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IMPLEMENTATION COMPLETION REPORT
(IDA-21040)

ON A

CREDIT

IN THE AMOUNT OF SDR 36.4 MILLION (US$48.0 MILLION EQUIVALENT)

TO THE

REPUBLIC OF MADAGASCAR

FOR A

FINANCIAL SECTOR AND PRIVATE ENTERPRISE DEVELOPMENT (APEX) PROJECT

December 21, 2000

Financial Sector Unit
Africa Region

CURRENCY EQUIVALENTS

(Exchange Rate Effective 12/31/1999)

Currency Unit = Malagasy Franc (FMG)
FMG 1 = US$ 0.0001528
US$ 1 = 6543 FMG

FISCAL YEAR
January 1 - December 31

ABBREVIATIONS AND ACRONYMS

APDF	Africa Project Development Facility
APEX	Financial Sector and Private Enterprise Project
BFV	*Banky Fampandrosoama ny Varotra*
BNI	Bank of Industry
BTM	*Bankin'ny Tantsama Mpamokatra*
CAS	Country Assistance Strategy
CCI	Chamber of Commerce and Industry
CSBF	*Commission de Supervision Bancaire et Financière* (Banking Supervisory Commission)
FIARO	*Société Financière d'Investissement ARO*
GDP	Gross Domestic Product
IDA	International Development Association
IFC	International Finance Corporation
IMF	International Monetary Fund
JCEM	*Jeune Chambre Economique Malgache*
MIEM	Ministry of Mining
MIGA	Multilateral Investment Guarantee Agency
PATESP	Private Sector Development and Capacity Building Project
PFI	Participating Financial Institutions
PPF	Project Preparation Facility
QAG	Quality Assurance Group
SAC	Structural Adjustment Credit
SAR	Staff Appraisal Report
SME	Small and Medium Enterprise

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Project ID: P001540	*Project Name:* FIN SECTOR/APEX
Team Leader: Andres D. Jaime	*TL Unit:* AFTPF
ICR Type: Core ICR	*Report Date: December 21, 2000*

1. Project Data

Name: FIN SECTOR/APEX
L/C/TF Number: IDA-21040
Country/Department: MADAGASCAR
Region: Africa Regional Office
Sector/subsector: FS - Financial Sector Development

KEY DATES

			Original	*Revised/Actual*
PCD:	09/20/87	*Effective:*	09/25/90	09/25/90
Appraisal:	01/22/90	*MTR:*	10/10/93	11/10/93
Approval:	03/20/90	*Closing:*	06/30/97	06/30/2000

Borrower/Implementing Agency: GOVT./CENTRAL BANK OF MADAGASCAR
Other Partners:

STAFF	Current	At Appraisal
Vice President:	Callisto E. Madavo	E. Jaycox
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2. Principal Performance Ratings

(HS=Highly Satisfactory, S=Satisfactory, U=Unsatisfactory, HL=Highly Likely, L=Likely, UN=Unlikely, HUN=Highly Unlikely, HU=Highly Unsatisfactory, H=High, SU=Substantial, M=Modest, N=Negligible)

Outcome: S
Sustainability: L
Institutional Development Impact: SU
Bank Performance: S
Borrower Performance: S

	QAG (if available)	ICR
Quality at Entry:		S
Project at Risk at Any Time:	No	

3. Assessment of Development Objective and Design, and of Quality at Entry

3.1 Original Objective:

The Financial Sector and Private Enterprise Development (APEX) project was approved by the Board on March 20, 1990, for a credit amount of SDR 36.4 million or US$48 million equivalent. The credit became effective on September 25, 1990. The principal objectives of the APEX project as described in the Staff Appraisal Report (SAR) were as follows: (i) complement the Government's on-going restructuring efforts of the economy through provision of funds for investments and reconstitution of permanent working capital in industry and all other productive sectors; (ii) help, in coordination with the International Monetary Fund (IMF) and the Public Sector Adjustment Credit (Cr. 1941-MAG), to improve the efficiency of the financial sector, including expanded term resource mobilization; further interest rate liberalization and deepening the competition in the financial sector through a number of monetary policy instrument changes; (iii) strengthen institutions operating in the financial and small and medium enterprise (SME) support sector; and (iv) expand employment opportunities. The project included an investment or line of credit component, a technical assistance component and a policy reform agenda principally dealing with the financial sector.

The APEX project had ambitious but clear objectives aimed at addressing key issues in the Government's economic liberalization agenda. The inclusion of policy reform activities in a line of credit project was innovative. The Central Bank, the key implementing agency, had good technical capacity for its time, and was committed to the reforms envisaged, which helped minimize the risks of the project. The project objectives were in line with the Country Assistance Strategy (CAS) for Madagascar, and supported the Government's liberalization program. The project provided a framework which enabled the Government and the World Bank to maintain a dialogue during an otherwise unstable period of political and economic transition which made formal macroeconomic discussions difficult.

3.2 Revised Objective:

Although the general original objectives of the project did not change, a greater emphasis was placed, in the course of implementation, on strengthening financial institutions with a particular focus on bank privatization. Project implementation coincided with a decade of political and economic change in Madagascar. Following long strikes, a new government was elected in 1992 which pursued policies that derailed the adjustment program and resulted in serious macroeconomic imbalances and an acceleration of inflation in the mid 1990s. This led to an increase in interest rates which sharply reduced the demand for credit in general, and for the APEX line of credit in particular. Inflationary pressures were fueled in part by imprudent lending by two state banks, which accounted at the time for over 60 percent of banking sector deposits. When the adjustment dialogue moved forward in 1995, the process of divestiture of the State from the banking sector, which had been halted in the early 1990s, became a central issue. The Government requested that the World Bank reallocate a portion of the uncommitted funds under the line of credit to support the divestiture process. The APEX project was thus first restructured in 1996. In 1998, funds were again shifted from the line of credit to finance new activities in the

financial sector, i.e, technical assistance for the privatization of two state-owned banks (*Banky Fampandrosoana ny Varotra* - BFV and *Bankin'ny Tantsana Mpamokatra* - BTM) and a staff retrenchment program at these banks. Both restructurings of the project were approved by the Executive Directors of the World Bank.

3.3 Original Components:

The original components of the APEX project, as described in the SAR and spelled out in the Development Credit Agreement, were the following: (i) an investment or **APEX Line of Credit Component** aimed at financing specific investment projects through sub-loans granted to investment enterprises by Participating Financial Intermediaries (PFIs). It was the largest component, and was allocated SDR 34 million or 94 percent of the credit (see Table 1); a multi-faceted technical assistance component including (ii) a **Financial Sector Component** aimed at strengthening the Central Bank supervision and monetary management capacity; (iii) a **Private Sector Framework Component** for, among other things, support to the restructuring of the Chamber of Commerce and Industry (CCI), and the establishment of an investment promotion center; (iv) **Development of SME Component** involving overseas in-plant training and in-company visits of SME entrepreneurs and promoters, provision of technical assistance to SMEs in management techniques and data processing, funds for feasibility studies for SME promoters, and strengthening of the SME Assistance Unit at the Ministry of Economy and Planning; and (v) a **Mining Sector Component** to assist in the preparation of a new mining code, assistance for small mining operators, and market opportunity studies for specific minerals in preparation of the reorganization of the mining laboratory of the Ministry of Mining (MIEM). In addition, the project envisaged policy reforms to be put in place, primarily concerning the financial sector, but also related to other activities and decisions supporting private enterprise development.

The multi-faceted technical assistance component included several activities that proved very challenging and slow to implement. As government priorities shifted, the restructuring of the CCI and mining sector reform proved difficult to handle under the project and were thus judiciously shifted to other World Bank projects (in fact, throughout implementation, the project remained flexible enough to respond and adapt to changes in country conditions).

The project components were directly related to the project objectives. The project team drew from previous experience of providing directed lines of credit to specific institutions in Madagascar and foresaw that the line of credit would be used by new private banks, which would enter the market with the liberalization of the financial system. The SAR spelled out in detail implementation arrangements which involved two main agencies: the Central Bank and the Ministry of Commerce for SME development activities. The arrangements aimed at ensuring that the APEX unit set up by the project within the Central Bank would have enough funds to operate.

