REEF and SDC when they become operational.

Project Level Impact

There has been no effort to determine how the projects have been integrated into broader community economic activity, although both projects have raised awareness and may be helping stimulate increased market activity and competition as the demand for solar home systems in the Dominican Republic and for energy-efficiency performance contracting in Mexico increases. The Soluz project has stimulated a local manufacturing industry for charge controllers and other businesses related to solar homes.

It is unclear what the long-term development impacts will be from these projects. There is no information available on employment impacts from these projects in the community. It should be noted that EESM does employ 20 technical people. Information on the number of employees at Soluz was not available, but local personnel are employed for sales and maintenance services, among others.

Effectiveness of the sub-Project Financing

Both EEAF projects would have happened without the SME. There is no 'but for' hurdle for EEAF's use of SME funds. That is, EEAF normally provides debt (or equity) from any of several pools of funds at its disposal to support an enterprise. It then retroactively applies for SME funds where it thinks they are applicable. EEAF argues that this is more effective for them, because it eliminates the need to complete the SME-GEF paperwork for a project that may end up not getting off the ground. However, this retroactive approach means that the projects EEAF funds with SME money would happen with or without the SME Program.

Both sub-Projects, to date, have been making their quarterly interest payments on their SME loans. Soluz began making principal payments in the first quarter of 1999, and has made two payments. The first one was late. EESM's first principal payment is due in August 1999.

Deal Flow

In the early years of EEAF's involvement with the GEF they submitted a number of projects and were rejected because they didn't 'remove barriers' as defined by GEF. For example, they tried to get funding for a small hydroelectric project in Costa Rica and for an organic strawberry project in Chile. The first was rejected on the grounds that there were no barriers to small hydro project development, and the second was rejected on the grounds that it did not have enough global impact. (Interestingly, the same project is now being funded by the Terra Capital fund, which also uses GEF money and presumably has the same guidelines on the use of GEF funds). EEAF was early in the GEF learning curve at that time, and now has a better understanding of what 'barrier removal' means and thus which of its projects will more likely qualify for SME funding.

Risk Management

According to EEAF, the debt forgiveness provision of the SME Program discourages risk-taking. The 50% forgiveness of the IFC loan for successful projects is viewed by EEAF as a major disincentive for EEAF to pursue risky projects, or rather, a very large incentive to pursue low-risk projects. The SME Program is intended to encourage Intermediaries to take risks. In EEAF's case, it reportedly encourages pursuit of more conservative projects because such projects are more likely to repay their loans and thus qualify EEAF for the 50% cut.

XXXIV. SAVÉ VALLEY WILDLIFE SERVICES LIMITED (DESK STUDY)

Summary

Savé Valley Wildlife Services Limited (SVWSL) is a for-profit entity established in 1995 to provide cooperative business services, such as purchasing and stocking wildlife for the Savé Valley Conservancy (SVC). The SVC, created in 1991, is a group of 24 former cattle ranches in

Zimbabwe who have established mutual wildlife management practices on their 3,200 km^2 to promote sustainable wildlife populations and eco-tourism businesses. SVC is attempting to create a model for the preservation of wildlife as a preferred land-use option, which can generate economic benefits through consumptive (game cropping and safari hunting) and non-consumptive (tourism) exploitation of wildlife.

The SME approved loan to SVWSL is US$1 million, and initial disbursements are expected in mid-September 1999. Loan proceeds are to be used for two purposes: the purchase, trans-location, and restocking of wildlife species to the Conservancy, and for social and environmental monitoring of this project by the WWF (US$50,000 of the total will be a grant earmarked to fund WWF's activities). The balance is to be used for wildlife restocking efforts. The loan is to be paid down over ten years at a 2.5% interest rate, with a two-year grace period and 50% debt forgiveness at the end of ten years, given yearly conformity with several positive covenants in the loan. Contributions agreed upon by members, amounting to US$2.5 million in the first ten years, will be used to pay off 50% of the loan and to purchase additional game animals.

Ranking by GEF Operational Program Objectives

The ranking of Savé Valley in terms of complying with GEF Operational Programs is "Positive" (likely to meeting GEF/OP objectives). This project falls under the GEF Operational Program No. 1, Arid and Semi-Arid Zone Ecosystems.

This project provides unique environmental benefits, which closely match GEF's biodiversity goals. This includes the demonstration of an integrated approach to the conservation of natural habitats and ecosystems through effective conservation strategies, protected areas, sustainable land use systems, and interventions to rehabilitate degraded areas. The GEF is concerned that the practice of trophy hunting may not be appropriate for a GEF-linked loan. However, the GEF has recommended that this loan be approved as long as management is consistent with the WWF's multi-use Wildlife Management Plan. Consumptive uses will be limited to abundant species such as buffalo, zebra, wildebeest, and sable; white rhino, roan antelope, elephant, and other species will be preserved.

In their efforts to return its lands to a natural state, the SVC has removed all fencing within the preserve, de-stocked all cattle, and initiated habitat restoration activities. The multi-use SVC Wildlife Management Plan was developed by WWF (Zimbabwe) and is supported by the Zimbabwe Department of National Parks and Wildlife Management.

One of the environmental risks that this loan presents is that the introduction of new animals in a short period of time could result in further diminishing habitat; the accelerated population growth may overwhelming the recovering ecosystem. The expectation is that careful monitoring and census taking by WWF and the Conservancy will help to properly manage populations. WWF is expected to provide training to workers who in turn should be able to manage these activities.

Ranking by Commercial Sustainability

The ranking of Savé Valley in terms of commercial viability is "Neutral-Plus" (too early to tell, but likely to meet debt-service requirements). Save Valley is dependent on tourists for its revenues. This industry in Zimbabwe has historically been very strong, and projections show that the market is still growing. It remains to be seen how well these activities will improve the overall 'wildlife viewing' quality of the Conservancy. If the improvement is nominal in comparison to other tourist operations in the region, Savé Valley's higher prices may cost them clients.

Leverage

This project effectively leverages the on-going contribution by Conservancy members, totaling US$2.5 million over ten years. These funds will be used to augment game purchases and contribute to habitat restoration. In addition, donors have received approximately US$380k to date. But, given the large scale of this project and potential environmental and economic benefits, leveraging of other resources in the future appears limited.

Public Participation

The Conservancy is a combination of many individual properties, managed under one umbrella plan. A program to incorporate the surrounding population into the economy of the Conservancy is being coordinated through the SVC Trust.

The Conservancy recognizes the district administration as the legal authority in the area. To this end, the Conservancy has been soliciting their involvement in many aspects of the program. A Joint Committee has been created to give the local community a voice in the activities of the SVC Trust. The principal objects of this Committee are:

1. To facilitate the direct involvement of communities as members of the Conservancy, via the inclusion of communal or re-settlement land within the boundary fence;
2. To promote good neighborliness at the farmer/community level;
3. To promote the participation of the surrounding districts in the tourism economy; and
4. To create a sustainable revenue stream for the people of the districts through their participation in the ownership of the wildlife resource within the Conservancy.

A trust fund has been set up to act as a fiduciary vehicle to accept and administer funds on the behalf of the community, and to promote local economic and micro-economic development. The expectation is that village industries surrounding the SVC will include "ethno-tourism" with production of crafts and curios. So far, funding is limited to seed capital and SVC indicates that several initiatives are "reasonably advanced".

The SVC is making some efforts to create economic opportunities for neighboring communities, by financing micro-projects identified by a joint committee of five Rural District Councils (RDC's). Also, the SVC has indicated that they hope to extend membership to include individual

RDC's, as communal land is allocated inside the boundary fence. To enable RDC's to purchase equity stakes in SVWSL, the SVC will reserve a portion of the donor funding received to date.

Project Level Activity

The average ranch size in southern Africa is typically too small for the sustainable production of wildlife. Thus the consolidation of 24 ranches creates a much larger habitat, allowing the Conservancy to flexibly and scientifically manage wildlife resources in tune with prevailing ecological forces. The perimeter fence surrounding the Conservancy is a requirement of the Department of Veterinary Services to control the spread of foot and mouth disease from wildlife to cattle on adjoining lands.

Project Mainstreaming

The landowners involved in the Conservancy have agreed to invest US$2 million dollars against the funds the IFC has provided. This funding is seen as a long-term investment into the future of the Conservancy. Most landowners are not currently making a profit because of this investment. Once the animal population begins to grow and the word is spread throughout the tourist industry, we expect that SVC will be able to take on commercial financing. We believe that in future years, Savé Valley will be ready for IFC mainstreaming.

Effectiveness of the sub-Project Financing

Financial *pro forma*s for the project anticipate yearly net revenues of approximately US $383k. Assuming that the SVC can achieve these goals, the interest coverage ratio would be an extremely healthy 15.5 in year one, and would double to 31 by the tenth year of the loan. SVWSL indicated that they will achieve economic sustainability through the cooperative commercial activities of SVC members. At the point at which wildlife populations reach the carrying capacity of the land, the Conservancy will become an exporter of wildlife, rather than an importer. These large-scale "game ranching activities" will be managed exclusively by SVWSL. In the absence of firm numbers on the anticipated prices for live game, it is difficult to assess the profitability of this strategy. Not including the value of exported wildlife after year ten and incorporating the 50% loan forgiveness, the approximate IRR for this project is 5.4%[1].

Risk Management Procedures

Two forms of risk currently exist in reference to Savé Valley: Political and Ecological. The government of Zimbabwe has a controversial land reform program in place, in which they acquire

[1] This IRR was calculated by a member of the IFC-SME Evaluation group, based on available data provided by SVC Staff.

white-owned agricultural land for resettlement by indigenous people. The land-owners who make up the Conservancy are a majority white, which could be a potential risk to the project as a whole if the government tries to take some or all of the land.

This project represents one of the largest restocking programs ever undertaken. As such, there are substantial uncertainties involved concerning the long-term stability of the animal populations. If the wildlife do not adapt to their new home, the likelihood of the Conservancy surviving is minimal. With that said, the Conservancy had contracted the World Wildlife Federation to monitor the program.

XXXV. INTERNATIONAL EXPEDITIONS (DESK STUDY)

International Expeditions (IE) is a private, U.S.-based ecotourism operator offering trips to 17 destination countries around the world, that emphasize environmental awareness, education, and wildlife conservation. IE is a unique Intermediary for the SME program – one which may be extremely effective for the following reasons. IE will place loans with ecotourism-related companies with whom IE will also conduct business. The promotion of conservation and biodiversity by these SME's will directly benefit IE and IE's patronage will directly benefit the SME's. Thus, IE has a financial stake in assuring the success of the businesses that they propose to fund – a symbiosis of sort.

The staff of IE has assisted in a number of in-country development projects and loans have been made to supplement these projects. In total, IE has loaned US$250k to several projects around the world.

The SME Program has approved a loan to IE of US$750k. Because IE is both an Intermediary and sub-Project, the SME Program has obtained collateral and personal guarantees from IE on the loan, totaling US$770k. IE plans to finance a minimum of four ecotourism projects in various countries, including Belize, Peru, Bolivia, and Ecuador. Loan terms will be for a duration of three to eight years, at a rate of 7.5% to 9.5%. In addition, loan forgiveness of 50% will be allowed, contingent on compliance with several positive covenants in the loan agreement.

Project Level Review

To date, no money has been drawn down and projects are still in the development stage. Although no projects are definite at this point, the following have been identified as leading candidates.

- Peru: IE is considering a US$250k loan to a Peruvian company who has been granted a ten-year concession by the Peruvian government. The site, according to the WWF and Peruvian government, is rich in biological diversity. Funds will be used to construct an interpretation center and facilities for researchers/scientists. The total financing needed will be US$500k. At present, there are no indications on whether the remaining funds have been raised (no cash-flow models are available on this proposal).

- Belize: A Belize company is constructing low-impact lodges and facilities for tourists, students, and researchers as part of a multi-year program being developed with public and donor assistance. The total project will require approximately US$4 million. IE will finance up to US$250k for the construction of a lodge and dining facility. IE has provided loans to this company in the past.
- Bolivia and Ecuador: IE proposes to establish a micro-credit facility for smaller ecotourism projects, handling projects up to US$50,000 from ecotourism SMEs. At present IE is considering eco-lodges in the coastal region of Ecuador and in a National Park in Bolivia.

Ranking by GEF Operational Program Objectives

The ranking of International Expeditions in terms of complying with GEF objectives is “Neutral” (too early to tell whether they will meet GEF Operational Program requirements). In the absence of more substantial information on the SME projects themselves, it is difficult to assess how well IE will be able to meet GEF’s SME program goals. However, given that IE’s business depends on the ecological and cultural integrity of destinations, their interests are directly in line with those of GEF. From a financial and environmental standpoint, this may prove a sustainable arrangement. At this point, no information has been made available to demonstrate how local communities will be affected by these projects and whether or not they will be socially sustainable.

Ranking by Commercial Sustainability

IE’s ranking in terms of commercial viability is “Neutral Plus” (too early to tell but likely to meet debt service requirements). Since no projects have been approved and no funds transferred, it is not possible to assess their commercial viability. Nevertheless, the financial performance of IE is directly linked to the financial performance of guarantees provided by IE to the SME Program. These guarantees are an additional mitigation factor in a worst case scenario (combined sub-Project and Intermediary bankruptcy, for example).

