PROJECT INFORMATION DOCUMENT (PID)
APPRaisal STAGE

Report No.: PIDA7473

<table>
<thead>
<tr>
<th>Project Name</th>
<th>Development Finance Project (P146319)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Region</td>
<td>AFRICA</td>
</tr>
<tr>
<td>Country</td>
<td>Nigeria</td>
</tr>
<tr>
<td>Sector(s)</td>
<td>Banking (10%), SME Finance (50%), Microfinance (30%), Other non-bank financial intermediaries (10%)</td>
</tr>
<tr>
<td>Theme(s)</td>
<td>Corporate governance (10%), Regulation and competition policy (10%), Micro, Small and Medium Enterprise support (80%)</td>
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<tr>
<td>Lending Instrument</td>
<td>Investment Project Financing</td>
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<tr>
<td>Project ID</td>
<td>P146319</td>
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<td>Borrower(s)</td>
<td>Federal Ministry of Finance</td>
</tr>
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<td>Implementing Agency</td>
<td>Federal Ministry of Finance</td>
</tr>
<tr>
<td>Environmental Category</td>
<td>F-Financial Intermediary Assessment</td>
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<tr>
<td>Date PID Prepared/Updated</td>
<td>26-Aug-2014</td>
</tr>
<tr>
<td>Date PID Approved/Released</td>
<td>27-Aug-2014</td>
</tr>
<tr>
<td>Estimated Date of Appraisal Completion</td>
<td>20-Jun-2014</td>
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<td>Estimated Date of Board Approval</td>
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I. Project Context

Country Context

The Nigerian economy has continued to grow at a rapid pace in recent years, although the performance of the oil sector has weakened. GDP growth has been in the range of 5-8 percent during the last decade, driven by expansion of domestic demand and concentrated primarily in trade, agriculture, and services. Oil output has periodically stagnated or declined since 2010, reflecting both regulatory uncertainty limiting investment and the disruptive effects of oil theft in the Niger Delta. 2013 was particularly difficult in that regard, involving major disruptions to pipelines, with oil output estimated at 2.18 million barrels a day, 5.8 percent lower than in 2012.

More restrictive macroeconomic policy has reduced inflationary pressures, and resulted in lower inflation in 2013. Inflationary pressures in Nigeria have eased in the context of a more restrictive macroeconomic policy stance since 2011. CPI inflation actually increased from 10.3 to 12.2 percent in 2012, but this was due largely to non-monetary factors: a 50 percent reduction in the fuel subsidy increases in utilities prices, and severe flooding that limited supplies of some goods and services. The pace of CPI inflation declined steadily in 2013, reaching 8 percent in December 2013 and declined slightly below 8 percent in early 2014.
Monetary policy in Nigeria has tightened along with the recovery of the banking sector from the 2008-2009 crisis. In the wake of the recapitalization and subsequent recovery of the banking sector in 2011 the CBN very sharply increased the monetary policy rate to 12 percent and raised reserve requirements to 8 percent, up from 6 and 1 percent, respectively. Despite sizeable transfers of non-performing assets to the Asset Management Company Of Nigeria (AMCON) in 2010 and 2011, the pace of credit expansion to the private sector has remained positive (3.4 percent in 2012 and 7.4 percent in the first 8 months of 2013).

While significant budget consolidation has been achieved since 2011, the recent weakness in oil output presents fiscal challenges. Strong efforts led by the Federal Government directed at budgetary consolidation have reduced the General Government deficit from an estimated 5.7 percent of GDP in 2010 to 1.9 percent in 2012. While oil output recovered somewhat in the second half of 2013, Nigeria faces major challenges because oil revenues are not expected to increase in the medium term at the same pace as GDP or the growth in population, making increases in other sources of Government revenues imperative.

Sectoral and institutional Context

The Nigerian financial system is dominated by banks. At end-2013 deposit money bank assets accounted for 30.3 percent of GDP (after GDP rebasing exercise). The twenty deposit money banks dominate the financial system, and do so in several ways in addition to lending. Banks are the main players in the money markets and also act as settlement agents in the capital markets. In addition, bank shares represent more than one-third of the market value of listed companies and are among the most actively traded shares. Underdeveloped corporate bond and equity markets have resulted in bank credit being the main source of formal financing for Nigerian corporations.

Following a period of turbulence the Nigerian banking system is well capitalized, liquid, and profitable, according to the Financial Soundness Indicators. Rapid credit growth following the tenfold increase in the minimum capital requirement for banks and the subsequent consolidation of the banking system (from 89 to 24 banks) in 2005 led to asset quality deterioration and contributed to the banking crisis of 2008-9. Following the banking crisis and decisive measures taken by the CBN, including the establishment of AMCON, significant strengthening of the CBN’s supervisory enforcement and the introduction of International Financial Reporting Standards (IFRS) for all banks as of end-2012, the level of banks’ non-performing loans (NPLs) has declined steadily since the peak of 35.6 percent reached in September 2010. As of December 2013, the NPL ratio was 3.2 percent. Further, banks’ capital adequacy ratio (CAR) grew from less than 2 percent to 17 percent from end-2010 to end-2013. The regulatory threshold for the CAR is 10 percent, and 15 percent for internationally active banks. By end–2013, return on assets (ROA) for the industry rose to 2.1 percent, while return on equity (ROE) rose to 20.1 percent. The restructuring and consolidation process (from 24 to 20 banks) that followed the 2008-9 crisis resulted in a stronger and more resilient banking system both as a result of the relief provided to the banks by AMCON, that allowed banks to surrender their non-performing assets to the asset management company, and due to the introduction of IFRS per January 1st, 2012 coupled with the CBN’s more stringent prudential regulation and oversight of banks.