Table 1: APEX Project Original Components and Costs

Component	Cost (SDR) in million	Cost (US$)*in million	Rating
Line of Credit	34.05	45.25	S
Financial Sector	0.26	0.35	HS
Private Sector Framework	0.30	0.40	S
SME Development	0.86	1.14	S
Mining Component & PPF	0.57	0.76	NR
Unallocated	0.36	0.47	--
Total	**36.40**	**48.37**	--

* SDR 1 = US$1.32897

3.4 Revised Components:

The project was restructured in 1996 and again in 1998 as stated earlier. In 1996, a sub-component was added to the financial sector component for the provision of technical assistance for the management and sale of public banks, and for the analysis, preparation and execution of related supporting activities. In 1998, a new item was added to the financial sector component which aimed at funding a staff retrenchment program resulting from the privatization of the two state banks, BTM and BFV. Both amendments to the credit reallocated funds (a total of SDR 10 million) from the line of credit to the financial sector component, and were approved by the Executive Directors. The results of these adjustments to the credit were to give a more prominent role to the project in dealing with the financial sector and strengthening of financial institutions. By the end of the project, disbursements for the financial sector component, including bank privatization activities, accounted for 26 percent of the credit compared to less than 1 percent originally (see Annex 2). The line of credit still remained the largest component of the project.

3.5 Quality at Entry:

The project pre-dates the introduction of the Quality Assurance Group (QAG) process at the World Bank and quality at entry was thus not evaluated by QAG. Nonetheless, the quality of the project at entry is satisfactory when evaluated by prevailing standards. The project also pre-dates the introduction of the logical framework approach, therefore this was not included in the SAR. However, several targets and in particular specific financial sector reform measures were listed in the SAR to be achieved by the project. These targets were useful performance indicator proxies to draw up the logical framework matrix presented in Annex 1 and used to evaluate quality at entry.

Project objectives and components were in line with the Government's economic reform program which was supported by both the World Bank and the IMF. As indicated in the SAR, the project sought to consolidate financial sector policy reforms and capitalize on the restructuring efforts in the financial sector initiated by the Government with its bank privatization program, through

additional supply-oriented measures. The credit was to pave the way for more private sector activities in the financial and real sectors. The design of the project took into account the importance given by Government to the development of private sector enterprises by allocating originally 94 percent of the proceeds of the credit to the line of credit for private enterprises. The design of the line of credit was flexible which permitted changes in pricing, the eligibility of institutions, and the types of enterprises to be financed as country conditions evolved.

The financial sector component was designed in close collaboration with the IMF to reflect its importance in the project. Financial sector policy reforms and key regulatory reforms were established as conditions of effectiveness or as conditions of disbursement of the second phase of the line of credit. These measures insured that ongoing reforms in the financial sector would be pursued by the Government since an efficient functioning financial sector constituted an essential condition for the growth objectives of the country. Despite the safeguards put in place in the project by the World Bank team with the effectiveness and disbursement conditions, risks to the project remained. Those risks were identified by the appraisal team as the will or lack thereof of the Government to continue its reform of the banking sector and especially to continue the privatization process of all state-owned banks. Given the Government's achievements during the last five years, the risks were correctly assumed not to be excessive.

4. Achievement of Objective and Outputs

4.1 Outcome/achievement of objective:

The project outcome is rated satisfactory with respect to the achievement of objectives and outcomes. As mentioned earlier, a logical framework was not included in the SAR because the project pre-dates the introduction of the logical framework approach in World Bank appraisal documents. The project objectives and targets given in the SAR were used to derive the indicators presented in Annex 1 of this report.

The project achieved its central objectives of contributing to the restructuring of the economy by increasing output through the provision of financing for productive activity, and of improving the efficiency of the financial sector. It also contributed to strengthening institutions and expanding employment opportunities. Reflecting this, the two most important components of the project, the line of credit and the financial sector reform program (expenditures accounting for 99 percent of credit proceeds) are rated satisfactory and highly satisfactory, respectively, as discussed in the section on outputs below.

The line of credit provided needed financing for productive investment in the private sector at a time when the Government was opening up the economy, there was considerable political and economic instability, and the modern banking system was embryonic. There was little or no access to term lending on commercial terms, both because of the changing political environment but also because banks as new entrants were risk averse and did not know the market. A number of new enterprises were created with APEX financing while existing enterprises were able to expand operations. The full impact of the line of credit on output and employment is yet to be determined as a number of enterprises only completed their investment program over the past year. However, some significant impact on the economy has already been achieved according to a Central Bank

survey of beneficiary enterprises. The 35 enterprises which responded to the Central Bank survey in 1997-98 (71 percent response rate) increased investment by 21 percent in real terms, generated 2,028 new jobs, and value-added of FMG 124 billion. Value-added generated by manufacturing enterprises accounted for 5 percent of average total value added in the manufacturing sector in 1997-98. Surveyed enterprises increased threefold their capacity to finance investments from internally generated funds and increased their exports by 97 percent.

The line of credit also played an important role in introducing new entrants in the banking sector to the market for investment financing in Madagascar. Signaling the impact of the line of credit, in the end, all banks operating in Madagascar participated in the project, and 75 percent of the line of credit commitments were provided by private banks which only began operations in the early 1990s.

The financial sector reform program covered a broad agenda in the monetary, regulatory and institutional areas which has contributed to making the financial sector more efficient and competitive. The emphasis of the project shifted to the financial sector in 1996 with the reallocation of funds from the line of credit to activities related to bank privatization. The project called for: (i) reforms in the instruments and implementation of monetary policy with a view to liberalizing the system and increasingly using indirect instruments for monetary control; (ii) improvements in banking legislation and strengthening of bank supervision; and (iii), after 1996, a program of state divestiture from the banking sector.

Only time will tell the full impact of the financial sector reforms introduced under the project. However, there is already evidence of an important development outcome. Today, Madagascar has a liberalized interest rate and exchange system and uses indirect methods to control monetary aggregates. After a period of high price instability in the mid-1990s, inflation has been kept at bay, despite fiscal pressures, and averaged 9.7 percent in 1999. Following the banking sector cleanup, financial deepening (measured as M2/GDP) increased to 18 percent in 1999, while M3/GDP reached 21 percent that same year. Those indicators of financial deepening are more in line with those found in similar Sub-Saharan African countries and show the progress made by Madagascar under the project.

The ability of the Central Bank to conduct monetary policy, as well as the ability of the newly empowered Banking Commission (CSBF) to exercise its regulatory and supervisory role, improved substantially with the passage of both the new Central Bank Statutes in 1994 and the Banking law in 1996. Bank regulation and supervision has improved substantially during the 1990s, as reflected in the role played by CSBF in the supervision of the management and eventual sale of the two state-owned banks. Also, CSBF's review of licensing requests by bank promoters has thus far strictly followed the criteria set in banking regulation, and no unqualified bank has been licensed to date.

Bank privatization in Madagascar under the Apex project was more successful than in many other African countries where such an exercise had failed because unqualified buyers were selected and because privatization did not result in increased competition. Although it is too early to detect a clear trend in Madagascar, partly because fiscal imperatives continue to have an important effect

on interest rate trends, increased competition and efficiency is already reflected in reduced intermediation margins and a downward pressure on interest rates. The increasingly competitive nature of the system is also reflected in a growing willingness of private banks to lend to non-traditional clients such as savings and loan cooperatives which are developing in parallel with the private international banks. Lending from the banking sector for microfinance institutions, for instance, went from zero in 1996 to FMG 28 billion (US$3.7 million) in 1999.

Bank privatization has resulted in an expansion of credit as the newly-privatized banks have increased lending (and profits). The impact on the economy is much greater than the simple expansion of credit inasmuch as banks are now lending for productive activities as opposed to unsound projects as was the case in the early 1990s.

Another direct result of the privatization of the state banking system was to stop the drain on public resources resulting from the successive cleanups of state banks. The multiple bailouts of the public banks, which were virtually bankrupt, cost taxpayers and the economy dearly. The cleanup operations and recapitalization of the three public banks, including Bank of Industry (BNI) which was privatized in early 1990 before the APEX project, cost some US$50 million. The final cleanup at the time of privatization of BFV and BTM in the late 1990s cost an additional US$75 million or over 2 percent of GDP. This latter figure does not take into account the future interest payments on special treasury bills transferred to the privatized banks to cover deposit claims. By contrast, during the period (through 1997) in which the public banks were accumulating losses of FMG 350 billion, the three private banks operating at the time contributed over FMG 180 billion, or 3 percent of Government revenues, in corporate taxes alone.

Performance and outputs by component are summarized below.