XXXVI. KIKORI PACIFIC/WWF (DESK STUDY)

Intermediary Overview

WWF is one the largest, most visible, and most influential NGO's worldwide working to conserve biological diversity. As an SME Intermediary, WWF provides environmental experience, financial viability, and experience with SMEs. GEF views WWF as an excellent partner for future replication of SME sub-Projects elsewhere. Their in-depth knowledge of environmental matters and biodiversity are strong resources for shaping new projects. Complementing this strength will be the financial assistance of ANZ Bank and IFC's South Pacific Project Facility, which will advise WWF on all SME projects. WWF's role as an Intermediary fulfills part of their larger strategy to support sustainable commercial enterprises that promote biodiversity conservation.

Kikori Pacific Ltd. sub-Project Review

WWF is initiating its role as an Intermediary for the SME Program in Papua, New Guinea (PNG), where WWF has developed an Integrated Conservation and Development Plan (ICDP) for an area of land covering 2.3 million hectares. This includes promoting the development of ecologically sound, locally owned/operated enterprises that provide an alternative to clear-cutting which threatens biodiversity in the region. Their first SME loan will be made to Kikori Pacific Ltd. (KPL), an affiliate of Collins Pine (a US-based certified forestry company), which produces timber that is locally harvested in an environmentally sustainable manner. It is hoped that the expanded capitalization of KPL will enhance its ability to process and market timber products purchased from private landowners --giving landowners (or clans) an economic incentive to sustainably manage and harvest their lands rather than selling the timber rights to larger international forestry companies.

WWF expects to on-lend approximately US$100,000 to KPL for working capital, purchasing logs, and equipment upgrades. To date, US$65,000 has been placed with the remaining US$35,000 to be disbursed in the third quarter of 1999. The process for this loan was delayed by at least a year due to an environmental impact assessment required by IFC. This was a result of the World Bank's forest investment policy that excludes natural forests. Negotiations over this project made community-based forestry an official long-term exception to the World Bank policy.

Ranking by GEF Operational Program

The ranking of WWF in terms of GEF objectives is "Positive" (likely to meet GEF/OP objectives). This project promotes the GEF Operational Program No. 3, the conservation of Forest Ecosystems. Forest management is undergoing Forest Stewardship Council sustainable certification and the process should be completed by early next year. Chuck Peters, a prominent forester, is assisting in overseeing the development of forest management plans.

PNG is an island of exceptional biodiversity. Thus, successful efforts here will result in a high positive impact on biodiversity. If landowners lose interest in harvesting their own land, they are likely to consider earning income by selling their timber rights to large-scale logging companies. The assumption is that small-scale, sustainable logging will be lighter on the land and will help to preserve biodiversity.

Ranking by Commercial Sustainability

The ranking of WWF in terms of commercial sustainability is “Neutral” (too early to judge the ability to meet debt-servicing requirements). WWF/KPL projects an after tax IRR of 12%, however, the SME Program believes the actual IRR to be closer to 9%. It is difficult to validate either of these projects since current pro forma cash-flow statements overestimate likely investment/debt placed in 1999 and 2000 by approximately US$600,000 (non-participation of Investors Circle and reduced WWF loan to US$100,000 from a projected US$250,000). WWF is attempting to build some momentum in the Kikori project in order to encourage an equity investment by regional sustainable forest products companies, in particular an Australian timber products company.

Leverage

A number of additional sources of funding are being used to complement the SME loans to KPL. WWF expressed that without the participation of the SME Program, no other loans would likely have been possible. The US$100,000 that WWF is placing with KPL will be matched with additional funds of US$1.15 million, resulting in a leverage ratio of 12.5:1 (8%). The KPL project is part of WWF’s larger project activity in PNG. This work has been funded by a three-year US$3.4 million grant by the Chevron Corporation. The MacArthur Foundation has provided US$350,000 to cover the soft costs of forest inventory, forest management training, and certification. WWF had hoped to raise an additional US$450,000 from the Investors’ Circle, a U.S.-based group of social investors, however, at this time it appears unlikely that they will participate in KPL. Non-cash assistance includes international marketing expertise being provided by Jim Quinn of Collins Pine in the U.S.

Public Participation

WWF indicates that several public consultations occurred during the development of the KPL project. Further KPL is working with a group of landowners that control approximately 120,000 hectares. It is hoped that by working with the local landowners in the Kikori River Basin of PNG, a foundation for environmentally sustainable forest management will be formed.

The production of timber from this project will go to a wide group of purchasers, many at the local level. Several local furniture producers purchase the wood and sell their products within Papa New Guinea.

Project Level

The KPL project is designed to retain greater economic value by processing the logs into timber within PNG rather than exporting unprocessed logs. Local employment is expected to be boosted both within the mill operations and also through use of local labor for logging and forest management operations. If this method is successful it could lay the ground-work for a new timber processing industry in PNG.

While WWF has mentioned the difficulty of working in PNG, the developmental returns could make up for any initial difficulties. By removing the high cost barriers to timber processing near the site of extraction, the project can create long-term jobs in PNG. This in turn could lead to them becoming a competitor for international producers of high quality hardwoods.

Risk Management Procedures

This project faces a number of significant risks ranging from supply issues, to competition and market risks, to country currency and political risks. WWF has, as an Intermediary, done an effective job of identifying the primary risks facing this project and has undertaken a number of initiatives to help overcome these risk. Their alliances with major business interests such as Chevron, landowners and strategic funding partners, and their outreach to international buyers have served to provide a good measure of risk mitigation. At present, the largest risk remains the ongoing under-capitalization of KPL.

XXXVII. CONSERVATION INTERNATIONAL (DESK STUDY)

Intermediary Overview

Conservation International (CI) is non-profit environmental advocacy organization, generating US$20 million in annual revenues to promote the conservation of biodiversity in targeted ecosystems around the world. CI has been active through its Conservation Enterprise Department in launching non-timber forest enterprises, ecotourism, and sustainable agriculture enterprises. It has experience with SMEs in 22 countries and projects a strong pipeline of projects. Trinity International Partners, a financial advisory firm, will support CI in the financial evaluation of deals. .

CI's initial loan will provide working capital to Campesino Ecologicos de la Sierra Madre de Chiapas (CESMACH). CESMACH is a 250 member cooperative of small local coffee farmers in Chiapas, Mexico. CESMACH, along with CI, has been working with cooperative members to promote sustainably managed, shade-coffee cultivation in the buffer zone of El Triunfo Biosphere Reserve.

The loan will be for US$97,303, for a term of 180 days at 20% interest, plus an additional 5% for loan administration. Proceeds from the loan will be used to provide working capital for

CESMACH to purchase un-milled beans from its members, process, and transport green coffee to port, and cover all customs and other costs before making delivery to international buyers

Ranking according to GEF Objectives

The ranking of CI in terms of complying with the GEF Operational Programs is “Positive” (likely to meet GEF Operational Program requirements). This project promotes Operational Program No. 3, the protection of Forest Ecosystems. In comparison to mono-culture coffee production, ecologically sound production of shade coffee plays an important role in biodiversity conservation. Shade coffee farms create a forested buffer zone around protected areas, harbor a diversity of species, and engage local people in promoting conservation strategies.

All CESMACH members are certified by the Organic Crop Improvement Agency, which ensures that farmers are using practices to avoid solid waste contamination of waterways . For example, coffee pulp is collected and composted to prevent contamination of waterways and water used for removing the coffee husks is diverted to settlement ponds before being returned to waterways. Members agree not to clear forest on their land, and to obey land use restrictions on the reserve, including no encroachment into core areas. Taken together, these efforts help to enhance and expand the ecological integrity of the Reserve.

Ranking by Commercial Sustainability

The ranking of CI in terms of commercial sustainability is “Positive” (likely to meet debt-servicing requirements). It is likely that CESMACH will be able to repay the loan in full after sale to the buyers. However, the short-term nature of the loan does not ensure a sustainable business going forward nor adequate capital for future efforts. Credit is currently expensive for coffee growers in Mexico; the federally supported agriculture bank provides loans to coffee cooperatives at nearly 39%, with an additional 4% for administration. CI has indicated that they may use proceeds from the 50% risk payment (loan forgiveness) for future loans to CESMACH (including a revolving line of credit to finance pre- and post-harvest needs). Continued profitable returns demonstrated by shade coffee growers may enhance the availability of low-cost debt from other lenders in the region, reducing the need for CI’s financial participation.

Leverage

In addition to the considerable time and effort that CI has committed to CESMACH, USUS$250k has been raised from Ford Motor Company, Starbucks Coffee, National Arbor Day Foundation, and World Wildlife Fund.

Effectiveness of the sub-Project Financing

This project allows CESMACH members to sell their product in a premium market, one which may command a 30% premium over commodity arabica bean market prices. Projected sale of coffee is expected to yield a profit of US$55k, a 35% margin on sales. There is no indication of whether or how this profit will be disbursed to CESMACH members.

Public Participation

The CESMACH cooperative appears to provide farmers with an effective means to advocate their interests to the Reserve.

Project Level

This project, while not long-term in nature, did introduce methods that promote sustainable farming practices and show local farmers the profitability of this product. This influence is likely to lead to a spread of shade grown coffee techniques in this region. CESMACH members receive a premium price for producing certified organic coffee, and increasing local employment and wages. This project has demonstration value for non-CESMACH growers and cooperatives, who may be interested in pursuing new market opportunities. In providing training in business planning, quality control, markets and credit, CI is encouraging the probability of ongoing success for CESMACH and other cooperatives.

Risk Management Procedures

This loan is a fairly low risk to CI for three reasons. First, it is strictly for the post-harvest operations of three containers of coffee and is secured against product and purchasing commitments, as well as collateral of the cooperative. Second, the loan is for a very short duration, 180 days. And third, the price for the coffee will be guaranteed with contracts signed prior to loan disbursement. In addition, the buyers will make payment in US dollars directly to CI, not through CESMACH, avoiding any risk of repayment failure by CESMACH as well as currency risk. The primary risk on this loan is the loss or damage to the coffee during processing and shipping. To mitigate this risk, insured freight handlers will handle all overseas and CI and CESMACH personnel will transport the beans to processing and port. Given the relative low risk of this loan, CI’s 20% interest rate, 5% loan structuring fee, and 50% risk compensation seems very high.

ANNEX I: TABLES ON PROGRAM AND SUB-PROJECT LEVEL LOANS

The following tables include all available data on sub-Project-level investment of the SME Program used in this evaluation.

Table 14: First of Two Tables Listing Intermediary FUNDECOR Investments

Project	Phase	Operational Program (OP)	Total Carbon Saved (meteric tons)	ngo/private	IRR (pre-loan)	Leverage	Total Project Cost	Intermediary to Project: Loan Amount	Receipt Date	Loan Lag Time (days)	Loan Terms: Loan Rate	Loan length
Fundecor Intermediary												
Forest Management Program												
FEDERRO S.A.	SME1	3	8229.5	Farmers	--	56%	$ 8,419.83	$ 4,725.00	01/10/1996	0 days	11%	1-3 years
Clinica Orlich	SME1	3	23707	Farmers	--	48%	$ 31,486.00	$ 15,000.00	--	--	11%	1-3 years
Industrias Agropecuarias	SME1	3	177718.5	Forestry	--	48%	$ 15,743.00	$ 7,500.00	12/19/1996	1 day	11%	1-3 years
Antonio Vargas Jimenez	SME1	3	7354.9	Farmer	--	48%	$ 9,603.00	$ 4,576.24	12/03/1996	0 days	11%	1-3 years
Lilllian Hernandez Lopez	SME1	3	8942	Farmer	--	53%	$ 8,240.31	$ 4,350.00	05/19/1997	0 days	11%	1-3 years
Juan Maria Vega Gutierrez	SME1	3	7736.8	Farmer	--	50%	$ 6,088.81	$ 3,053.00	--	--	11%	1-3 years
Agricola Rojomaca, S.A.	SME1	3	14228.4	Forestry	--	56%	$ 17,794.59	$ 10,000.00	--	--	11%	1-3 years
Mireya Otarola Flores	SME1	3	1156	Farmer	--	48%	$ 1,017.00	$ 487.50	--	--	11%	1-3 years
Enrique Otarola Flores	SME1	3	6473.9	Farmer	--	48%	$ 5,694.00	$ 2,730.00	--	--	11%	1-3 years
Enrique Otarola Flores	SME1	3	4990.9	Farmer	--	48%	$ 4,408.00	$ 2,100.00	12/19/1996	0 days	11%	1-3 years
Hector Otarola Flores	SME1	3	818.1	Farmer	--	48%	$ 720.00	$ 345.00	--	--	11%	1-3 years
Odir Otarola Flores	SME1	3	4375.2	Farmer	--	48%	$ 3,848.00	$ 1,845.00	--	--	11%	1-3 years
Odir Otarola Flores	SME1	3	3119.4	Farmer	--	48%	$ 2,755.00	$ 1,312.00	12/19/1996	0 days	11%	1-3 years
Olivier Otarola Flores	SME1	3	2543.4	Farmer	--	48%	$ 2,237.00	$ 1,072.50	--	--	11%	1-3 years
Lauri Martini County	SME1	3	3617.5	Farmer	--	48%	$ 4,693.00	$ 2,250.00	--	--	11%	1-3 years
Antonio Molise Molise	SME1	3	6270.2	Farmer	--	48%	$ 8,134.00	$ 3,900.00	--	--	11%	1-3 years
Agropecuaria Corinto	SME1	3	25284.3	Farmer	--	55%	$ 5,065.00	$ 2,793.00	--	--	11%	1-3 years
Alvaro Sibaja Soto	SME1	3	10124.2	Farmer	--	44%	$ 6,313.00	$ 2,788.90	--	--	11%	1-3 years
Lizanias Ugalde	SME1	3	8994.4	Farmer	--	47%	$ 6,233.00	$ 2,922.40	--	--	11%	1-3 years
RARA AVIS S.A.	SME1	3	6029.1	Forestry	--	48%	$ 7,822.00	$ 3,750.00	--	--	11%	1-3 years
RARA AVIS S.A.	SME1	3	6632	Forestry	--	48%	$ 8,604.00	$ 4,125.00	--	--	11%	1-3 years
Amos R. Bien Schneider & Diane Barbara Stoecker	SME1	3	6029.1	Farmer	--	48%	$ 7,822.00	$ 3,750.00	--	--	11%	1-3 years
Federico Rojas Rodriguez	SME1	3	2346.4	Farmer	--	56%	$ 2,331.00	$ 1,296.00	--	--	11%	1-3 years
Alberto Molina Hernandez	SME1	3	18496.9	Farmer	--	48%	$ 16,269.00	$ 7,800.00	--	--	11%	1-3 years
Octavio Rocha Chavarria & Justo Victor Diaz	SME1	3	2089.8	Farmer	--	56%	$ 2,536.00	$ 1,410.00	--	--	11%	1-3 years
Hansy Rodriguez Perez	SME1	3	19279.4	Farmer	29.20%	56%	$ 19,739.00	$ 11,092.50	--	--	11%	1-3 years
Hansy Rodriguez Perez	SME1	3	8590.3	Farmer	--	56%	$ 8,795.00	$ 4,942.50	--	--	11%	1-3 years
Rogelio Gonzales Rojas	SME1	3	15294.8	Farmer	--	56%	$ 15,659.00	$ 8,800.00	--	--	11%	1-3 years
Total: Fundecor:Forest Management Program			410,472.40				$ 129,575.00	$ 66,194.80				