Access to finance is a major obstacle faced by SMEs. Only around 9.5 percent of Nigerian SMEs
had a loan or line of credit in 2011 and bank financing of working capital and fixed assets was estimated to fill respectively only 3 and 2 percent of outstanding needs. SME lending averages about 5 percent of total lending in terms of volume by commercial banks (equivalent to only 2 percent of banking sector assets). A total of six Nigerian commercial banks with SME loan portfolios were surveyed in early 2014 to assess current trends in SME finance, and the results were generally consistent with those in the 2011 survey. According to the 2014 survey conducted for the purposes of this project, only 6.7 percent of enterprises reported having a loan or active line of credit (compared to the global Enterprise Survey average of 36.5 percent) lagging behind other countries. A mere 3 percent of micro firms (with less than 5 employees) have a loan or line of credit; among SMEs (with more than five and fewer than 250 employees) this rate is 7 percent, of large firms (more than 250 employees) 44 percent have access to a loan or a line of credit.

Relationship to CPS

The proposed Development Finance Project is fully aligned with the priorities set out in the FY14-17 Country Partnership Strategy (CPS). The CPS explicitly calls for focusing on “increasing access to finance, including long-term financing, for key sectors such as housing, SMEs, agriculture, and infrastructure, through various mechanisms involving both private sector and PPPs, and potentially through a state-owned wholesale financing mechanism.” The proposed operation addresses the provision of finance, including term finance, through eligible PFIs to expand outreach to urban and rural MSMEs.

II. Proposed Development Objectives

The project development objective is to increase the availability and access to finance for micro, small, and medium enterprises through eligible financial intermediaries with the support of a new wholesale development finance institution.

III. Project Description

Component Name
Component 1: Technical Assistance and Capacity Building (US$12 million)

Comments (optional)
The project will fund tailored technical assistance to the Development Finance Institution (DFI) and participating financial institutions (PFIs) and provided by qualified external providers. The support to the DFI will include technical assistance and institution building to enhance its operational capacity. The project will also support strengthening the institutional and human resource capacity of PFIs with the tailored technical assistance to enhance their ability to serve the micro-, small, and medium enterprise (MSME) sector.

Component Name
Component 2: Line of Credit Facility (US$445 million)

Comments (optional)
This component will provide US$445 designated for lines of credit to eligible PFIs for on-lending to eligible enterprises and sub-projects. Sub-loans will be extended to eligible MSMEs and to a limited extent small corporates (up to 10 percent of available line of credit resources will be allocated for the latter) which will include both investment and working capital loans in the expected amount of up to US$500 thousand equivalent for MSMEs and up to $2 million for small corporates.
Component Name
Component 3: Credit Guarantee Facility (US$35 million)

Comments (optional)
The project will support the establishment of a Credit Guarantee Facility (CGF). The credit guarantee facility will provide a 50 percent guarantee on bank loans made to SMEs. Banks will have to meet the same criteria for eligibility as for the DFI’s credit line instrument. Guarantees will be priced, based on each bank’s performance indicators in managing its SME portfolio, notably the level of non-performing loans and write-offs.

Component Name
Component 4: Project Management (US$6.75 million)

Comments (optional)
This component will fund the project management functions supporting overall project implementation. It will also provide support for developing and testing mechanisms for reducing the cost of SME credit such as auctioning of credit line funds and incentives-based first loss facility (unrelated to CGF outlined in component 3).

In addition to four project components, the front-end fee of US$1.25 million will also be financed out of the proceeds of the Loan.

IV. Financing (in USD Million)

<table>
<thead>
<tr>
<th>For Loans/Credits/Others</th>
<th>Amount</th>
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<tr>
<td>Borrower</td>
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<tr>
<td>International Bank for Reconstruction and Development</td>
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<td>Total</td>
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V. Implementation

VI. Safeguard Policies (including public consultation)

<table>
<thead>
<tr>
<th>Safeguard Policies Triggered by the Project</th>
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<th>No</th>
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<tbody>
<tr>
<td>Environmental Assessment OP/BP 4.01</td>
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<tr>
<td>Natural Habitats OP/BP 4.04</td>
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<td>Forests OP/BP 4.36</td>
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<td>Pest Management OP 4.09</td>
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<td>Physical Cultural Resources OP/BP 4.11</td>
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<td>Indigenous Peoples OP/BP 4.10</td>
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<td>Involuntary Resettlement OP/BP 4.12</td>
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<td>Safety of Dams OP/BP 4.37</td>
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<td>Projects on International Waterways OP/BP 7.50</td>
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<tr>
<td>Projects in Disputed Areas OP/BP 7.60</td>
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Comments (optional)
It was decided that the project would apply World Bank Performance Standards instead of regular Safeguards Policies. The application of Performance Standards has been cleared by the Regional Safeguards Advisor.

WBG Performance Standards Applicable   Yes   No   TBD

PS 1: Assessment and Management of Environmental and Social Risks and Impacts (Yes)
PS 2: Labor and Working Conditions   (Yes)
PS 3: Resource Efficiency and Pollution Prevention (No)
PS 4: Community Health, Safety, and Security (No)
PS 5: Land Acquisition and Involuntary Resettlement (Yes)
PS 6: Biodiversity Conservation and Sustainable Management of Living Natural Resources (No)
PS 7: Indigenous Peoples   (No)
PS 8: Cultural Heritage (No)

VII. Contact point

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Borrower/Client/Recipient
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Implementing Agencies
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