4.2 Outputs by components:

Line of Credit (APEX) Component:

The line of credit component is rated satisfactory. The line of credit was designed to provide medium and long-term financing to private sector enterprises through financial institutions. The specific objective of providing financing for productive investment was reached by making term loans to a number of enterprises which have generated increased investment and employment. The credit was able to reach satisfactorily 49 enterprises (of which 25 were new enterprises) in all regions of Madagascar with the participation of all commercial banks in the country.

When the line of credit closed, it had provided 61 medium and long-term loans to 49 enterprises throughout Madagascar for US$33 million. All five banks operating in Madagascar in the 1990s participated in the line of credit activities, although applications from the two state banks were stopped in 1992 because of their poor lending practices and financial performance. Loans were generally granted to medium-sized enterprises, as PFIs who were new entrants into the market were cautious about lending to the riskier small enterprise sector. Credits covered all sectors, although they were concentrated in industrial fishing, agroindustry and textiles. Interest rates had been liberalized in the early nineties, and rates on loans to private enterprises were always freely determined by PFIs. The APEX refinancing rate charged by the Central Bank was adjusted several

times to take into account changing economic conditions. The APEX rate was linked to the Central Bank reference rate whose method of calculation changed to ensure that it took into account the growing price instability of the mid-1990s. This helped insure that rates to enterprises reflected inflation levels in the country. The credit was modified in 1997 to allow lending in foreign exchange to enterprises in the free zone.

The repayment rates for loans to enterprises under the APEX line of credit remained very high throughout the life of the project. By the time of completion of the project, only five loans representing 3.46 percent of outstanding loan portfolio were in arrears. A survey of the enterprises which received financing revealed that 74 percent of recipients rated the project highly satisfactory or satisfactory. Participating private enterprises were particularly pleased with the possibility to obtain a loan in either local or foreign currency and to have access to 12-year loans. Commercial banks were satisfied with the financial conditions applied under the refinancing agreements, finding that the rates were acceptable and loan lengths appropriate, but wished that the procedures were simpler.

Financial Sector Reform Component:

The outcome of the financial sector component is rated highly satisfactory. Specific actions listed in the SAR as well as all measures agreed upon during the restructuring of the project in 1996 and 1998 were carried out successfully. Financial sector reform measures were either conditions of credit effectiveness or disbursement of the second phase of the APEX line of credit. As previously discussed, the project was restructured to focus also on divestiture of the state from the banking system.

Specific achievements by sub-components are described below.

Implementation of Monetary Policy. Under the project, the Government and the Central Bank committed to the gradual substitution of direct for indirect methods of monetary control. The Central Bank was to take a number of actions which included: (i) introduction of flexibility and subsequent elimination of the Central Bank prior authorization system for credits by commercial banks; (ii) reorganization of the money market and rediscount mechanisms to establish a more rational interest rate structure; (iii) elimination of credit ceilings; and (iv) regular publication of the results of Treasury bill auctions and resumption of the publication of the Central Bank statistical bulletin.

The system of credit authorization, which required the Central Bank's prior approval of any commercial bank credit above certain limits, was liberalized in 1990 and eliminated in August 1991. In addition, the system of bank-by-bank credit ceilings was modified to promote competition among banks in 1994, and the ceilings themselves abolished in 1995. Finally, the reserve requirement system was simplified in 1990 to make it a quantitative credit control instrument based on deposits, rather than credits.

The money market and refinancing operations of the Central Bank were reformed significantly, which resulted in a substantially changed interest rate policy. In 1990, auctions were introduced

to enable the Central Bank to manage liquidity in the banking system. A flexible short-term refinancing facility was established in 1991 in the form of special advances at a rate significantly higher (initially by 5 percentage points) than the Central Bank reference rate. The establishment of a refinancing mechanism for Treasury bills was delayed because of the initial non-negotiability of those bills and the provisions of the Central Bank statutes which precluded it from participating in the primary market. Treasury bills are now negotiable, and the Central Bank spelled out the modalities for its intervention in the secondary market of the Treasury bills in May 1998. Moreover, the method for determining the Central Bank reference rate was improved in 1995 when a formula that takes into account past and expected future rates of inflation was adopted, in line with agreements with the World Bank. The application of this methodology had an important role in putting a break on inflation in the mid 1990s.

As planned, the Central Bank has improved the availability of information. The results of the Treasury bill auctions have been made immediately available to participants since 1990 and published in the press since 1998. The Central Bank also resumed the quarterly publication of its statistical bulletin in 1991, which had been suspended in the 1980s.

Strengthening of Regulations and Bank Supervision: The program called for clarification of the provisions of the 1988 Banking Law which imposed very restrictive guidelines for lending to one borrower, and ceasing Central Bank representation in the board of commercial banks. In 1995, the Government and the World Bank agreed that a condition of disbursement for the second phase of the line of credit relating to the Chamber of Commerce, which could not be addressed at the time, be replaced with the enactment of a new banking law. That condition was fulfilled when a new banking law was enacted in 1996 on the activities and control of credit institutions. The legislation clarified the relationship of the Central Bank and the Banking Commission (CSBF) and established clearly the powers of CSBF in the prudential field. The representation of the Central Bank on the board of state banks was discontinued. The 1996 banking law also formally repealed a section of the 1988 law that restricted lending to the same client and replaced it with a system based on risk ratios. Throughout the period the Banking Commission was strengthened as staff increased and was trained. An IMF-seconded specialist helped provide the training.

Government Disengagement from the Public Banks/Privatization. The financial position of the two public banks, BFV and BTM, which accounted for some 60 percent of banking sector deposits in the early 1990s, deteriorated sharply during the 1990s (annual losses reached a peak of FMG 175 billion or US$51.1 million in 1995). Politically-motivated unsound lending of the state banks contributed to the macroeconomic imbalances and monetary expansion of the mid-1990s. Furthermore, the non-compliance of these banks with the monetary regulations in fact initially rendered ineffective the monetary policy instruments being introduced under this project. A divestiture program was agreed upon with the Government, calling for the sale or liquidation of the two state banks, and an action plan was negotiated to ensure divestiture. As part of the program, the Central Bank initially, and subsequently the Government, appointed interim management in each public bank in line with banking legislation. Sales agents were also appointed for each bank.

As a result of this program, the sale of BFV to *Société Générale* (France) was completed in December 1998. The sale of BTM to Bank of Africa (Benin), with IFC participation, took place a year later in December 1999. The full impact of privatization of state banks will only be known in the medium term. However, improved management of public banks and state divestiture have already contributed to increased efficiency in the system as reflected in reduced intermediation margins (which in relation to the credit portfolio declined by three percentage points between 1995 and 1999), and a downward pressure on interest rates, despite Government financing needs which tended to drive interest rates up. Bank privatization has also reduced the fiscal impact of possible future bank failures.

The performance of the public banks started improving in 1995 after the appointment of interim management. Their annual losses declined steeply from a peak of FMG 175 billion in 1995 (US$51.1 million) or 1.3 percent of GDP to FMG 9 billion (US$1.7 million) in 1997. Moreover, after a full year of operating as a private bank, BFV showed a marked expansion of operations, with credit doubling and net profits increasing tenfold from a very low base at the time of sale. In the first few months of operation, the second privatized bank (BTM) also showed marked expansion of credit and profitability.

Private Sector Component:

The Private Sector Component is rated satisfactory. The actions to be achieved under the component included: (i) restructuring of the CCI; (ii) a communication and motivation campaign targeted at the creation and expansion of private enterprises; and (iii) promotion of a One-Stop Investment Approval and Promotion Center (*Guichet Unique*). Although activities related to the CCI and the Investment Promotion Center were transferred to another project, remaining actions were implemented successfully. The communication campaign was carried out by *Jeune Chambre Economique Malgache* (JCEM) through meetings with professional associations and media advertisements. among other things, it was credited for making the APEX line of credit better known to potential beneficiaries. The restructuring of the CCI, which was a condition of disbursement for the second phase of the line of credit, was replaced with a new condition requiring the enactment of a new banking law, a reflection of Government's shifting priorities toward the financial sector. Support to the restructuring of the CCI, and the creation of a one-stop window for private enterprises, were continued under the Private Sector Development and Capacity Building Project (PATESP, Cr. 2956-MAG) approved in May 1997.