Table 15: Second of Two Tables Listing Intermediary FUNDECOR Investments

Project	Phase	Operational Program (OP)	Total Carbon Saved (meteric tons)	ngo/private	IRR (pre-loan)	Leverage	Total Project Cost	Intermediary to Project: Loan Amount	Receipt Date	Loan Lag Time (days)	Loan Terms: Loan Rate	Loan length
Fundecor Intermediary												
Reforestation Program												
Beltran Torres Torres	SME1	3	244.4	Farmer	--	90%	$ 2,979.67	$ 2,669.51	12/19/1996	0 days		12 years
Isidro Quesada Rojas	SME1	3	41.7	Farmer	--	61%	$ 609.00	$ 371.74	12/19/1996	0 days		9 years
Lilliam Nunez Mora	SME1	3	44.1	Farmer	11.00%	87%	$ 906.10	$ 789.43	12/18/1996	0 days	7%	6 years
Ganadera La Esperanza de Sarapiqui S. A.	SME1	3	2025	Farmer	--	76%	$ 33,041.00	$ 25,000.00	--	--	--	12 years
Isidro Quesa. Arguedas	SME1	3	940.4	Farmer	--	78%	$ 11,906.70	$ 9,330.96	04/17/1997	0 days	--	12 years
Juan Maria Vega Gutierrez	SME1	3	445.5	Farmer	--	71%	$ 4,763.00	$ 3,379.35	06/20/1997	0 days	--	12 years
Daniel Caamano Polini & Mayra Carvajal Munoz	SME1	3	199.1	Farmer	--	85%	$ 2,530.17	$ 2,151.67	--	--	--	12 years
Julio Sanchez Ramirez	SME1	3	109.1	Farmer	--	105%	$ 1,786.00	$ 1,884.00	--	--	--	12 years
Julio Sanchez Ramirez	SME1	3	89.1	Farmer	--	76%	$ 1,191.00	$ 905.60	--	--	--	12 years
Sarita Midey Castro	SME1	3	111.4	Farmer	--	211%	$ 1,786.00	$ 3,760.80	--	--	--	--
Daniel Alvarado Padilla	SME1	3	79.3	Farmer	--	260%	$ 1,191.00	$ 3,091.80	--	--	--	--
Fabian Vargas Rojas	SME1	3	334.1	Farmer	--	282%	$ 5,953.00	$ 16,758.00	--	--	--	--
Carlos F. Cubero B.	SME1	3	799.7	Farmer	--	202%	$ 8,811.00	$ 17,809.00	--	--	--	--
El Manu S.A.	SME1	3	2360.8	Forestry	--	227%	$ 20,837.00	$ 47,294.00	--	--	--	--
Roger Luis Jimenez Rojas	SME1	3	1998.3	Farmer	--	259%	$ 14,645.00	$ 37,892.00	--	--	--	--
Jorge Luis Jimenez Rojas	SME1	3	274.7	Farmer	--	429%	$ 2,977.00	$ 12,774.00	--	--	--	--
Jorge Luis Jimenez Rojas	SME1	3	384.6	Farmer	--	508%	$ 4,167.00	$ 21,181.90	--	--	--	--
Ana Virginia Chacon B.	SME1	3	943.4	Farmer	--	508%	$ 6,906.00	$ 35,100.20	--	--	--	--
Maribel Paniagua Chacon	SME1	3	872.3	Farmer	--	616%	$ 8,603.00	$ 53,004.90	--	--	--	--
Juan Vicente Panigua C.	SME1	3	524.8	Farmer	--	768%	$ 5,834.00	$ 44,816.48	--	--	--	--
Mario Arias Quesada	SME1	3	262.4	Farmer	--	768%	$ 2,977.00	$ 22,865.50	--	--	--	--
Mario Arias Quesada	SME1	3	177	Farmer	--	768%	$ 2,977.00	$ 22,865.50	--	--	--	--
Jose Arias Quesada	SME1	3	217.8	Farmer	--	642%	$ 2,977.00	$ 19,120.00	--	--	--	--
Jose Arias Quesada	SME1	3	222.8	Farmer	--	604%	$ 2,977.00	$ 17,994.00	--	--	--	--
Marcial Arias Q.	SME1	3	123.6	Farmer	--	440%	$ 1,786.00	$ 7,851.00	--	--	--	--
Marcial Arias Q.	SME1	3	131.7	Farmer	--	457%	$ 2,977.00	$ 13,607.60	--	--	--	--
Sociedad Rio Danta	SME1	3	752.8	Farmer	--	627%	$ 8,799.00	$ 55,185.84	--	--	--	--
Hacienda La Esperanza	SME1	3	--	Farmer	--	72%	$ 29,766.75	$ 21,500.00	02/24/1997	0 days	--	--
Isidro Quesada Rojas	SME1	3	--	Farmer	--	61%	$ 609.00	$ 371.74	12/19/1996	0 days	--	12 years
Orlich	SME1	3	--	--	--	48%	$ 20,938.00	$ 10,000.00	12/19/1996	54 days	--	12 years
Total: Fundecor: Reforestation Program			14,709.90				$ 218,206.39	$ 531,326.52				

Table 16: El Sewedy Investments

Project	Phase	Operational Program (OP)	Total Carbon Saved (meteric tons)	ngo/private	IRR (pre-loan)	Leverage	Total Project Cost	Intermediary to Project: Loan Amount	Intermediary to Project: Receipt Date	Intermediary to Project: Loan Lag Time (days)	Intermediary to Project: Loan Terms: Loan Rate	Intermediary to Project: Loan Terms: Loan length
El Sewedy Intermediary												
Arabia Beach Resort (Hurghada) 1/97	SME1	5	15.450	private	13.54%	75%	$ 44,000.00	$ 32,000.00	07/20/1997	119	4%	12 months
Giftoun Beach Resort (Hurghada) 2/97	SME1	5	12.590	private	15.97%	75%	$ 26,600.00	$ 20,000.00	07/20/1997	119	4%	12 months
Kanzy Hotel (Giza) 3/97	SME1	5	1.094	private	5.28%	75%	$ 5,600.00	$ 4,200.00	07/20/1997	119	4%	12 months
Bell Air Resort (Hurghada) 4/97	SME1	5	7.030	private	--	75%	$ 18,227.00	$ 13,670.95	07/20/1997	10	4%	12 months
Palmera Beach Resort (Hurghada) 5/97	SME1	5	10.235	private	--	75%	$ 26,139.00	$ 19,604.78	07/20/1997	10	--	12 months
Fayrouz Hilton Resort (Sharm Elsheikh) 6/97	SME1	5	1.744	private	--	75%	$ 23,123.01	$ 17,342.26	07/20/1997	10	--	12 months
Hilton Residence Resort (Sharm Elsheikh) 7/97	SME1	5	0.826	private	--	75%	$ 9,753.00	$ 7,315.17	07/20/1997	10	--	12 months
Hurghada Hilton Resort (Hurghada) 8/97	SME1	5	3.642	private	--	75%	$ 13,330.49	$ 9,997.87	07/20/1997	10	--	12 months
Marriot Resort (Sharm Elsheikh) 9/97	SME1	5	1.974	private	--	75%	$ 13,762.65	$ 10,321.84	07/20/1997	10	--	12 months
Moevenpick Elgouna Resort (Hurghada) 10/97	SME1	5	2.169	private	--	75%	$ 6,114.70	$ 4,596.03	07/20/1997	10	--	12 months
Moevenpick Airport Hotel (Cairo) 11/97	SME1	5	0.655	private	--	75%	$ 8,642.64	$ 5,131.98	07/20/1997	10	--	12 months
Moevenpick Hotel (Cairo) 12/97	SME1	5	1.376	private	--	75%	$ 14,433.50	$ 10,825.13	07/20/1997	10	--	12 months
Moevenpick Resort (Luxor) 13/97	SME1	5	0.000	private	--	75%	$ 1,561.76	$ 1,171.32	07/20/1997	10	--	12 months
Moevenpick Resort (Sharm Elsheikh) 14/97	SME1	5	0.862	private	--	75%	$ 11,147.92	$ 8,360.94	07/20/1997	10	--	12 months
Noeiba Hilton Resort (Sinai) 15/97	SME1	5	1.019	private	--	75%	$ 10,563.16	$ 7,922.37	07/20/1997	10	--	12 months
Safir Hotel (Cairo) 16/97	SME1	5	0.417	private	--	75%	$ 2,109.56	$ 1,582.17	07/20/1997	10	--	12 months
Safir Hotel (Giza) 17/97	SME1	5	1.360	private	--	75%	$ 6,881.22	$ 5,160.92	07/20/1997	10	--	12 months
Semiramis Intercontinental (Cairo) 18/97	SME1	5	0.891	private	--	75%	$ 4,007.96	$ 3,005.97	07/20/1997	10	--	6 months
Sol Media Resort (Hurghada) 19/97	SME1	5	1.930	private	43.73%	75%	$ 7,485.29	$ 5,613.96	10/22/1997	81	4%	12 months
American University in Cairo 20/97	SME1	5	1.217	private	127.00%	75%	$ 4,705.88	$ 3,529.41	10/23/1997	18	4%	12 months
Moevenpick El Gouna (El Gouna)	SME1	5	0.541	private	92.03%	75%	$ 4,705.88	$ 3,529.41	10/23/1997	88	4%	12 months
AEDCO / Lighting Div. 1/98	SME1	5	10.562	private	14.83%	75%	$ 43,382.35	$ 32,536.75	03/01/1998	8	4%	12 months
Pyramisa Hotels & Resorts 2/98	SME1	5	-	private	45.40%	75%	$ 33,354.00	$ 22,035.00	04/19/1998	4	4%	12 months
El Sewedy Light Division 3/98	SME1	5	-	private	56.77%	75%	$ 38,860.45	$ 29,145.11	04/15/1998	10	4%	12 months
El Sewedy Light Division 4/98	SME1	5	-	private	58.59%	75%	$ 58,250.59	$ 43,687.94	05/11/1998	0	4%	12 months
El Sewedy Light Division 5/98	SME1	5	-	private	46.38%	75%	$ 34,855.09	$ 26,125.57	06/01/1998	0	4%	12 months
Ministry of Foreign Affairs 6/98	SME1	5	4.218	private	21.66%	75%	$ 29,380.00	$ 22,035.00	08/10/1998	2	4%	12 months
El Sewedy Light Division 7/98	SME1	5	3.864	private	42.42%	75%	$ 17,488.00	$ 13,116.00	08/10/1998	2	4%	12 months
El Sewedy Light Division 8/98	SME1	5	8.865	private	65.61%	75%	$ 32,514.44	$ 24,385.00	10/12/1998	57	4%	12 months
El Sewedy Light Division 9/98	SME1	5	9.632	private	50.89%	75%	$ 32,849.97	$ 24,637.00	10/12/1998	42	4%	12 months
SEGA Energy & Environment Co. 10/98	SME1	5	3.067	private	10.97%	75%	$ 19,900.00	$ 14,925.00	10/16/1998	9	4%	12 months
Total: El Sewedy			107.231				$ 603,729.51	$ 447,510.85				