SME Development Component:

The SME component is rated satisfactory. The SME technical assistance program had several activities, including: (i) a program for overseas in-plant training and in-company visits for SME promoters and technical staff of SMEs; (ii) funds for SME feasibility studies; and (iii) technical assistance to enterprises. The component was supposed to be carried out by a unit in the Ministry of Economy and Plan, which proved ineffective. At mid-term review the execution of the component was revised and entrusted to three private institutions with close ties to SMEs: *Société Financière d'Investissement ARO* (FIARO), *Entreprendre à Madagascar*, and Africa Project Development Facility (APDF). After that adjustment, some 175 SMEs received training and

assistance in formulating a bankable project; 15 studies were carried out for SMEs operating in the food industry, chemicals, mechanics, manufacturing, construction materials, hotels and restaurants; and three enterprises received in-plant training in other companies. The most comprehensive program was carried out by *Entreprendre à Madagascar*, which noted that about half of the SMEs supported also received financing.

Mining Component:

Activities under the mining component were transferred to other projects, and the component was not rated. The project envisaged some assistance to the mining sector, including preparation of a new mining code, studies and reorganization of the mining laboratories of the ministry of mines. Some preliminary work was financed under the Project Preparation Facility (PPF) for this project, but activities were stopped when no agreement could be reached on the role of the National Mining Office. Discussions were reinitiated in 1996 under a new Government, but since the work was expected to take longer than the life of the project, it was decided to transfer the mining activities, first to PATESP and subsequently to a Mining Project (Cr. 3111-MAG), approved on June 30, 1998.

4.3 Net Present Value/Economic rate of return:

No NPV/ERR was computed in the SAR.

4.4 Financial rate of return:

No financial rate of return was computed in the SAR.

4.5 Institutional development impact:

The APEX project had the greatest impact on Madagascar's financial sector by helping improve the ability of the Central Bank to perform its role through the introduction of modern monetary policy instruments and the privatization of poorly-performing state banks. Support under the project enabled the Government to complete the privatization of all state-owned banks, making the banking sector more competitive and healthier. As part of the project-supported agenda, a new banking law was also passed that is in line with internationally accepted practices.

As mentioned in outcomes, the use of the line of credit enabled new banks which were established in the early 1990s to learn the market for investment financing, the clients, and to train staff in term lending. This happened at a particularly difficult time, when it was unlikely that they would have provided term financing, both because of the changing political environment, and because, as new entrants, they were unfamiliar with the market. Nonetheless, by the end of the project, commercial banks were pleased to have established durable and sustainable ties with SMEs.

5. Major Factors Affecting Implementation and Outcome

5.1 Factors outside the control of government or implementing agency:

Disbursements under the line of credit remained low in the first years of project implementation, from 1990 to 1992. The first half of the 1990s saw a period of severe political instability and change which affected the implementation of the project. IDA disbursement procedures, which did not allow direct payment to suppliers for small contracts, combined with a two-step process requiring sign-off for disbursements from both the Central Bank and the Treasury, resulted in delays in obtaining APEX financing. Some sub-borrowers and/or their banks resorted to pre-financing that resulted in additional costs. Procedures were simplified after the mid-term review.

With respect to the line of credit, the 1993 mid-term review noted that factors outside the implementing agency control were impediments to bank borrowing and the utilization of the line of credit. Some, like foreign exchange shortages, were eliminated with the liberalization of the exchange rate, and improvements in macroeconomic management. Equally, constraints to lending to a single client were eliminated initially through instructions clarifying the 1988 banking law and ultimately with the enactment of the 1996 banking legislation.

5.2 Factors generally subject to government control:

The release of the second phase of the line of credit was delayed because the disbursement condition pertaining to enactment of the new banking law by the Government was not met on time. Reforms in the banking sector were effectively implemented when the Government was able to move forward in the second half of the 1990s.

5.3 Factors generally subject to implementing agency control:

A few factors associated with the implementing agency were responsible for the slow disbursement under the line of credit in the early years of the project. According to project guidelines, only PFIs were to assess and assume the financial risk of loan operations with subborrowers. However, the APEX unit in the Central Bank assumed the task of reviewing requests submitted by PFIs not only from the point of view of their conformity with the APEX criteria and requirements, but also from the point of view of their substance, i.e., assessing their commercial risks. This practice led to very slow appraisal and approval processes. Procedures were adjusted after the mid-term review which resulted in faster loan approval and disbursement.

5.4 Costs and financing:

The APEX credit had an original implementation period of seven years but took 10 years to complete. Disbursements remained slow in the first years of the project, until 1992, due to long civil strikes and an unstable economic environment. The project was then restructured to judiciously reallocate funds to other components and the original closing date of June 30, 1997 was extended three times with the Credit closing on June 30, 2000. The first extension was

granted to enable the World Bank to finance the management and sale of the two state-owned banks, while the last two enabled completion of payments on the staff retrenchment plan. All new activities added with the restructuring were finalized by the time the project closed.

The original cost of the project was US$66.30 million including an IDA credit of SDR 36.4 million (US$48 million equivalent). Project cost at completion was US$61.89 million, representing 93 percent of the project's original cost (see tables in Annex 2). The difference in original project cost is explained by two main factors: (i) the total contribution of the subborrowers was reduced when the allocation to the line of credit was cut back to SDR 24 million; and (ii) SDR 2 million (US$2.6 million) was canceled from the IDA credit. In the end, 95 percent of the remaining SDR 34.4 million of IDA credit was disbursed.

6. Sustainability

6.1 Rationale for sustainability rating:

The sustainability of the project is likely. The most important components, financial sector reforms and the line of credit, achieved results that are likely to have lasting positive effects on the Malagasy economy. The legal, institutional and monetary policy reforms and the privatization of poorly-performing state banks have contributed to making the financial system more efficient and competitive. Ultimately, the test of the sustainability of the program will be the Government's willingness to allow the Central Bank and CSBF to apply the banking legislation and the Central Bank to carry out its monetary policy functions. The track record since the mid-1990s has been quite good. Notwithstanding unavoidable pressures since the privatization of the state banks, CSBF has not given licenses to unqualified banks. The tradition of a serious banking supervisory body has begun to take root, and there is reason to be optimistic.

The availability of the APEX line of credit enabled new banks which were established in the early 1990s to learn the market for investment financing, the clients, and to train staff in term lending. Discussions with bankers involved with the line of credit confirmed that banks have gained valuable knowledge of previously unknown clients with whom they will continue doing business beyond the life of this project.

6.2 Transition arrangement to regular operations:

Activities under the project related to financial sector reform were carried out by the Ministry of Finance, the Central Bank and CSBF, which performed functions associated with their regular mandates and improved their technical skills. Discussions are underway with the Malagasy authorities and other stakeholders on future World Bank support to extend and deepen the financial sector reform program achieved by this and other World Bank projects. It is envisaged that support will be focused on eliminating the principal bottlenecks to increased production and exports, and will complement World Bank initiatives in infrastructure and other fields. Activities under the new project would have a direct and measurable effect on improved governance, in line with the CAS for Madagascar. The future project will aim at eliminating key fiscal, legal and institutional constraints to enterprise financing (including SME and microenterprises), and the introduction of new financial services. Support will also enhance the functioning of financial

markets, such as the markets for government and commercial paper to increase access to term finance. The Government has also requested World Bank support for reforms in the areas of insurance, pension and social security. These reforms should have a positive impact on the availability of term finance. Work will be carried out in close collaboration with the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA). Although the banking and enterprise sectors have requested a continuation of the APEX line of credit, it is not expected that IDA will provide a follow-up line of credit. However, IFC has been in discussions with specific banks on the possibility of providing lines of credit.

7. Bank and Borrower Performance

Bank

7.1 Lending:

World Bank performance in the identification, preparation, and appraisal of the Apex project was satisfactory. The project objectives were consistent with government priorities and supported Government's efforts to promote financing of private enterprises through the banking system, and to create an enabling environment through policy changes in the financial and private enterprise sectors.

Project preparation lasted almost two years until Board approval. During the appraisal of the project, the World Bank team worked closely with the Malagasy Government and the IMF. That helped ensure that the policy reforms envisaged and the support to be provided under each component complemented measures aimed at financial stabilization being implemented with IMF assistance. Government's commitment to continue policy reforms was reviewed and an assessment of the types of SMEs in existence, as well as their financing needs, was also carried out.