Table 17: Remaining Intermediary Investments

								Intermediary to Project				
											Loan Terms	
Project	Phase	Operational Program (OP)	Total Carbon Saved (meteric tons)	ngo/private	IRR (pre-loan)	Leverage	Total Project Cost	Loan Amount	Receipt Date	Loan Lag Time (days)	Loan Rate	Loan length
EEAF Intermediary							$ -	$ -				
Soluz Inc.	SME1	6	1030.5	private	30%	20%	$ 375,000.00	$ 75,000.00	11/05/1997	38 days	12%	5 years
EESM	SME1	5	4390	private	27%	38%	$ 217,450.00	$ 60,000.00	--	--	13%	5 years
Total: EEAF							$ 592,450.00	$ 135,000.00				
Caresbac-Polska Intermediary												
Symbio Impex Polska	SME1	3	--	ngo	19%	60%	$ 250,000.00	$ 180,000.00	04/23/1998	--	--	--
Jukan	SME1	3	150630	private	21%	12%	$ 1,256,989.00	$ 150,000.00	04/02/1997	11 days	8-12%	5 years
Triada Druk S.K.	SME1	Short-term Response	341.25	private	30%	8%	$ 210,225.00	$ 17,500.00	06/19/1997	103 days	10%	4 years
Agroplon	SME1	3	--	Farmers	22%	7%	$ 1,890,405.00	$ 135,000.00	02/07/1997	113 days	5%	5 years
POLKAT	SME1	3	--	private	19%	2%	$ 2,586,058.00	$ 50,000.00	11/09/1998	9 days	10%	4 years
Total: Caresbac-Polska S.A.							$ 6,193,677.00	$ 532,500.00				
WWF												
Kikori River	SME1	3	--	ngo	12%	17%	$ 600,000.00	$ 100,000.00	--	--	5%	--
Total: WWF							$ 600,000.00	$ 100,000.00				
Dessau-Soprin ADS (Econoler)												
STGE	SME1	5	--	ESCO	40%	21%	$ 1,405,000.00	$ 240,000.00	--	--	--	--
Total: Dessau-Soprin ADS (Econoler)							$ 1,405,000.00	$ 240,000.00				
Conservation Int'l.												
Casmach	SME2	3	--	ngo	17%	100%	$ 97,303.00	$ 97,303.00			20%	180 days
Total: Conservation Int'l.							$ 97,303.00	$ 97,303.00				
FCG*												
GEOTEC, S.A.	SME2	6	N/A	ngo	N/A	N/A	N/A	N/A	N/A	N/A	7%	N/A
F.D.N. Tilapias	SME2	3	N/A	private	N/A	N/A	N/A	N/A	N/A	N/A	7%	N/A
Fincas Organicas	SME2	3	N/A	ngo	N/A	N/A	N/A	N/A	N/A	N/A	7%	N/A
Promoción Ecoturistica	SME2	3	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	7%	N/A
Total: FCG							$ -	$ -				
Selco Vietnam												
PV Home Lighting System	SME2	6	--	private	--	--	--	$ 203,350.00			15%	
Total: Selco Vietnam							$ -	$ 203,350.00				
Grameen Shakti												
PhotoVoltaic Cell Sales	SME1	6	--	nfp	18%	75%	$ 1,225,000.00	$205,611.00	--	--	12%	3 years
Total: Grameen Shakti							$ 1,225,000.00	$ 205,611.00				
Save Valley Wildlife												
Save Valley Conservancy	SME2	1	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Total: Save Valley Wildlife							$ -	$ -				
International Expeditions*												
Peru	SME2	4	N/A	N/A	N/A	N/A	$ 500,000.00	$ 250,000.00	N/A	N/A	N/A	N/A
Belize	SME2	3	N/A	N/A	N/A	N/A	$ 4,000,000.00	$ 250,000.00	N/A	N/A	N/A	N/A
Bolivia	SME2	4	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Equador	SME2	4	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Total:International Expeditions							$ 4,500,000.00	$ 500,000.00				

ANNEX 2: IFC/GEF SMALL AND MEDIUM-SIZED ENTERPRISE PROGRAM – UPDATE TO THE EVALUATION, JUNE 2002

July 1, 2002

IFC/GEF Small and Medium-sized Enterprise Program

--*Update to the Evaluation*

for the

International Finance Corporation (IFC)

and the

Global Environment Facility (GEF)

Econergy International Corporation
1925 K Street, Suite 230
Washington, DC 20006
(202) 822-4980

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SUMMARY

This report is an update of the Evaluation of the IFC/GEF SME Program ("the SME Program") completed by Econergy International Corporation (EIC) and EA Capital in January of 2000. The update itself reflects all changes and continued activities that took place after May of 1999 until May of 2002.[1]

This document has two parts:

1) the main text of the document takes the set of issues and findings discussed in the 2000 Evaluation and updates them based on the two extra years of activity by the SME Program; and,
2) the Annex, which describes the Intermediaries that have been added to the Program since the data collection began for the 2000 Evaluation.

Overall, we find the SME Program to be well structured and functioning better then the original designers had intended. Despite changes in management during this period, the Program has delivered more projects than they had originally promised with a high rate of loan repayment to date. The SME Program has illustrated that it is possible to meet GEF Objectives using non-grant financing mechanisms on terms approaching commercial levels. Of the three strategies outlined in the original Project Document, only the strategy *Monitoring, evaluation, and dissemination of the Program results* could be addressed more fully in our opinion.[2] The SME Program Management has made efforts to undergo outside review and evaluation, but more steps could be taken to regularly monitor the results of the Program's lending activities and disseminate this information to Program stakeholders.

The Evaluation Team was also able to review the planned changes to the SME Program that would occur if the GEF Council endorses a new replenishment of the Program. The planned SME Program replenishment will focus on the identification of commercial financial institutions to become the project's new financial intermediaries ("FI"). Under this new model, the SME Program would work with these FI's to improve their knowledge of and invest in SME markets offering projects with global environmental benefits. A system to monitor and evaluate the global environmental benefits and financial success of the projects and the FIs will be developed and implemented to allow for a more accurate quantification of these benefits. This new model would also greatly improve the leverage ratio of GEF funds and increase the likelihood of mainstreaming lending into these developing but risky markets.

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[1] While the original IFC/GEF SME Program Evaluation was published in January of 2000, data collection stopped as of September 1999 and only reflects projects developed by Intermediaries that were active as of May 1999.

[2] The document, *Global Small and Medium Scale Enterprise Program Replenishment, Project Document, January 1997* outlined three specific strategies. These are: 1) a sufficient number of projects need to be developed to provide a basis for future conclusions and lessons, 2) building capacity in non-financial Intermediaries, and 3) m*onitoring, evaluation, and dissemination of the Program results.*

FINDINGS AND RECOMMENDATIONS

GOALS AND GENERAL OPERATION

To date, the Program has surpassed its targets of lending to 100 SMEs through the use of local intermediaries and has funded 139 projects up until May 2002. Of the 21 intermediaries, only one is currently experienced real difficulty making timely payments, reflecting a 95% program repayment rate to date[3]. This high collection rate of the SME Program portfolio reflects the careful development of the Program's investment criteria for both intermediaries and projects. The table below list the number of projects for each Intermediary. **The 2000 Evaluation Team's original critique of the Program's Goals and General Operations stands.**

Table 18: Number of projects for each Intermediary

	Approved as of 2000 Evaluation	Approved to Date	Difference
Intermediaries (2000 Evaluation)			
CARESBAC	5	6	1
.EEAF	2	2	0
FUNDECOR	58	63	5
El Sewedy	31	34	3
WWF	1	1	0
Econoler Int'l	1	1	0
Grameen Shakti[4]	1	1	0
SELCO Vietnam[4]	1	1	0
Conservation Int'l	1	6	5
FCG	4	12	8
Save Valley Wildlife	1	1	0
Peer Consultants	0	3	3
International Expeditions	1	1	0
sub-total	**107**	**132**	**25**
New Intermediaries (Update to the 2000 Evaluation)			
Cogener		1	
Wilderness Gate		1	
Pilco[4]		1	
Barclay's Bank of Botswana		0	
Soluz Honduras[4]		1	
Boundary Hill		1	
E&Co		2	
Credicoop		0	
sub-total		**7**	
Projects Total:	**107**	**139**	**25**

[3] The intermediary Cogener is currently having financial problems and cannot make its required payments to the SME Program.

[4] These Intermediaries sold individual renewable energy and energy efficiency system units. The total number of units sold was not used in the table because it would artificially increase the number of projects listed. For illustrative purposes; Grameen Shakti sold 7,463 solar units, Selco Vietnam sold 1,408 solar units, Pilco sold 599 solar units, and Soluz Honduras sold 1,528 solar units.

LOAN QUALITY AT THE INTERMEDIARY LEVEL

The SME Program Management has taken special care to ensure the quality of each loan given to an Intermediary.[5] The review and selection process necessary for an organization to become an intermediary appears thorough enough to ensure the high quality of the SME portfolio. This is illustrated by the fact that only one of twenty-one intermediaries is currently experiencing difficulties resulting in non-payment to the IFC.

In many cases the SME Program has required some additional security in the form of a personal or corporate guarantee or a letter of credit for the loan. Guarantees or letters of credit are currently in place for Pilco, Wilderness Gate, Savé Valley, El Sewedy, Selco Vietnam, Pilco, Peer, Boundary Hill, Econoler, Cogener, and International Expeditions. Table 19 below updates the table presented in the original document ranking the quality of each Intermediary's loan. The rating system used is as follows:

Positive:	able to service principal and interest payments
Neutral plus:	too early to judge but likely to meet debt-servicing requirements
Neutral:	too early to judge ability to meet debt-servicing requirements
Neutral minus:	too early to judge but unlikely to meet debt-servicing requirements
Negative:	not likely to be able to meet debt-servicing requirements and losses likely

Table 19: Loan Quality Ranking by Intermediary[6]

Positive	***Neutral Plus***	***Neutral***	***Neutral Minus***	***Negative***
El-Sewedy	CARESBAC			
	Soluz-Honduras			
FUNDECOR	Grameen Shakti			
	FCG	Boundary Hill		
Conservation International	SELCO			
		Wilderness Gate		
Pilco				
		Econoler Int'l	Cogener	
WWF	International Expeditions	Savé Valley		
E&Co.	EEAF	Peer		

Repayment risk lies for the most part with the Intermediary. Most intermediaries have a large enough portfolio enabling them to withstand one or two bad loans and still meet their obligations to the SME Program. Only in situations where the Intermediary is the "SME" (they only intend to invest in one SME activity) does the SME Program expose itself to substantial repayment risk. These intermediaries are: Savé Valley, Cogener, and Boundary Hill.

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[5] Quality in this context is defined as a low probability of default.

[6] Barclay's Bank of Botswana and Credicoop was not included in this analysis because they have not placed funds in any projects at the time of this report, and because of this their future with the SME Program is not known at this time. However, we consider them to be financially able to pay back any loans from the IFC.

In these cases, the SME Program should consider requiring more risk guaranteeing mechanisms to reduce overall exposure to non-payment. It should be mentioned that of the three above listed Intermediaries; Save Valley is currently experiencing troubles (although able to make loan payments) due to Sovereign Risk[7] and Cogener is not able to service its debt due to a problem regarding access to working capital.[8]

PROGRAM IMPACT

It is clear from a review of the payback rates and the number and type of projects financed that the program has been a success. The SME Program has clearly demonstrated to date that grant-based and other concessional financing are not the only vehicles for meeting GEF goals. Further, the terms and conditions under which the newly financed Intermediaries have agreed to draw SME funds are beginning to approach market terms (higher interest rates and less risk compensation).

In our opinion, it is still too early to evaluate whether the SME Program has stimulated commercial institution investment in the targeted markets. Anecdotal evidence indicates that, when the SME Program invests in a project, the market sees this as an indication of quality for the project, but no empirical data or other source data related to the SME Program currently exists to qualify this assessment.

Moving forward, The Evaluation Team has identified three recommendations:

1) the SME Program, when possible, should lend at terms closer to market rates,
2) the SME Program should more directly link risk compensation to specific market and project risks; and
3) the SME Program Team should make efforts to monitor and measure the longer-term efficacy and sustainability indicators to better understand how the project-level activities impact the program level goals.

LEVERAGING

The current requirement for leveraging of SME Program funds simply states *"the amount of funding provided by the SME Program generally will not equal the full cost of the project,"* which equates to a leverage ratio of only one (1) or a little over one (1.x)[9]. Based on provided balance sheet information from SME intermediary and project investments, the weighed average leverage ratio for the original 13 Intermediaries is 4.08, while six of the eight (8) intermediaries added since the last evaluation have a leverage ratio of 3.67, which is somewhat lower than the original group of intermediaries (two of the intermediaries, Credicoop and Barclay's Bank of Botswana, have not yet invested in any SME activities so we were unable to calculate a leverage ratio). The small decrease in the leverage ratio is not of concern, but we feel as the SME Program

[7] Further, Savé Valley has a corporate guarantee from Delta Hotels.

[8] Cogener's senior lender (UBS) has changed its lending policy toward SMEs. See the section on Cogener in the Annex for more detail.

[9] "*Global Small and Medium Scale Enterprise Program Replenishment, Project Document,"* International Finance Corporation, January 1997.

develops and gains more experience that it should strive to increase this level substantially. This is based on the idea that the IFC/GEF SME Program funds should act as a quality indicator for a project and attract other forms of debt and equity financing (the figures below indicate the average ratio of leveraging for each Intermediary).

While this is very likely happening in many cases, the SME Program should try to ensure that SME funds achieving higher leverage ratios in the future and more accurately reflect the level of risk associated with the project.

Figure 1: Leverage of SME Program Funds by Intermediaries (list of intermediaries from 2000 Evaluation)[10]

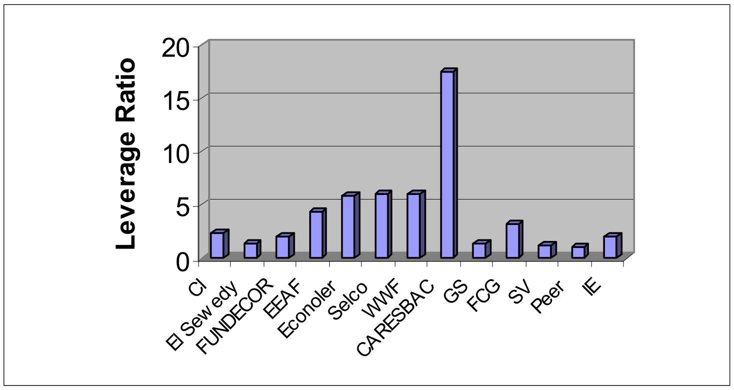
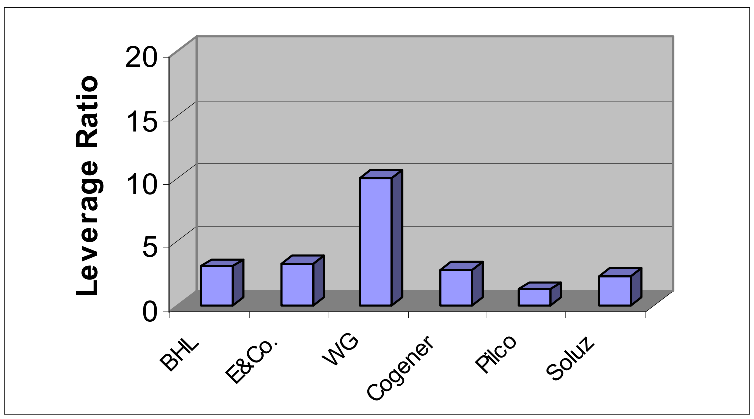


Figure 2: Leverage of SME Program Funds by New Intermediaries (Update to the 2000 Evaluation)[10]



COUNTRY-DRIVENESS

The SME Program, generally speaking, has done a good job at ensuring a global distribution of project activities across GEF eligible countries. They exceeded their target in Central America, South America and the Caribbean, North Africa and Middle East. Their target for China, Oceania, South East Asia, the India-Pakistan-Bangladesh region, Eastern Europe, West Africa, South and East Africa have not been met to date (See Table 20 below). It should be noted that these targets were a rough indicative guideline and were not to be used as specific milestones.

Table 20: Regional Distribution of SME Projects

[10] Credicoop and Barclay Bank of Botswana were not included in these tables because they have not placed funds in any SME activities to date.

Intermediaries	Region	Number of Projects, January 1997	Target for first replenishment	Number of Projects, May 2002
EEAF, Fundecor, FCG, Int'l. Expeditions, Conservation Int'l.	Central America, South America and Caribbean	5	15	88
Barclays Bank of Botswana	West Africa	0	5	0
Peer Consulting, Save Valley Wildlife	South and East Africa	0	10	5
El Sewedy, Econoler, Cogener, PILCO	Northern Africa and Middle East	6	10	37
Caresbac-Polska S.A.	Eastern Europe	4	10	6
Grameen Shakti	India, Pakistan and Bangladesh	0	15	1
Selco Vietnam	South East Asia	0	10	1
	China	0	15	0
WWF	Oceania	1	10	1
	Total	**16**	**100**	**139**

The SME Program is currently operating in 21 countries with a strong focus in Latin America and North Africa. It is SME Program policy to require Intermediaries to obtain GEF Operational Focal Point approval before operating in-country, which they have received from each of these countries. In the process of getting this approval, the Program has requested and received an additional 51 "no-objection" responses from other Country Focal Points. In some cases, this process took a longer then expected amount of time and unnecessarily delayed project development activities. **For those countries that the SME Program does not already have approval, we suggest advising new Intermediaries to immediately begin discussions with the GEF Focal Point (before loan signing) to account for delays in this process.**

FINANCIAL SUSTAINABILITY

At the time of the 1999-2000 SME Program Evaluation, the Evaluation Team found that most of the loans to the Intermediaries were offered at 'concessional' rates, with substantial covenants in place for risk mitigation[11]. This allowed the Intermediaries to pass on a portion of the financial concessionality to the SME, and thus not contributing to the long-term sustainability of this type of lending. Looking at the portfolio of 8 new intermediary participants since the last Evaluation (as of May 1999), 3 have no risk sharing clauses and 4 have market or near market interest rates

[11] These covenants included: low rate loan interest rates, risk compensation for delivery of project investments and required payments, and coverage of expenses through specified fees which the Program agreed to pay to certain Intermediaries.

(See Table 21 in the Annex for further detail)[12]. Of these intermediaries that do have risk sharing agreements in place, the level of risk compensation has dropped from 50 percent to 25 percent.

The Evaluation Team is pleased with the overall trends and the positive direction in which these variables are heading. **We recommend that the SME Program continue to reduce the level of risk compensation with the intermediaries and increase the interest rates closer to commercial terms to better reflect underlying project risks and benefits.** This will, in turn, attract more (financially viable) projects to come forward. In time, this should encourage the development of more direct private sector lending on commercial terms to the sectors which the SME program is currently serving.

INCREMENTAL COST AND INCREMENTAL RISK

For the purposes of this Evaluation Update, the incremental cost to a project is the difference between the cost of the baseline activity (the option the SME would have chosen if they did not have access to SME Program financing) and the cost of the project being proposed (with global environmental benefits). The incremental risk is the added risk associated with investing in these "non-traditional" markets identified by the SME Program.[13]

At the intermediary level, these costs and risks are well covered by fees paid to the Intermediaries and risk compensation by the SME Program. The SME Program has increased the usage (since the last evaluation) of these options in an effort to more accurately link concession to risk and cost.

At the project level, we feel that due to the small size of many of the SME loans and the high level of effort necessary to calculate the incremental cost, that this should remain as is and not be a requirement for lending to SMEs. Further, for performing loans, no incremental cost or risk is incurred once funds are returned to the IFC. This incremental cost and incremental risk should instead be examined, up front, by the SME Program and Intermediary staff when they are selecting specific sectors and countries in which to invest.

The development of a risk matrix examining the risks and subsequent associated costs of investing in these countries and sectors should be developed to help guide the investment process.

THE ROLE OF TECHNICAL ASSISTANCE

The original goal of the technical assistance funds was to: strengthen management capacity and commission business plans. In the case of FCG, Econoler, and Fundecor, TA funds were used to improve the capacity of Intermediaries in this way. The use of technical assistance funds continues to be used for this purpose, but now is also used to improve or help quantify GEF

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[12] Cogener, Boundary Hill, and Soluz do not have risk sharing agreements.

[13] Looking at the incremental risk at the project level is outside the mandate of the SME Program, and is instead covered by the Intermediary.

related project benefits (specifically in the case of CARESBAC, Savé Valley, Boundary Hill, and Credicoop).

Under the next replenishment of GEF funds for the SME Program, the Program should us TA funds to: 1) develop a standardized system to evaluate, monitor, and quantify the environmental benefits that contribute to GEF objectives, 2) help Intermediaries better identify potential SME projects that contribute to GEF Objectives, and 3) strengthen the SME projects and markets at the country level. In essence, use funds which would normally be taken up by the concessional interest rate and use them for more targeted technical assistance leading to more market development and better understand the financial and global environmental benefits of this form of SME debt financing.

COORDINATION BETWEEN THE IFC AND THE GEF

One of the recommendations of the 2000 SME Program Evaluation was the creation of a GEF Advisory Panel to evaluate whether a project met the goals of the GEF Operational Program identified by the Project Sponsors. This Panel has been created and now reviews proposed projects and either provides an “objection” or “no objection” ruling.

Further attention should be given to the communication of Program results and activities to the GEF Secretariat. Specifically, the GEF Secretariat needs to be better informed as to the level of GEF benefits each of the SME projects contributes. As stated above, **the SME Program should develop a monitoring and evaluation system for quantifying the GEF benefits associated with its investments and a system to report regularly to the GEF Secretariat and other interested parties.** This system should integrate any current GEF or IFC indicators already developed.

SUB-PROJECT LEVEL ACTIVITY

The original Evaluation Team ranked the quality of the SME investments based on two criteria: 1) Commercial Strength and 2) ability to meet GEF environmental objectives. Generally speaking, all project investments were chosen for their ability to meet GEF objectives. Therefore when evaluated independently, all projects rank highly in this regard. However, the methodology used to make this evaluation was one that was more “qualitative” then “quantitative,” in nature and thus it is not possible to specifically say on a project-by-project basis what the micro-level global environmental benefits would be (i.e. tons CO_2 reduced, number of species protected, etc…)[14]. The only time the delivery of GEF benefits is at risk is when the commercial viability of a project is in question or when an Intermediary is not actively investing in SME projects.

[14] It should be noted that these “qualitative” reviews were done by experts in the project investment area and are deemed of high value for their ability to qualify global environmental benefits.

Four Intermediaries are worth noting concerning the risk of non-delivery of environmental benefits. These are: Barclay's Bank of Botswana, Savé Valley, Cogener, and CARESBAC[15]. These projects are presently being monitored by SME Program Staff to help mitigate the risk of non-delivery of global environmental benefits.

MARKETING THE SME PROGRAM

As was the case during the original Program Evaluation, the SME Program is still not widely known outside a small community of actors in the fields of climate change and biodiversity. If the future objective is to create a commercial lending market to the targeted industries, than more interaction with mainstream private sector commercial financial institutions will be needed. The Program has done a good job at building this capacity with the current set of intermediaries, but it must go further and share their experiences with other possible institutions that may be interested in serving this market.

Following the next replenishment of GEF financing of this program, the SME Program should identify and actively pursue interested traditional commercial financial institutions to become Intermediaries. These institutions will be better able to continue financing the target sectors on a sustainable basis after SME funds have been placed in investments and repaid.

It should be noted, that concern has been raised within the GEF Secretariat that as the SME Program attempts to 'mainstream' or 'commercialize' this program, some projects with marginal returns (but large global environmental benefits) may not be able to take on loans at commercial rates. The underlying logic of this concern presents the following scenario; one might assume that *most* projects [in the SME Program's target sectors] with large global environmental benefits offer less attractive financial returns, and the reverse also is true (*environmental benefits and financial returns are negatively correlated*) [16].

This dilemma can be addressed by using a portfolio approach when selecting project investments. The two overall deliverables a SME loan must present are: financial returns (so that the loan may be repaid) and global environmental benefits. By graphing environmental benefits and financial returns of each potential investment type (specific sector or technology) within a country, the SME Program can develop a portfolio with an optimal distribution of projects providing the greatest possible amount of global environmental benefits and financial returns. [17] By selecting a predetermined distribution of projects with high financial returns but low global environmental benefits, projects with high global environmental benefits but low financial returns, and a set with characteristics somewhere in between, the portfolio can deliver the required returns and benefits without excluding some 'ideal' projects with high global environmental benefits.

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[15] **CARESBAC** is a marginal case, where looking at their entire portfolio they should be able to deliver the promised environmental benefits, but it should be noted that 2 out of 6 projects will not deliver global environmental benefits. **Barclay's Bank of Botswana** has not placed funds into SME activities because of several management changes. **Savé Valley** is currently at risk due to uncertainties over the issue of land reform in Zimbabwe. **Cogener** is currently having cashflow problems.

[16] This underlying assertion is by no means proven. Circumstantial evidence from the market does show that small-scale environmentally benign projects are less financially attractive then large-scale traditional energy projects, but no solid analysis of the relationship between environmental benefits and financial returns has been proven quantitatively.

[17] An optimal distribution will offer a portfolio of projects that maximizes both global environmental benefits and financial return, without substantially reducing either.

The SME Program should investigate this trend to verify whether this is in fact true. If so, they should construct a matrix of environmental benefits and financial returns by project investment type (i.e. solar voltaic, eco-lodge, energy efficiency, etc…) in an effort to develop a strong portfolio of investments. This will allow the SME Program Management to develop a set of lending terms that takes into account this environmental-benefit/financial-return relationship and create a portfolio of loans that meet the [financial and global environmental] goals and objectives of the Program most effectively. By taking this portfolio approach, and evaluating the overall ability of the Program to meeting its objectives and goals (and not always examining this at the project level), the Program should be more effective at goal delivery.

GENERAL STRUCTURE

The evaluation Team considered four areas of the SME Program Structure: Risk Mitigation, Cost Management, Project Identification, and the Investment Review and Authorization Process.