7.2 Supervision:

The supervision of the project by the World Bank was satisfactory. Despite the length of the APEX project (10 years of implementation) and several different task teams, the project was closely followed via frequent supervision visits. There were usually two visits per year except in 1991 when political uncertainties limited supervision visits (see Annex 4). The supervision team often included consultants specializing in monetary reforms and banking legislation in addition to World Bank staff. Project implementation progress was well reported in *aide-mémoire* that addressed issues of the moment and recommended actions to be undertaken. Detailed *aide-mémoire* with clear recommendations were highly appreciated by the implementing agencies. Performance ratings given in the Supervision Form 590 and in the PSRs were also realistic, ranging from Highly Satisfactory to Satisfactory. The project was never found to be at risk and never rated Unsatisfactory (see Annex 4). The Bank team was quite responsive to changing conditions during project implementation and made needed adjustments to the project. The project was, thus, restructured twice. In addition, the legal documents were amended six times and the closing date extended three times. These actions allowed a refocus of activities to better support the Government's program in the financial sector, address problems with underutilized funds under the line of credit, revisit disbursement conditions, eligibility criteria, and procurement procedures to ensure project success. Project supervision was evaluated twice by the QAG. The project received an award for excellence in supervision in 1998.

7.3 Overall Bank performance:

Overall Bank performance was satisfactory. The appraisal team assessed the changing country environment, and successive Bank teams who supervised the project were proactive and showed flexibility in adjusting to the country's changing conditions.

Borrower

7.4 Preparation:

Borrower performance in project preparation was satisfactory. Borrower involvement and commitment to the APEX project was clearly demonstrated during project preparation. The Malagasy team who worked on the project included high level staff from the Government and the Central Bank who were technically qualified and played an active role in determining project components. This was reflected in the quality of the project design.

7.5 Government implementation performance:

Government's overall performance in project implementation was satisfactory. Work on banking sector reform is rated highly satisfactory. All major financial sector policies listed in the SAR, and subsequently in the amendments, were carried out. The appointment of highly qualified staff at the Central Bank and the Ministry of Finance as well as two senior advisors to the prime minister permitted the far-reaching reforms achieved in the banking sector.

7.6 Implementing Agency:

Overall, the performance of the main implementing agency, the Central Bank of Madagascar, was satisfactory. Except for a brief period during the political transition in the early 1990s, the Central Bank always maintained qualified staff which made project implementation successful. The Ministry of Finance was responsible for implementation of the Bank Privatization/Redundancy Payments component and its performance was highly satisfactory. The implementing agencies managed funds effectively, especially after the special account management was entrusted to the Central Bank instead of the Treasury. Accounts were audited regularly and in a timely manner, except in 1991 when the audit encountered a slight delay. Procurement procedures were generally adhered to. Some modifications of the procedures were adopted after the mid-term review, with respect to the line of credit, mainly to accommodate small enterprises and those outside of the capital city and to minimize delays in the processing of subloans. All key studies proposed in the project were performed, including an impact study of the line of credit on the enterprises who received a loan.

7.7 Overall Borrower performance:

The overall Borrower performance was satisfactory. Despite a slow start to the project including economic instability and slow disbursements, the borrower stayed the course, implemented all the major recommendations that were made after the mid-term review and other supervision missions to make the project a success. In the end, the Government came through with regard to all financial sector policies to be implemented under the project. Also, enterprises who benefited

from the line of credit were very satisfied with the services they received.

8. Lessons Learned

Implementation of the APEX Project offers several valuable lessons.

- **Flexibility built in the design and in supervision helps achieve objectives.** The appraisal team understood that Madagascar had embarked on a process of change and built flexibility into the project design. The project had a policy agenda, particularly for financial sector reform, although the largest cost component was the line of credit. The reform agenda in the project provided the framework for a sustained dialogue between the government and the World Bank even in difficult periods, and permitted adjustments in project design to respond to changing conditions. Government agencies involved in the project and World Bank staff reacted quickly to developments. When the line of credit commitments slowed down in the mid-1990s, the government requested a change in the project content to include bank privatization, and the World Bank agreed to the changes, which were submitted for Board approval. In the early stages of the project, the interest rate mechanisms and eligibility criteria under the line of credit were adjusted successfully to meet the changing country environment. In the end, the major legacy of the project will be the changes brought about in the financial sector, as envisaged in the appraisal.

- **Commitment by Government and implementing agencies key to success of a reform agenda.** The financial sector and privatization agendas were carried out successfully because the Government and the Central Bank were committed to change. Actual divestiture of state banks only occurred when successive electoral processes were completed, and the Government was able to give its full support to change. Some reforms in monetary policy instruments, like the changes in the reference rate to curb inflation in the mid-1990s which were undertaken with support from the World Bank were, in hindsight, courageous at a time when there were important political changes underway. The implementation of monetary policy was partially thwarted in the early years by the poor performance of state-owned banks. The problems with the banks began to be resolved once the Government authorized the Central Bank, and the CSBF (part of the Central Bank until 1996) to actually perform their role and reign in the state banks via the appointment of conservators. The problem was not fully resolved until the Government actually decided to sell the banks.

- **Competence of implementing agencies critical.** The changes in monetary policy instruments and of monetary policy could be introduced even in a period of political instability because the Central Bank authorities understood their importance and were capable of implementing them. These competencies increased over the project implementation with support from the World Bank, the IMF and other donors. The Bank had two operations in support of the Central Bank. The IMF seconded a banking supervision specialist and fielded six technical assistance missions during the period. Actions taken by the Central Bank and the CSBF in halting the deterioration of the financial sector through their interventions in the two state-owned banks also

reflected the capabilities of the institutions. This was further demonstrated by both the Government and the CSBF's work on privatization after 1996 as well as the Government's successful negotiation of a retrenchment plan with the trade unions.

- **Reforms need to be based on a technically solid approach which enjoys the support of key stakeholders.** The project was designed and modified in close collaboration with the Government, the Central Bank and the IMF. The problems posed by the poor performance of state-owned banks in the late 1980s and early 1990s were well understood by the Government introducing the reforms, and also by the technical staff of the banks being privatized. The World Bank and IMF staff worked closely throughout project supervision. Other key donors in the financial sector, such as the Government of France and the European Union, also participated actively in the privatization discussions. IFC was actively involved in the privatization of one of the banks. On the World Bank side, the activities supported by the adjustment credits and the agenda spelled out in the project were consistent, and the same World Bank teams took the lead in discussing the reform agenda under the project and the Structural Adjustment Credit (Cr. 2937-MAG).

- **Policy reforms have to be supported by considerable technical work and adequate provision of necessary resources.** It is improbable that the divestiture process would have been carried out successfully in the absence of the technical input financed under the Credit. Equally, it is unlikely that the divestiture process would have been completed successfully and without any social disruptions if allocations had not been made for the staff retrenchment program of the privatized banks.

9. Partner Comments

(a) Borrower/implementing agency:

The Borrower's completion report on the project (see summary in Annex 8) notes that the project had a positive impact on the Malagasy economy. The line of credit allowed new enterprises to start, and for established enterprises, to expand their operations. Exports and investments saw a significant increase and 2,028 new jobs were created. The privatization of the two state-owned banks contributed to a healthier financial sector, thus meeting one of the main objectives cited by the Government in its 1996-99 economic policy document. According to the report, bank privatization would not have been successful without redundancy payments made under the project to former staff of the banks to facilitate their integration into the private sector. The report congratulates World Bank staff for providing clear recommendations in *aide-mémoire* written after supervision missions. The Central Bank, the main implementing agency of the project, noted that supervision and coordination of project components were made difficult due to a lack of a national coordinator. Also, a single Special Account for several implementing agencies made project management more difficult as the Central Bank often lacked necessary information from the other agency to properly plan disbursements and account replenishments. The Central Bank finally noted that some supporting documents sent to World Bank Headquarters were lost, causing unfortunate delays in loan disbursements.

(b) Cofinanciers:

N/A

(c) Other partners (NGOs/private sector):

A survey of the private sector enterprises (49) that had access to the line of credit revealed that 74.3 percent of the enterprises rated the project highly satisfactory or satisfactory. Beneficiaries appreciated the availability of hard currency at any time, the length of the loans (up to 12 years), and the loan repayment in local currency. Among the criticisms of the project, beneficiaries mentioned long and cumbersome procedures for loan application as well as IDA's demanding procurement procedures.