We have found that the SME Program has a very strong risk mitigation strategy at the Program level. The total cost of risk mitigation strategies is estimated at 10.4 percent of financing to intermediaries as of June, 2002.[18] Risk is limited to failure to repay loans by the Intermediary, which in most cases is guaranteed by other forms of security. Further, the program has shown a considerable level of refinement in the use of risk management tools since the original Evaluation. **The SME Program should consider ways to share these tools and experiences with other Intermediaries so they can also use them to reduce risk of non-payment by SMEs.**

Generally speaking, the Program has been able to quantify the costs associated with completing a transaction. However, the SME project authorization process actually contains several hidden costs, which are not accounted for in the SME budget. For example, part of the project review process is conducted by non-SME Program staff (i.e. the voluntary Advisory Panel). **Metrics should be developed to more actively monitor these costs.** This way the Program can better understand the costs associated with due diligence and project review.

The current process used to review and authorize SME investments should be appraised to identify possible efficiency improvements in order to more effectively meet the needs of the potential recipient. In the case of E&Co., the process to authorize a loan required the review of a project by 6 different individuals outside of E&Co. **The SME Program should work toward reducing the amount of time and effort involved in reviewing SME project investments and allow Intermediaries to independently make these decisions (based on a predefined set of criteria developed by the Intermediary and the SME Program Management)**. To this end, every new Intermediary should be required to take all the steps necessary to become an Authorized Intermediary to reduce the time and steps necessary to authorize a loan.[19] After a set

[18] This figure was calculated by dividing total funds lent to intermediaries by all costs associated with risk mitigation (completion fees, risk compensation, and monitoring fees). This percentage was based on data from FY1997-2002 and will change as more lending takes place, it should be considered a static indicator.

[19] There are currently two types of Intermediaries: **Qualified Intermediaries** and **Authorized Intermediaries**. Qualified Intermediaries must obtain Program approval before lending funds to a SME activity, Authorized Intermediaries do not need this approval.

time, if the Intermediary has not shown the ability to become an Authorized Intermediary, the later tranches of funds should be de-obligated and redirected towards other Intermediaries.

MAINSTREAMING

The main indicator used by the GEF to assess how GEF objectives are being mainstreamed into an Implementation Entity's business is the level at which a GEF project is leveraged by other Implementation Entity funds. Substantial sums of IFC and World Bank co-financing have been raised for GEF sponsored projects, but when directly examining the SME Program portfolio, very little IFC or World Bank co-financing has been mobilized to date.

It is very difficult to assess the SME Program's impact on the other macro-oriented measures of mainstreaming within the World Bank[20]. These include: amount of loans going to projects with GEF benefits, internal incentives for staff to pursue projects with GEF benefits, and level of integration of GEF objectives into normal operations. No doubt, some cross-pollination of activities is taking place, but it was not possible to evaluate the level at which this is occurs due to the nature of the program and the small size of the project investments[21].

We are pleased to report that the Program Team is currently developing a strategy that will improve the level of IFC co-financing for future projects. **This strategy is also designed to leverage GEF funds with other multi-lateral and commercial sources of debt and reposition the SME Program to more closely benefit from other SME activities within the World Bank.**

[20] As defined by the GEF Secretariat.

[21] The example where this is taking place is the intermediary Boundary Hill.

ANNEX 1: NEW INTERMEDIARY REVIEW

This section describes the Intermediaries, which have secured financing from the SME Program after May 1999. A basic comparison of the terms of these loans indicate that the SME Program is trying to reduce the amount of risk compensation and increase interest rates in an effort to attract projects that are more commercially viable and thus show the commercial lending sector that these types of SME financing arrangements are viable opportunities for capital deployment.

Table 21: Terms for the Intermediaries signed after May 1999

Borrower	Location	Approved Amount	Amount Disbursed	Interest Rate	Term (yrs.)	Grace Period (yrs.)	Risk Compensation	TA Grants	GEF Benefits
Pilco 2222222222222222222	Egypt	$ 750,000	$750,000	2.5%		3	25%	none	5, 6
Cogener	Tunisia	$500,000	$500,000	8.0%	6	1	none	none	5, 6
Wilderness Gate	Central America	$1,000,000	$500,000	2.5%	10	none	25%	none	3, 4
Soluz Honduras – loan	Honduras	$400,000	$400,000	8.0%	10	none	none	none	5, 6
Soluz Honduras – equity	Honduras	$100,000	$100,000	n/a	n/a	n/a	n/a	n/a	n/a
Boundary Hill	Tanzania	$200,000	$200,000	12.5%	8	none	none	$ 35,500	1, 3
E&Co	Global	$1,000,000	$500,000	5.0%	8	none	0%	$7,000	5, 6
Credicoop	Chile	$600,000	$0	2.5%	7	3	25%	$50,000	5, 6
Totals		$4,550,000	$2,950,000						

PILCO

Pilco was originally referred to the SME program by another intermediary, El Sewedy. The SME funds were used to purchase 1000 solar water heaters for sale to Egyptian households and to set up a customer-crediting program. Their goal is to sell 700 systems by October 2002, which they appear to be on track to meet.

The project has reported losses in 2001 and has been hit by the devaluation of the Egyptian Pound in relation to the U.S. dollar. However, we feel that this will not impact the firm's ability to make debt repayments to the IFC. Pilco is a separate company within a group of family run businesses. The SME Program loan benefits from a personal guarantee by one of the senior officers/owners.

COGENER

Cogener is an example of a single project intermediary. The project involves the purchase and installation of solar cell powered digital and video advertising screens in the Tunisian International Airport. The main source of revenue from this project is from advertising contracts. At project inception, the project IRR was calculated to be 34%.

At present, the project is experiencing near-term cash flow problems related to a delay in the signing of new advertising contracts. The delay in these contracts has led the project's other creditors to reduce Cogener's credit and thus their working capital. The project is currently in a difficult situation, where they need capital to close future advertising contracts, but cannot get access to capital until they close these contracts. This problem has been exacerbated by a reduction in credit from Cogener's senior lender. UBS (Cogener's senior lender) changed its policy towards lending to SMEs and is no longer allowing Cogener to access the amount of credit originally agreed to.

This loan is at risk and is now in arrears for 2002 payments. SME Program staff are currently trying to help the management of Cogener explore options to become current on their debt service. Should Cogener default on its loan, the guarantees in place will not cover current outstanding loans receivable. In the case of a default, it is likely that the global environmental benefits will persist because the equipment will be resold and continue to be used.

WILDERNESS GATE

Wilderness Gate is a U.S. based company with the mandate to invest in Latin American eco-tourism projects. The agreement with the SME Program calls for the identification and investment in 4 eco-lodges.

At present, it only have one investment, which is the *Lodge at Pico Bonito*. The Lodge at Pico Bonito is a luxury eco-tourism resort located on Honduras' Caribbean coast near the Pico Bonito National Park and approximately 30 minutes from the city of La Ceiba (one of the main Caribbean ports for Honduras). Total project cost is $2.6 million, with a Wilderness Gate equity investment of $500,000 ($250,000 of which is SME Program funds). The overall project return (based on high room occupancy rates) is 24 percent, but a more conservative rate of 13 percent is offered, which takes into account lower than expected occupancy rates.

Much like the other eco-tourism investments, Wilderness Gate's Pico Bonito project will be very dependent on the perception of the country (in this case Honduras) as a safe vacation destination. Lower than expected occupancy rates have severely hindered the project and caused them to reschedule some of their debt. This is impacting negatively Wilderness Gate's ability to develop more SME projects. It is our assessment that this will not impact Wilderness Gate's ability to pay back the SME Program because the loan benefits from several forms of security in the form of one letter of credit and three personal guarantees from the partners of Wilderness Gate. This security should be sufficient to cover the SME loans.

This project meets the requirements of the GEF's Operational Programs 3 and 4 (forest and mountain ecosystems). Further, the creation of this eco-lodge will promote knowledge in the local community by showing it the financial value of preserving the region's ecosystem for tourism.

SOLUZ HONDURAS

Soluz Honduras' mandate is to deliver solar electricity to otherwise un-electrified rural communities in Honduras. Homeowners can rent complete systems from Soluz, which offer enough electricity to power lights and a TV or radio.

Soluz has received their entire $400,000 loan from the SME Program. Soluz Honduras is unique in the SME Program portfolio in that it was also awarded $100,000 in equity financing. The project has three milestones to meet: they must sell 1,500 units to get access to second a tranche of investor financing (totaling $1.0 million, which they have now received), 2,500 units to breakeven, and 5,000 units representing a high profitability mark. It is too soon to tell if they will make these two other milestones.

This project meets the requirements of the GEF's Operational Programs 6 and 7 (*Promoting the Adoption of Renewable Energy by Removing Barriers and Reducing Implementation Costs* and *Reduce the Long-term Costs of Low Greenhouse Gas Emitting Energy Technologies*).

BOUNDARY HILL LIMITED

Boundary Hill Limited ("BHL") is an eco-lodge along the border of the Tarangire National Park that works with the local community to preserve the region's ecosystem. $200,000 in SME funds in addition to an IFC loan of $200,000 and $400,000 in additional private funds will be used to develop a 16 bed luxury lodge within 60,000 to 70,000 acres of land which creates a buffer ecosystem around a portion of the park. BHL is jointly owned and managed by the local Maasai community of Lolkisale Village.

The project was given a technical assistance grant of $35,500 to supplement $65,000 of BHL funds for the purchase of equipment to improve the wildlife management plan of the private reserve.

Most of the annual supervision as well as the monitoring and evaluation of the project is done by an IFC team as the result of a $200,000 loan to the project from the IFC Regional Office.

This project was referred to the SME Program by the African Project Development Facility.

This appears to be a strong project with a high likelihood of repayment of funds. The main risks associated with this project are two-fold: 1) it is dependent on strong management, and 2) it is exposed to sovereign risk. As the SME program managers have seen elsewhere, project viability is often dependent on the quality of management, without which some project may flounder. Should the management of this project change, the viability of this project would have to be reassessed. The success of the tourism industry in Tanzania will be highly correlated to the country's sovereign risk as well as global economic conditions. Should the overall perception of Tanzania become negative, tourists will look to other countries in the region and BHL will lose its source of foreign revenues.

E & CO.

E&Co. is a U.S.-based not-for-profit firm with a project office in Costa Rica, which promotes micro-financing for clean energy projects in the developing world. The agreement with the IFC/GEF SME Program is to identify and lend funds to a total of 5 projects.

Two projects have received SME funds to date. These are *Consorcio de Inversiones Sociedad Anonima (CISA)* and *Econergy Ltd. of Jamaica*.

Consorcio de Inversiones Sociedad Anonima (CISA) is a run-of-the-river mini-hydro project in Honduras that generates 485kW of electricity. The total project cost was approximately $1.0 million with a total E&Co. loan of $250,000 at 7 percent ($125,000 of which used SME funds. Funds have not yet been disbursed for this project. The project, while only offering a 4 percent IRR (just meeting the SME's profitability requirement) does have a long-term power purchasing agreement (PPA) and is deemed a relatively low investment risk.

Econergy Ltd. of Jamaica is a small energy services company (ESCO) that is currently developing a building energy efficiency project in one of the Petroleum Corporation of Jamaica's headquarters buildings. This project has a 4-yr performance-based contract to reduce electricity and water consumption in the building. Total project cost is $257,700, which was met by a loan for $109,500 from E&Co's own funds, a loan from the SME Program funds of $109,500 at 11 percent interest rate, and $38,700 of Econergy Ltd's own funds. The project's IRR is 17.6%. While financial leveraging by other sources could be higher, the project is a relatively low investment risk with a letter of credit in place from E&Co.

While E&Co. is a relatively new addition to the SME Program's portfolio of intermediaries, they appear well positioned to offer a good supply of strong projects, delivering substantial GEF benefits. It should also be mentioned that on one occasion E&Co. decided to use other financing sources for two projects (cooker and mini-hydro), because the turn around time for SME funds was too long for their project development needs. If these first two projects are implemented successfully, E&Co. should be given a greater amount of leeway to identify and fund projects.

CREDICOOP

Credicoop is a traditional Chilean financial cooperative. And is the newest of the SME Program's Intermediaries and has not yet signed a loan agreement. They are, at present, hesitant to take on dollar debt due to the devaluation of the Chilean Peso over the last year. Creditcoop is expected to invest in a minimum of 20 SMEs that contribute to climate change mitigation.

This project is unique with respect to the other SME Intermediaries, in that it has a special relationship with Cepri SA which acts as Credicoop's "environmental advisor," contributing technical knowledge on the environmental aspects of each project. The development of this relationship will be assisted by SME Program staff with a technical assistance grant of $50,000.

This Intermediary (if successful at placing SME funds) should be used as a potential model for the replenishment of the SME Program, due to its unique arrangement with Cepri. By showing that a traditional financial institution can effectively place funds in projects that produce global environmental benefits, the SME program can show the market that this type of lending can be commercially viable.