10. Additional Information

N/A

Annex 1. Key Performance Indicators/Log Frame Matrix

Outcome / Impact Indicators:

Indicator/Matrix	Projected in last PSR[1]	Actual/Latest Estimate
APEX LINE OF CREDIT -Increased production, exports and employment in the private sector. -Increased lending by the banking sector for investment projects	-Number of medium and long-term loans increased.	-Increase in annual sales of FMG 255 billion; value added of FMG 124 billion and exports of FMG 29 billion (for 35 enterprises who responded to the project survey launched in 1997). -Over 2000 jobs created in the modern sector. - Participating banks competent to provide medium term financing.
FINANCIAL SECTOR REFORM -Increased efficiency of the financial sector through improved monetary policy formulation, modernized banking legislation and regulation, and divestiture of state ownership in the banking sector.	-M2/GDP increase to 20% -Inflation rate stabilized to 10% -Interest rate spread decreased - New monetary policy instruments introduced -Banking legislation and regulation modernized -Two banks privatized	- M2/GDP increased to 18%. M3/GDP increased to 21% (M3 more relevant as foreign exchange deposits are now authorized). - Inflation rate was 9.7% in 1999 after having accelerated to over 30% in the mid-1990s. -Regulation and supervision enhanced: state bank operations improved before privatization, and no unqualified banks licensed. -Interest rate spread decreased in part as a result of increased competition - Public sector subsidies to the banking sector eliminated.
SMALL AND MEDIUM ENTERPRISES (SME) DEVELOPMENT Improve entrepreuneurial skills	Progress not reported in last PSR	- Three scholarships granted to entrepreneurs who received training abroad. - 175 entrepreneurs received training in Madasgascar to improve their competencies in accounting, and management information systems.

Performance indicators were not set up during the project design in 1990 and thus, none existed in the SAR. The World Bank team came up with the above performance indicators during project implementation and supervision.

Output Indicators:

Indicator/Matrix	Projected in last PSR[1]	Actual/Latest Estimate
APEX LINE OF CREDIT Increased access to medium and long-term loans by entrepreneurs	- Number of medium and long-term loans increased	- 61 medium and long term loans granted to 49 enterprises - All 5 banks operating in Madagascar participated. Private banks provided over 75% of loans (commitments).
FINANCIAL SECTOR REFORM 1. Bank Privatization: eliminate state control of banking institutions.	All 3 public banks privatized, two under the project.	Total of 3 public banks privatized. The 2 banks privatized under the project accounted for 60% of deposits in the early 1990s; 6 private banks in total exist in Madagascar
2. Monetary policy reforms to allow control by indirect means. Reforms in: - Central Bank refinancing - Reserve requirements - Treasury bill system - Reference rate calculation - Credit ceilings - Access to economic information	- New Refinancing mechanisms established; -Central Bank paper auctioned -Reserve requirements based on deposits rather than credit -Credit ceilings eliminated. -Treasury bills auctioned and secondary market created; access by non-banks. -Reference rate linked to past/projected inflation (1995). -Central Bank quarterly statistical reports published	Monetary policy implemented using indirect instruments. -New refinancing mechanisms: Central Bank paper auctioned (starting in 1994). -Reserve requirements based on deposits instead of credit (1990). - Credit ceilings modified initially in 1990 and eliminated in 1995. -Treasury bills auctioned (1995)and secondary market created (1998). Access by non-banks (1999). - Reference rate linked to past/projected inflation (1995). Reference rate in November 2000 = 12%. - Central Bank quarterly statistical reports published starting in 1991. Treasury bill auctions public since 1991 and published in the press since 1998.
3. Banking Legislation/Bank Supervision: - Revise banking legislation - Improve bank supervision	- New Central Bank statutes in June 1994. - New modern Banking law in February 1996 gives more power to the Central Bank. -Banking Commission solely responsible for regulation & supervision as per 1996 banking law.	- New Central Bank statutes in June 1994. -Banking Commission solely responsible for regulation & supervision as per 1996 banking law. -New modern Banking law of February 1996 gives more power to the Central Bank.
SME DEVELOPMENT -Training provided to entrepreneurs -Feasibililty studies undertaken -Technical assistance provided	Progress not reported in last PSR	-175 small entrepreneurs trained. - Three enterprises received scholarship for training abroad. - 15 sector feasibility studies carried out. - 83 entrepreneurs were provided assistance to apply and obtain a loan

[1] End of project

Annex 2. Project Costs and Financing

Project Cost by Component (in US$ million equivalent)

Project Cost By Component	Appraisal Estimate US$ million	Actual/Latest Estimate US$ million	Percentage of Appraisal
Line of Credit	62.50	47.15	75
Financial Sector/Bank Privatization	0.35	8.52	2434
Redundancy Payments for Bank Privatization	0.00	4.98	
Private Sector Framework	0.48	0.05	10
SME Development	1.73	1.03	60
Mining & PPF	0.76	0.16	21
Unallocated	0.48	0.00	0
Total Baseline Cost	66.30	61.89	
Total Project Costs	66.30	61.89	
Total Financing Required	66.30	61.89	

The original cost of the project was estimated at US$66.30 million. The proposed IDA credit of US$48 million was to cover 72.4 percent of the total cost of the project. The remainder (27.6 percent) was to be financed by subborrowers of the line of credit and the SME assistance Unit. The final cost of the project was US$61.89 million.

Project Costs by Procurement Arrangements (Appraisal Estimate) (US$ million equivalent)

Expenditure Category	Procurement Method[1] ICB	NCB	Other[2]	N.B.F.	Total Cost
1. Works	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)
2. Goods	0.00 (0.00)	0.00 (0.00)	0.70 (0.20)	0.00 (0.00)	0.70 (0.20)
3. Services	0.00 (0.00)	0.00 (0.00)	3.10 (2.80)	0.00 (0.00)	3.10 (2.80)
4. Miscellaneous	0.00 (0.00)	0.00 (0.00)	62.50 (45.00)	0.00 (0.00)	62.50 (45.00)
5. Miscellaneous	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)
6. Miscellaneous	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)
Total	0.00 (0.00)	0.00 (0.00)	66.30 (48.00)	0.00 (0.00)	66.30 (48.00)

Project Costs by Procurement Arrangements (Actual/Latest Estimate) (US$ million equivalent)

Expenditure Category	Procurement Method[1] ICB	NCB	Other[2]	N.B.F.	Total Cost
1. Works	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)
2. Goods	0.00 (0.00)	0.00 (0.00)	0.70 (0.70)	0.00 (0.00)	0.70 (0.70)
3. Services	0.00 (0.00)	0.00 (0.00)	8.76 (7.10)	0.00 (0.00)	8.76 (7.10)
4. Miscellaneous	0.00 (0.00)	0.00 (0.00)	47.45 (33.68)	0.00 (0.00)	47.45 (33.68)
5. Miscellaneous	0.00 (0.00)	0.00 (0.00)	4.98 (4.98)	0.00 (0.00)	4.98 (4.98)
6. Miscellaneous	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)
Total	0.00 (0.00)	0.00 (0.00)	61.89 (46.46)	0.00 (0.00)	61.89 (46.46)

1/ Figures in parenthesis are the amounts to be financed by the IDA Credit. All costs include contingencies.

2/ Includes civil works and goods to be procured through national shopping, consulting services, services of contracted staff of the project management office, training, technical assistance services, and incremental operating costs related to (i) managing the project, and (ii) re-lending project funds to local government units.

Project Financing by Component (in US$ million equivalent)

Component	Appraisal Estimate			Actual/Latest Estimate			Percentage of Appraisal		
	IDA	Govt.	CoF.	IDA	Govt.	CoF.	IDA	Govt.	CoF.
Line of Credit	45.00	0.00	17.50	33.44	0.00	13.71	74.3	0.0	78.3
Financial Sector	0.35	0.00	0.00	7.10	1.42	0.00	2028.6	0.0	0.0
Bank Privatization/Redundancy Payments	0.00	0.00	0.00	4.98	0.00	0.00	0.0	0.0	0.0
Private Sector Framework	0.40	0.08	0.00	0.05	0.00	0.00	12.5	0.0	0.0
SME Development	1.14	0.59	0.00	0.73	0.30	0.00	64.0	0.0	0.0
Mining & PPF	0.76	0.00	0.00	0.16	0.00	0.00	21.1	0.0	0.0
Unallocated	0.48	0.00	0.00	0.00	0.00	0.00	0.0	0.0	0.0

Annex 3: Economic Costs and Benefits

N/A

Annex 4. Bank Inputs

(a) Missions:

Stage of Project Cycle	No. of Persons and Specialty (e.g. 2 Economists, 1 FMS, etc.)		Performance Rating	
Month/Year	Count	Specialty	Implementation Progress	Development Objective
Identification/Preparation				
7/90	*2*	Economists		
	3	Operations Analyst		
Appraisal/Negotiation				
3/89	*3*	Economists		
	2	Financial Specialists		
Supervision				
10/90	*2*	1 Financial Economist, 1 economist	HS	HS
02/91	*1*	1 Financial Economist	S	HS
1/92	*2*	1 Financial Economist, 1 Consultant	S	S
3/92	*6*	1 Financial Economist, 5 consultants	S	S
6/92	*1*	1 Private Sector Economist	S	HS
11/92	*2*	1 Financial Economist, 1 Economist	S	S
8/93	*1*	1 Financial Economist	S	S
11/93	*5*	1 Financial Economist, 1 Private Sector Economist, 3 Economist	S	S
2/94	*2*	1 Financial Economist, 1 Economist	S	S
11/94	*2*	2 Economists	S	S
3/95	*3*	1 Pr. Operat. Officer, 2 Economists	S	S
2/96	*2*	1 Economist, 1 Pr. Operat. Officer	S	S
4/96	*1*	1 Industrial Economist	S	S
7/96	*2*	1 Economist, 1 Operat. Officer	S	S
11/97	*2*	1 Sr. Economist, 1 Economist	S	S
11/98	*1*	1 Economist	S	S
7/99	*2*	1 Pr. Operat. Officer, 1 Economist, 1 Consultant	S	S
2/00	*3*	1 Pr. Operations Officer, 1 Sr. Financial Specialist, 1 Consultant	S	S
6/00	*2*	1 Sr. Financial Specialist, 1 Consultant	S	S
ICR				
1/2000	*1*	Principal Operations Officer	S	S
1/2000	*1*	Consultants	S	S

(b) Staff:

Stage of Project Cycle	Actual/Latest Estimate	
	No. Staff weeks	US$ (,000)
Identification/Preparation	43.9	73.0
Appraisal/Negotiation	38.4	77.7
Supervision	156.8	388.3
ICR	14.5	39.6
Total	253.6	578.6

Annex 5. Ratings for Achievement of Objectives/Outputs of Components

(H=High, SU=Substantial, M=Modest, N=Negligible, NA=Not Applicable)

	Rating				
☐ *Macro policies*	○ *H*	● *SU*	○ *M*	○ *N*	○ *NA*
☐ *Sector Policies*	○ *H*	● *SU*	○ *M*	○ *N*	○ *NA*
☐ *Physical*	○ *H*	○ *SU*	○ *M*	○ *N*	● *NA*
☐ *Financial*	○ *H*	● *SU*	○ *M*	○ *N*	○ *NA*
☐ *Institutional Development*	○ *H*	● *SU*	○ *M*	○ *N*	○ *NA*
☐ *Environmental*	○ *H*	○ *SU*	○ *M*	○ *N*	● *NA*
Social					
☐ *Poverty Reduction*	○ *H*	○ *SU*	○ *M*	○ *N*	● *NA*
☐ *Gender*	○ *H*	○ *SU*	○ *M*	○ *N*	● *NA*
☐ *Other (Please specify)*	○ *H*	○ *SU*	○ *M*	○ *N*	● *NA*
☐ *Private sector development*	○ *H*	● *SU*	○ *M*	○ *N*	○ *NA*
☐ *Public sector management*	○ *H*	● *SU*	○ *M*	○ *N*	○ *NA*
☐ *Other (Please specify)*	○ *H*	○ *SU*	○ *M*	○ *N*	○ *NA*

Annex 6. Ratings of Bank and Borrower Performance

(HS=Highly Satisfactory, S=Satisfactory, U=Unsatisfactory, HU=Highly Unsatisfactory)

6.1 Bank performance	*Rating*
☐ *Lending*	○ *HS* ● *S* ○ *U* ○ *HU*
☐ *Supervision*	○ *HS* ● *S* ○ *U* ○ *HU*
☐ *Overall*	○ *HS* ● *S* ○ *U* ○ *HU*

6.2 Borrower performance	*Rating*
☐ *Preparation*	○ *HS* ● *S* ○ *U* ○ *HU*
☐ *Government implementation performance*	○ *HS* ● *S* ○ *U* ○ *HU*
☐ *Implementation agency performance*	○ *HS* ● *S* ○ *U* ○ *HU*
☐ *Overall*	○ *HS* ● *S* ○ *U* ○ *HU*

Annex 7. List of Supporting Documents

- *Aide-Mémoire* and Back-to-Office Reports
- Consultant Mission Reports
- Staff Appraisal Report
- Credit Agreement
- Project Agreement
- Borrower's Evaluation Report

Additional Annex 8. Summary of Borrower's Contribution to ICR

Summary of Borrower's Contribution to the Implementation Completion Report

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Financial Sector and Private Enterprise Development (APEX) Project (Credit No. 2104 - MAG)

Introduction

The Financial Sector and Private Enterprise Development Project was financed by APEX Credit No. 2104-MAG signed on April 4, 1990 between the Republic of Madagascar and the International Development Association for a total amount of SDR 36.4 million. The APEX Credit became effective on September 25, 1990 and was originally scheduled to close on June 30, 1997. In accordance with Section 3.02 of the Credit Agreement, the Treasury, through a Subsidiary Loan Agreement dated August 3, 1990, onlent the following funds to the Central Bank :

1. In the form of a loan, a portion of the credit proceeds initially totaling SDR 34.05 million to finance specific investment projects via sub-loans granted to enterprises by the Participating Financial Institutions (PFIs) (under Part A of the Project) ; and
2. As a non-reimbursable subsidy, the sum of SDR 260,000 to finance financial sector interventions such as seminars for higher level staff of Participating Financial Institutions and the Central Bank; training; and the provision of data-processing equipment to the Central Bank (under Part B of the Project).

For purposes of implementing Part A of the Project, and in accordance with the terms of the Credit Agreement, the Central Bank entered into Participation Agreements with the PFIs; these agreements were accompanied by Operating Standards defining the general conditions and eligibility criteria for the APEX credit line.

Since a relatively large balance remained a year before the initial closing date, the Government of Madagascar and IDA agreed that, instead of resorting to a new IDA credit, the Project would be reorganized as of June 1996 to include financing for the Government's program of disengagement from public banks, and support for the related accompanying measures. The Credit's closing date was thus postponed to June 30, 1998.

The Project was modified a second time on June 25, 1998 to help cover severance packages for personnel affected by staff reductions at privatized banks (Category 9). In this connection, there was a second extension of the Project's closing date: to June 30, 1999 for Category 1 and to December 31, 1999 for Category 2 (strengthening of the financial sector) and Category 9 (redundancy payments). In order to allow the Government of Madagascar to privatize the BFV and BTM, the World Bank postponed the closing date for Categories 2 and 9 to June 30, 2000.

The APEX Project had far-reaching objectives, including:

- Financial support for productive capacities and services likely to contribute to Madagascar's economic and social development, through the provision of investment credits to support the creation and restructuring of enterprises;

- Strengthening of institutions in the mining, financial and SME support sectors, through the recruitment of technical assistance and the provision of supplies and equipment.

The two most important Project components were the APEX credit line and technical assistance for the restructuring of the banking system.

Project Performance

In terms of gross commitments, the envelope allocated to the credit line managed by the APEX Unit was entirely used: the total of loans granted amounts to SDR 35.6 million. The level of disbursements (SDR 23,4 million), which is considerably lower than the amount initially allocated to the credit line, is due to exogenous factors completely unrelated to the Unit's managerial capacity. The economic climate and internal problems of enterprises caused several beneficiaries to forego the use of some or all of their borrowings (36.2 % of gross commitments were cancelled).

A difficult economic climate

The Project was implemented in a difficult economic climate which prevented it from reaching the hoped-for pace of commitments and disbursements. The following factors were involved:

- The prolonged strike of 1990 and 1991, which paralyzed economic activity and compromised Project start-up.

- The lack of information on the part of entrepreneurs and the complexity of procedures, which prevented the Project from reaching full development in 1992-1993.

- The fact that the increased credit line use, which had been expected once the mid-term review recommended the simplification of procedures, was then hampered by the change that occurred in the foreign exchange regime. The introduction of the floating exchange rate (the inter-bank currency market) in May 1994, had a negative impact on credit consumption due to the resulting increase in the cost of imported goods.

- The fact that the information and outreach campaigns did not have the expected results due to the economic conditions prevailing at the time.