ANNEX 3: GEF OPERATIONAL FOCAL POINTS

GEF Operational Focal Points which have expressed NO OBJECTION to the operation of the SME Program in their respective countries

Country	Name of responding GEF Operational Focal point
Albania	Dr. Narin Panariti
Argentina	Silvia B. Garcia
Bahamas, The	Dr. Donald Cooper
Bangladesh	Abdul Malek
Belize	Yvonne Hyde
Bolivia	Ricardo Simon Pereira
Bulgaria	Kliment Dilianov
Cape Verde	Manuel Carvalho
Chad, Republic	Mr. Baba El Hadj Mallah
Chile	Patricio A. Bernal
Cuba	Ricardo Sanchez Sosa
Congo, Democractic Republic	Dr. Kankolongo Mujika
Colombia	Fabio Arjona Hincapie
Cote d’Ivoire	Mme Diaby Kone Alimata
Croatia, Republic of	Nenad Mikulic
Czech Republic	Alexandra Orlikova
Djibouti, Republic de	Mohamed Ali Moumin
Dominica	Gerald Hill
El Salvador	Cesar R. Abrego
Estonia	Allan Gromov
Fiji	Bhaskaran Nair
Gambia, The	Nuha Ceesay
Guinea	Kadiatou N”diaye
Honduras	Sandoval Sorto
Hungary	Dr. Tibor Farago
India	R.K. Singh
Iran	Pirooz Hosseini
Jordon	Rima Khalaf Hunaidi
Kiribati	Tererei Abete
Kyrgyz, Republic of	Kyshtob--
Lesotho	Bore Motsamai
Libya	Dr. Bashir Mohamed Fares
Lithuania	Antanas Jankauskas
Macedonia	Dr. Taki Fiti
Malawi	Dr. Zipangani M. Vokhiwa
Mali	Soumaila Cisse
Mauritius	G. Wong So
Marshall Islands	Banny de Brum
Micronesia	Jeeem S. Lippwe
Moldova	Margareta Petrusevschi
Mongolia	Ts. Adyasuren
Myanmar	U. Phae Thann Oo
Nicaragua	Garcia A. Cantarero
Nigeria	Ms. Anne Ene-ta
Niue	Bradley Punu
Oman	Mahmood Mohammed Al-Zakwani
Pakistan	Azmatullah Shah
Paraguay	Luis Fernando Villalba
Peru	Mr. Carlos G. Soldi
Poland	Zbigniew Szymanski
Romania	George Dulcu
Samoa, Western	Apia
Sierra Leone	Jemimah E. Cole (Mrs)
Slovakia	Ivan Mojik
Slovenia	Mr. Emil Ferjancic
Solomon Islands	Moses Biliki
South Africa	Dr. F. Hanekom

Country	*Name of responding GEF Operational Focal point*
Sri Lanka	Chandra Amerasekare
Suriname	Lilian Monsels-Thompson
St. Kitts, West Indies	Randolph Walters
St. Lucia	Bernard La Corbiniere
St. Vincente & the Grenadines	Reynold Murray
Syria	Eng. Yahia Awaidah
Thailand	Dr. Wanee Samphantharak
Tunisia	Mme. Amel Benzarti
Turkey	Murat Sungur
Trinidad	Dr. Dave McIntosh
Uganda	E. Kassami
Vanuatu, Republic of	Ernest Bani
Vietnam	Nguyen Dac Hy
Zambia	Lubinda Aongola
Zimbabwe	C. Chipato
72	

GEF OPERATIONAL/POLITICAL FOCAL POINTS - NO RESPONSES	
Country	
Algeria	Jamaica
Afgahanistani	Kenya
Antigua and Barbuda	Kiribati
Armenia	Lao Peoples' Democratic Republic
Barbados	Latvia
Belarus	Lebanon
Benin	Madagascar
Botswana	Malaysia
Burkina Faso	Maldives
Burundi	Malta
Brazil	Mexico
Cameroon	Morocco
Central African Republic	Nauru
China	Niger
Comoros	Nepal
Cook Islands	Panama
Costa Rica	Papua New Guinea
Dominican Republic	Russia Federation
Korea, Dem. Peoples Rep.	Senegal
Korea	Sudan
Ecuador	Swaziland
Egypt	Tanzania
Eritrea	Tonga
Gabon	Tuvalu
Georgia	Venezuela
Guatemala	Ukraine
Guyana	Uzbekistan
Grenada	Yemen, Republic of
Haiti	57

ANNEX 4: IFC'S NEW APPROACH TO MICRO, SMALL AND MEDIUM ENTERPRISE FINANCE

The importance of SMEs to economic development and, therefore, poverty reduction is undisputed. Typically, SMEs account for the creation of a large share of new jobs in an economy, provide an avenue for the involvement of most indigenous people in the economy, and constitutes a significant contribution to the GDP of any economy. These enterprises thrive because they offer low-income populations opportunities for economic self-sufficiency. During economic crises, microenterprises and small businesses are often the most resilient, serving as a crucial backbone of the domestic economy. SMEs' impact on economic development in turn depends on a number of factors, the core comprising access to credit, business environment, infrastructure, and availability of appropriate human capital. Yet, despite their size and importance, these businesses rarely have access to the savings, credit and payment services provided by banks and overall the SME sector is the least served by the financial services industry. Financial services for these 'under-served' businesses have been lacking for several reasons including the high transaction costs and perceived credit risks associated with small loan sizes and the unreliability of financial information from entrepreneurs that operate outside the formal economy. Mainstream banks find SMEs too expensive to service, falling between consumer finance and conventional banking for large corporations; SMEs are sandwiched in no man's land. On the one hand, as businesses, banks have hitherto, considered it inappropriate to apply character lending techniques in extending credit to SMEs. On the other hand, it is also recognized that mainstream corporate banking techniques are neither appropriate nor cost effective.

Microenterprises and small businesses cite the lack of access to finance as one of the primary constraints to the growth of their enterprises. If economic development is to reach the millions of poor people around the world that run profitable microenterprises and small businesses, new ways must be found to encourage formal financial systems to be more inclusive, so that large numbers of these under-served entrepreneurs can obtain high quality financial services. Given IFC's experience as a risk-taking financial investor in emerging and frontier markets around the world, it is well placed to help address this issue. Consequently, micro and SME finance is increasingly playing a larger role in IFC's financial sector strategy.

IFC has traditionally provided financing to banks for SME lending through credit and agency lines. These products, however, do not always meet the needs of IFC's clients. The banks on-lend in hard currency to SMEs, thereby significantly increasing their portfolio risks, as most SMEs do not generate dollar-denominated earnings to service the loans. The SMEs that IFC's client banks have traditionally targeted are in the upper quartile of the size range and can be categorized as mid-sized companies. Banks have not been able to target micro and small businesses due to the perceived risks and costs mentioned above. Many of the financial institutions in emerging and transition countries have high liquidity, and invest in government securities rather than take the risk on financing to micro and small businesses.

The World Bank Group (WBG) has long assisted SMEs but has only recently developed a strategic approach[1], through the creation of the WBG SME Department. The SME Department is focusing on strengthening SME finance targeting four key needs: capacity building, information and technology, access to capital and improved business environments. These initiatives are supported through eight SME facilities in eight different regions, administered by the WBG SME Department. Through these specialized project development facilities (PDFs)[2] IFC and its partners provide local entrepreneurs with technical assistance needed to build commercially viable businesses. These facilities typically operate in low-income countries with underdeveloped private sectors. They play a useful role, both helping SMEs directly and creating local capacity and technical and financial support. The facilities help SMEs attract necessary financing for their ventures, prioritizing projects with potential to develop self-sustaining enterprises, generate employment, increase skills, and stimulate export earnings. They also provide other essential services such as training and research, and work with the World Bank to frame and promote policy reforms aimed to improve the local business climate.

IFC's increased emphasis on banking services for the under-served comes at an opportune time. The globalization of the financial services industry has created fierce competition for the small pool of large and mid-size corporate clients in emerging and transition economies. As a result, many financial intermediaries are looking for ways to target the largely unclaimed micro-enterprise and small business market. The challenge is how to profitably target this market segment. The aim is to make micro and small business finance profitable and sustainable for FIs by improving risk / reward ratios so that they become attractive investment choices for financial intermediaries. In doing so, the volume and range of financial products available to microenterprises and SMEs should substantially increase.

IFC focuses on mainly providing financing through FIs, and not on direct financing to small businesses. Lessons from experience support the importance of building local capacity of FIs for SME finance, in combination with financing. As a result, IFC is increasingly complementing its investments in FI and building on its solid track record as a risk-taking financial investor by resuming the role of strategic advisor and technical assistance provider.

Common to the approaches to develop SME finance is the need to combine financing with well-targeted TA in order to bring needed operating know-how, expertise, and MIS/IT systems to FIs and MFIs. The central principle underlying the provision of TA is the leveraging of IFC's resources through selectivity (focusing on activities with greatest development impact and replication potential) and strategic internal and external partnerships (to maximize impact within a framework of constrained resources).

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[1] IFC's core strategy, calls for a move towards areas with high multiplier effects, i.e. whose impact goes well beyond the capital investment, focusing on frontier countries, strengthened domestic institutions, markets and infrastructure, SME development and sustainability. Sustainability, both social and environmental, has emerged as an important new strategic priority as illustrated by the corporate sustainability initiative. It is recognized that sustainability is a business differentiator that helps business growth and one of the fundamentals of public concern that drive policy decision and pose private sector risks. IFC's corporate sustainability role to enforce its environmental and social safeguard policies has evolved into a value-added role and IFC is considered to be at the leading edge with regard to environmental and social policies and practices in developing countries

[2] The SME facilities are: Africa Project Development Facility (APDF), African Management Services Company (AMSCO), Mekong Project Development Facility (MPDF), Southeast Europe Enterprise Development (SEED), South Pacific Project Facility (SPPF) as well as three new facilities: China Project Development Facility (CPDF), Southasia Enterprise Development Facility (SEDF), and North Africa Enterprise Development Facility (NAEDF).

IFC efforts in SME finance focuses on three levels of intervention:

1. **Assisting the development of the underlying infrastructure** for FIs serving the SME sector. Examples of financial infrastructure investments are, legal and regulatory framework development, corporate governance and credit bureaus, shared credit scoring arrangements and smartcard processing centers, using the latest information, communication and financial technologies.

2. **Supporting the commercial development of FIs** (e.g., banks, leasing companies and microfinance institutions) by, among other activities, providing access to specialized financial and information technologies, which enable them to significantly reduce their unit transaction costs and improve their portfolio risk management, thus enhancing their commercial viability.
3. **Supporting the commercial development of individual SMEs** through FIs, local business development suppliers and strategic partnerships with best practice providers through institutional strengthening in the areas of business plan development, project preparation, monitoring, reporting and control. As mentioned above, the PDFs play a key role in developing SMEs.

The challenges for microfinance are quite different. The industry has been developed over the past 20 years, primarily by a set of institutions outside the formal financial sector whose principal objective was the reduction of poverty. In recent years, it has become evident that well-managed MFIs can make major contributions to poverty reduction and at the same time be profitable commercial entities. Commercialization is important because it will allow the industry to augment the donations that have fueled the development of the industry so far with commercial capital, thus enabling a massive increase in the availability of financial services for the poorest of the economically active population. The commercialization of the microfinance industry is a major challenge that IFC is helping to address, given its experience as a risk-taking investor in financial markets around the world.

A principal key for increasing the access of SMEs to formal financial services lies is the creation of conditions that encourage FIs to serve small businesses. The "old" unprofitable approach of providing limited services to a limited number of customers needs to be replaced by a 'mass-customized approach'. Such an approach uses technology to increase the number of small business clients while at the same time reducing transaction costs, improving asset quality and broadening service offerings. The result is a business model that offers a complete set of financial services tailored to the needs of individual SME clients with an improved bottom-line contribution per customer. The approach that IFC is pursuing enhances profits for the FI and involves:

- Identifying and adapting viable business models for IFC client FIs
- Introducing financial technologies that improve profitability and increase efficiency
- Investing in FIs that target SMEs and
- Building management expertise and knowledge through strategic partnerships, technical assistance and training.

IFC is adopting this approach with a few FIs keen on pursing profitable opportunities in SME finance by capitalizing on innovations in financial, information, and communication technologies. These technologies include lending strategies that revolutionized the U.S. market for small business credit in the 1990s, particularly the application of consumer lending techniques, such as credit scoring, to small business finance. Reliable information from credit bureaus enables lenders to make rapid credit decisions driven by data and forecasting models, rather than relying exclusively on subjective assessments of credit officers. These tools hold great potential for micro and small business finance in emerging markets.

ANNEX 5: THE FINANCING FACILITY PARTIAL GUARANTEES

The Financing Facility of the Expanded SME Program has been designed to provide financing modalities focusing on debt or debt-like instruments. These modalities are direct financing, partial guarantees or quasi-debt (subordinated loans) to FIs and in exceptional cases to mid-sized companies. The selection of the appropriate financing mechanism will depend on the state of development of the domestic financial market, the needs of the FIs and the SMEs and the size of the potential market to finance.

Local Currency Financing for SMEs

Historically, IFC's support to the SME sector has largely been in the form of foreign currency financing, typically US dollar denominated, since other instruments were lacking. SMEs that are meant to benefit from this support are generally not engaged in export-generating activities, while in many countries the financial sector is thin and not sufficiently developed for the management of exchange rate risk through the swap market. As became very obvious during the Asian Financial Crisis foreign currency financing exposes SMEs and banks to foreign exchange risk that they are often not equipped to handle.

To address this need, IFC has been working to develop local currency products that could be offered to FIs. As an example, a risk-sharing facility, securitized by portfolios of SME loans, is being field-tested in select pilot countries. Structured properly, this product can also make a significant contribution to the development of domestic financial markets. IFC is also exploring swaps and guarantee instruments with local institutions such as pension funds, as well as with selected central banks with high reserve requirements, to unleash the local currency liquidity within a particular country for SME lending.

Partial Guarantees and Risk Sharing for SME Financing

Securitization of portfolios of SME loans can allow local banks to increase their lending to SMEs, while sharing the portfolio risk with other financial investors, including the SME Program and International Financial Institutions (IFIs). A securitization transaction could take these two forms:

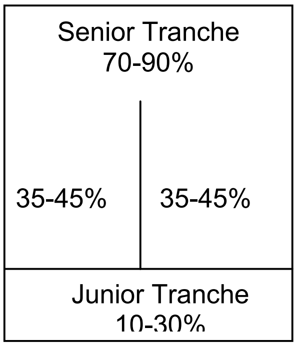
1. **Straight securitization**

    The FI would sell its portfolio of SME loans to a Special Purpose Vehicle (SPV) created by it or by investors, which issues different classes of debt instruments (notes) against the pool of loans. Interest payments are made to the SPV and the notes are serviced from the SPV. This structure is suitable for countries where the financial markets are sufficiently developed to attract international and domestic investors and where FIs are in need of additional liquidity.

2. **Synthetic securitization/layered risk sharing**

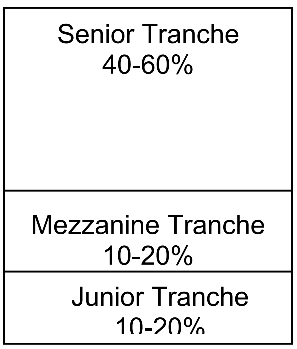
    The loan portfolio stays on the books of the FI. The portfolio risk is divided into different risk classes, from a Senior Risk Tranche (low risk) to a Junior Risk Tranche (higher risk). The risk sharing takes place through partial guarantees issued by one or more investors covering different risk classes. The Junior Tranche stays with the originating FI and could be shard with the SME Program for pools of GEF-eligible SMEs. Synthetic securitization is of special interest to FIs having sufficient liquidity who, for a variety of reasons, are seeking to reduce their risk for a variety of reasons, including when entering a new market where the portfolio risks are unknown such as for GEF-eligible SMEs.

In many if not most emerging and transition countries, a straight securitization is not feasible, leaving a synthetic securitization as a possible risk-sharing alternative. In order to illustrate alternative structures for a synthetic securitization two case examples are described below. The subordination of tranches divides the credit risks over two or three tranches of securities and risk-classes, depending on local circumstances and preferences.



Case I:

- The ***senior tranche*** is split 50/50 between the originating FI and IFC and/or other investors including other IFIs.
- The ***junior tranche*** represents a first loss position and is held by the originating FI and possibly shared with the SME Program for a pool of loans to GEF-eligible SMEs.



Case II:

- The ***senior tranche*** representing the lowest risk tranche is held either by the originating FI or by institutional investors having a preference for a high credit-rating.
- The ***mezzanine tranche*** is held by IFC and/or other investors including other IFIs.
- The ***junior tranche*** represents a first loss position held by the originating FI and possibly shared with the SME Program for a pool of loans to GEF-eligible SMEs.

The SME Program would in both cases described above share the first loss with the originating FI, structured on a case-by-case basis, to reflect the size and risk of the pool of loans to GEF-eligible SMEs.

Benefits of the partial guarantee structures

The partial risk guarantee structures described above offer a number of advantages namely:

- *Better financing terms:* The innovative structure allows fine-tuned risk determination and enables the FIs to obtain significantly better financing terms for guarantees than through traditional guarantee mechanism.
- *Balance sheet management:* risk sharing can reduce the regulatory and economic capital that the lending FI needs to hold against the SME portfolio. This could improve the return on equity, and will allow the lending FI to extend more SME loans with a given amount of equity.
- *A well defined pool of SME loans* that can be managed and monitored independently from other business of the originating FI
- *Creation of larger loan volumes* than otherwise possible due to internal policies for sector or country restrictions.
- *Sharing of credit risk* allows FIs to enter new markets where they do not have a previous experience such as the SME market targeting GEF-eligible activities.

Some general requirements

- The pool of loans that falls within the guarantee structure must be well defined (e.g. eligible loans, size, quality, maturity) up to the maximum portfolio limit, and must be structured to ensure that there is no adverse selection made as to which loans to include in the pool.
- The originating FI must have appropriate SME-relevant risk management techniques, or alternatively, TA to establish the systems will need to be made available prior to starting the lending program.
- The originating FI has to develop and install an appropriate monitoring, supervision and reporting system. Strict reporting requirements will need to be agreed on.
- In order to attract investors for the Senior Tranche, an independent rating must be obtained from a recognized rating agency. This may only be feasible in a limited number of markets.

The partial guarantee structures offer a clear advantage to the SME Program in the potential for significant leveraging and mainstreaming. For example, the SME Program can offer to share the first loss tranche of a pool of loans to GEF-eligible SMEs for 10% of the total pool. In this case the leveraging effect would be ten times. These structures also allow for mainstreaming of this type of financing within FIs as they gain more experience with the portfolio. If this financing is successful, the FI would not need the partial guarantee from the SME Program after a few years of track record with the portfolio. In terms of mainstreaming with IFC of GEF activities, the SME Program will be pursing the partial guarantee structures described above in close collaboration with IFC's Financial Market, Risk Management and Treasury departments, in order to integrate the SME Program guarantees with IFC's guarantees. It is also possible to expand to other IFIs and introduce SME Program activities to them through the provision of the partial guarantee structures.

ANNEX 6: TECHNICAL ASSISTANCE PROGRAM

Objective

The TA Program objectives are to strengthen the capacity of the recipient financial intermediaries, the non-financial intermediaries and their GEF-eligible SME clients. It proposes to address the impediments to GEF-eligible SME finance in a comprehensive manner by combining three TA components that complement each other, in order to provide a solid foundation for a scale-up of financing made available to GEF-eligible SMEs on a sustainable basis: The SME Program will strive to transfer needed operating know-how, expertise, and systems to its clients through focused TA projects to build institutional capacity, conduct market studies to identify GEF-eligible opportunities, develop new products, improve systems and technologies to enhance productivity, and introduce improved risk management techniques.

Approach

The TA Program will be designed to target three levels of interventions:

1. Country level: (i) country specific market assessments to identify the potential for GEF-eligible activities, including financing opportunities, and future growth potential; (ii) dissemination activities such as workshops and seminars to demonstrate the potential in the country for GEF-eligible activities.
2. Intermediary level: (i) build the capacity of intermediaries for SME finance, (ii) work with IFC and other IFIs to support, in a limited way, the establishment of much-needed financial markets infrastructure such as credit bureaus, payment systems and a favorable legal and regulatory frameworks; (iii) develop with local training institutions (including bank training centers) specific training programs to support FIs in adapting to the requirements of best practice SME lending, as well as to be able to identify, evaluate and monitor GEF-eligible activities; (iv) assist FIs to adopt best practices in SME finance, including the development of new products and services, the introduction of systems and procedures for risk management, technologies to enhance productivity and lower transaction costs, appropriate delivery channels to reach a large number of SMEs and capacity building of managers and staff; (v) support for the evaluation, supervision and reporting of GEF-eligible activities.
3. SME level: building local GEF-eligible SME capacity, by providing support for developing feasibility studies, business plan preparation, project preparation,

Implementation

Partnerships will be entered into both within IFC and externally for the SME Program to benefit from the experience and know-how that is available across the international development community. The Program will leverage on IFC's SME project development facilities to provide support to for the TA Program thus achieving significant impact through economies of scale and benefiting from IFC's global private sector experience and best practices. Suppliers of Business Development Services (BDS) and other best practice providers will be sought out and strategic partnerships may be entered into with carefully selected leaders in their field, which include technology providers, successful SME banks or consultants with demonstrated hands-on experience. These partnerships will provide the FIs and the SMEs with access to tested technology, training and advice they need to expand their client base and services, while strengthening their management, systems and governance.

As a result of the TA Program, SMEs will be better served by the financial institutions in their countries, and IFC and other investors will have a broader range of GEF-eligible SME intermediaries in which they can consider investing. .

ANNEX 7: SME PROGRAM TARGET MARKETS AND ACTIVITIES

	GEF Operational Program	Target Sector	Target Sub-Sector/Activity	Technical Assistance
	Biodiversity Conservation:			Capacity building, market studies, legal & regulatory framework, new product and technology development, operations, MIS, business plan development and WB Environmental Management System. Biodiversity, climate change, international waters and land degradation finance training
OP 1	Arid and Semi Arid Zone Ecosystems	Eco-Tourism and Eco-Enterprise	Conservation and sustainable livestock grazing, and tourism, sectoral integration addressing e.g. livelihood issues of indigenous communities, agribusiness and commercial utilization of wildlife	
OP 2	Coastal and Freshwater Ecosystems	Aquaculture Management, including Eco-Tourism and Eco-Enterprise	Commercial sustainable low impact tourism development and e.g. eco-fisheries	
OP 3	Forest Ecosystems	Forest Management including e.g. Eco-Tourism and Forest Based Enterprises	Commercial forest management and utilization of wildlife including e.g. logging, hunting, gathering medicinal plants and sustainable productions systems, provision of hydrological services and carbon sequestration	
OP 4	Mountain Ecosystems	Eco-Tourism/Agribusiness	Low impact alpine, sub-alpine, mountain grassland and montane forest management, including agribusiness	
OP 13	Conservation and Sustainable Use of Biological Diversity Important to Agriculture	Organic and low-impact Agriculture, Forestry and Fishing	Diversified Edible Agriculture Crops, Horticulture, Natural Fibers, Cattle Farming, Poultry Farming, Animal Aquaculture, Fishing, Natural Forest, Plantation Forest, Fertilizers, agribusiness (lower impact cultivation and harvesting methods) e.g. www.balkanherbs.org	

	GEF Operational Program	Target Sector	Target Sub-Sector/Activity	Technical Assistance
	Climate Change Mitigation:			Capacity Building, Market Study/legal, regulatory framework, New product and Technology development, Operations, MIS, Business Plan Development and WB Environmental Management System, and Biodiversity, Climate Change International Water and Land degradation Finance Training
OP 5	Removal of Barriers to Energy Efficiency and Energy Conservation	EE component for lighting and heating	Lighting e.g. manufacturing of fluorescent lighting, rehabilitating and replacing (Coal fired) transmission systems, and replacing non-ee housing solutions e.g. building chillers, electricity driven public transportation	
OP 6	Promoting the Adoption of Renewable Energy by Removing Barriers and Reducing Implementation Costs	EE component	Photovoltaic Technology, including indigenous production transmission, distribution and grid connection, solar water heating, solar street lights, solar billboards, solar cookers and fans, solar irrigation, solar telecommunication and solar water pumping, solar driven cars etc.	
			Pico and micro-hydropower stations, including run of the stream facilities	
			Natural Gas, CNG and LNG driven public transportation	
			Biodigestors, biomass energy products e.g. biomass charcoal stoves	
			Wind turbine manufacturing and servicing companies and systems developers e.g. water wind pumps	
			Thermal and steam generation, manufacturing and maintaining e.g. heating equipment	
			Solar thermal applications, including producers, suppliers and maintenance	
			Biomass: charcoal stoves	
OP 7	Reducing the Long-Term Costs of Low GHG Emitting Energy Technologies	EE R&D	Technology for reducing CO2 emissions, including carbon funds and national emissions trading systems	
OP 11	Promoting Environmentally Sustainable Transport	Reducing fossil-fuel burning motorized transport	CNG, LNG and battery driven public transportation, EE solutions reducing and replacing fossil fuel	

	GEF Operational Program	Target Sector	Target Sub-Sector/Activity	Technical Assistance
	International Waters:			Capacity Building, Market Study/legal, regulatory framework, New product and Technology development, Operations, MIS, Business Plan Development and WB Environmental Management System, and Biodiversity, Climate Change International Water and Land degradation Finance Training
OP 8	Waterbody-based	Clean Water Supply	Water Resource Management Systems, remediation of damaged systems, e.g. mobile water purification systems, waste water and discharge systems, bilge pumping, marine yard cleaning, oil sludge processing oil pollution treatment, water treatment on ships and on shore	
OP 9	Integrated Land and Water Multiple Focal Area	Coast Environment Management system including hydrocarbon reduction	Remediation of damaged land and water systems (integrated management), ship waste disposal, integrated water and land management plans and strategies, oil pollution management	
OP 10	Contaminant-Based	Water Treatment	Oil spill response capacity and equipment, financial and institutional arrangement for oil spill	
	Multifocal Area:			Capacity Building, Market Study/legal, regulatory framework, New product and Technology development, Operations, MIS, Business Plan Development and WB Environmental Management System, and Biodiversity, Climate Change International Water and Land degradation Finance Training
OP 12	Integrated Ecosystems Management: **focusing on land degradation**	Rehabilitation of **Land Degradation** (including soil degradation, desertification and afforestation)	Rehabilitation and/or preventive measures to address land and water management, including water capture systems, low impact cultivation and irrigation methods	

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