Impact of the APEX Line of Credit

The Project allowed new businesses to start up their activities and existing businesses to strengthen their means of production. In order to be able to gauge the Project's impact, the APEX Unit sent a model evaluation sheet to participating banks, which was to be filled out by beneficiary enterprises.

Beneficiaries' assessments

Examination of the 35 evaluation forms revealed the following:
- 11 enterprises out of 35 – or 31.4 % -- stated that they were satisfied with the Project;
- 15 beneficiaries out of 35 – or 42.9 % -- rated the Project acceptable; and
- 9 enterprises out of 35 – or 25.7 % -- did not provide general assessments.

Beneficiaries expressed satisfaction mainly with the following aspects of the Project:
- the availability of hard currency regardless of the country's foreign exchange reserve situation;
- the credit repayment period, which could be as long as 12 years; and
- the fact that materials could be imported without restrictions with a loan repayable in FMG.

According to some beneficiaries, however, APEX financing entails some inconveniences, such as:

- cumbersome procedures for preparing and processing the loan application file, a process that sometimes required the services of a consulting firm;

- procurement procedures that required enterprises to consult at least three suppliers, which can be inconvenient, especially for small businesses or in cases involving specific materials; three enterprises were accustomed to entering into negotiated contracts with their usual suppliers; and potential suppliers sometimes failed to respond to a request for a quote;

- the use of bridge financing facilities for imports below US$100,000.00 (the minimum required threshold for a special IDA commitment), a requirement that some beneficiaries found constraining. This bank pre-financing, which is unforeseen at the time of a loan request or notification of loan approval, represents an additional cost for the enterprise.

Assessment at the enterprise level :

Four indicators were used to evaluate the Project's impact at the enterprise level:

1. **Turnover** : Examination of available evaluation sheets reveals that there were additional

sales totaling FMG 255.5 billion; total turnover of the 35 enterprises went from a pre-project figure of FMG 139.3 billion to a post-project figure of FMG 394.8 billion. It should be pointed out, however, that for the firm ZITAL, turnover fell from FMG 3,254 million to FMG 2,528 million ; this decrease is due to the fact that the pre-project turnover included the sale of buildings for which the cost was not specified on the corresponding sheet.

2. **Value added :** The Project helped create additional value added totaling FMG 69.2 billion, since total value added generated by these enterprises went from FMG 55.0 to a post-project figure of 124.2 billion;

3. **Net results :** Overall, net income of these enterprises improved by FMG 20.1 billion, going from FMG 18.0 billion to 38.1 billion. It should be noted, however, that for some large-scale enterprises, such as SCOI or SIH, net income will only be positive once the sub-projects reach full development.

4. **Capacity for self-financing** : The self-financing capability of the beneficiary enterprises was boosted by FMG 48.7 billion, rising from FMG 29.6 billion to FMG 78.3 billion.

Assessment at the level of the economy :

Three criteria were selected for assess the Project's impact on the economy:

1. **Exports :** Enterprises benefiting from the project increased exports by FMG 28.8 billion (from FMG 29.6 billion to FMG 58.4 billion). It should be noted, however, that the proportion of exports within total sales of the beneficiary enterprises remains low (14.8 %). It should also be pointed out that for SOPROMER (*Société des Produits de la Mer*), exports fell from a pre-project level of FMG 1,003.6 million to 724.5 million post project; this firm chose to cater more to the local market by creating several sales outlets in various regions of the country, thus leaving exports to other firms in the group. The increase in exports is mainly due to the industrial fishing firms, which account for 14.0 billion, and duty-free garment enterprises, which account for 13.1 billion.

2. **Jobs created:** The Project helped create 2,028 new jobs, of which 967 are in the textile industry, 261 in food industries and 213 in other manufacturing industries.

3. **Investments :** Investments went from FMG 63.2 billion to FMG 215.9 billion, an increase of FMG 152.7 billion.

Government Disengagement from the Banking Sector

The adjustment program of the Government with the World Bank and International Monetary Fund included a commitment by the Malagasy Government to reduce state ownership in each of the two public banks (BFV and BTM) to a maximum of 30%. To accomplish this objective, the Government appointed a managing director to head each of the two banks and assigned them responsibility for managing and protecting the assets of these institutions, pending privatization.

These managing directors were assisted by specialist consultants in credit and internal audit. The banks were restructured and unprofitable branches were closed. The portfolio of the two banks had deteriorated because of an increase in bad debts and debt in litigation, a factor that placed monetary and financial reform efforts in grave jeopardy.

As part of the reorganization of BFV's operations, the Government assumed responsibility for clearance of the bank's losses. To facilitate that process, special treasury bills (BTS) linked to the reorganization of the bank's portfolio were issued. In August of 1998, *Société Générale* was chosen to take over the activities of BFV. The entity BFV-*Société Générale* was created in November 1998 with 70 billion in capital. The Government retained 30% of the shares.

In February 1999, the AFRICA FINANCIAL HOLDING/BANK OF AFRICA group was chosen to take over the activities of BTM. A bank to be known as BOA MADAGASCAR was registered on November 17, 1999, with 40 billion in capital. The Government retained 15% of the shares while IFC held 10%, and the rest went to national private sector investors.

The financial performance of the BFV over the past two years has made it possible for the Treasury to reduce the amount of special treasury bills issued to cover its reorganization. After privatization of the banks, the bad debts not assumed by the new buyers were transferred to a private recovery agency (SGR). The work done by the team headed by the managing directors prior to privatization led to the recovery of substantial amounts of bad debt. BFV collection activities in 1998 brought in FMG 21.6 billion out of a projected 25 billion. In the case of BTM, collection as of September 1999 was FMG 30.4 billion.

Retrenchment programs, formulated and decided upon by agreement between management and labor, were put in place for the staff of both banks. In addition to the legal rights associated with redundancies, accompanying measures were put in place to facilitate reassignment of redundant staff.

Severance payments were determined on the basis of professional rank and seniority. Redundant staff members were informed prior to their departure of the existence of a reintegration fund and a fund providing credit for the establishment of micro-enterprises. To receive reintegration assistance, employees were required to submit applications describing their planned business activities. The amount of this assistance was tied to the amount of severance pay received. A number of employees established small private enterprises, primarily in transport and commerce.

The number of redundant employees who benefited from the BFV and BTM retrenchment programs stands at 592 and 566, respectively, that is, a total of 1,158 redundant employees out of total staff of 2,985. In terms of overall obligations, severance payments and reintegration compensation totals SDR 3,682,924.22, or 92.07% of the package allocated to Category 9.

In the end, the measures adopted under the auspices of the state on the one hand, and the managing directors and negotiators on the other, served to improve the situation of BFV and BTM, thereby permitting divestiture of government holdings in these two banks under favorable conditions. Privatization of BFV and BTM contributed to the general reorganization of the

financial sector, one of the key objectives spelled out in the 1996-1999 Economic Policy Framework Document.

Without the financial assistance provided by donors for redundant staff, the retrenchment component of the privatization of BFV and BTM might have stood in the way of completion of state withdrawal from these two public banks. This retrenchment program allowed these individuals to transition into the activities chosen by them. However, state monitoring of the use made of this assistance is not possible at the moment because of a lack of financing and a dearth of human resources.

Lessons Learned

The absence of a national coordinator affected project implementation and the ability of the APEX Unit to supervise all project components. In fact, the role of the APEX Unit was reduced to that of a « payer » for components other than the line of credit which it managed directly. The management of a single Special Account on behalf of several implementing agencies proved difficult since the « manager » lacked reliable information to forecast disbursements and replenishment requests.

The project did not make funding allowances to follow-up on the use of redundancy payments. Since employees are scattered all over the island, oversight will require financing. Monitoring would have made it possible to obtain precise information on the socio-economic impact of this accompanying measure.

World Bank Performance

The APEX Unit did not have difficulty implementing the recommendations of supervision missions, which were clearly laid out in *aide-memoire* written after supervision missions.

Periodic meetings at the Resident Mission with members of the Monitoring Committee of the Project were useful in providing solutions to problems common to many sub-projects under the line of credit (e.g., procurement, special account management, etc.).

The installation of an electronic mail connection to the APEX Unit's computer, which provided direct communication with IDA Headquarters, speeded up the non-objection process and the resolution of various ad hoc problems.

The Central Bank finally noted that some disbursement supporting documents sent to the World Bank headquarters were lost, causing unfortunate delays in loan disbursements.