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IMPLEMENTATION COMPLETION REPORT
(IDA-28510)

ON A

CREDIT

IN THE AMOUNT OF SDR47.5 MILLION

TO THE

REPUBLIC OF ZIMBABWE

FOR AN

ENTERPRISE DEVELOPMENT PROJECT

March 28, 2003

Finance, Private Sector and Infrastructure Unit
Africa Region

CURRENCY EQUIVALENTS

(Exchange Rate Effective February 6, 2003)

Currency Unit	=	Zimbabwe Dollar
Zim$1	=	US$ 55.4
US$ 1	=	Zim$0.0180343

FISCAL YEAR

July 1 June 30

ABBREVIATIONS AND ACRONYMS

DFID	Department for International Development
EDP	Enterprise Development Project
EPZs	Export Processing Zones
ICR	Implementation Completion Report
IDA	International Development Association
PFIs	Participating financial intermediaries
RBZ	Reserve Bank of Zimbabwe
SBAI	Sub-sector Business Associations Initiative
SME	Small and medium-scale enterprises

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ZIMBABWE
ENTERPRISE DEVELOPM

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Project ID P035628	*Project Name.* ENTERPRISE DEVELOPM
Team Leader. Sherri Ellen Archondo	*TL Unit.* AFTFS
ICR Type· Core ICR	*Report Date* March 28, 2003

1. Project Data

Name.	ENTERPRISE DEVELOPM	*L/C/TF Number·*	IDA-28510
Country/Department	ZIMBABWE	*Region*	Africa Regional Office
Sector/subsector.	General industry and trade sector (62%); Micro- and SME finance (37%); Central government administration (1%)		

KEY DATES

			Original	*Revised/Actual*
PCD	03/30/1994	*Effective.*	06/30/1996	04/07/1997
Appraisal.	10/10/1995	*MTR·*	06/30/1999	05/24/1999
Approval	04/25/1996	*Closing*	12/31/2002	12/31/2002

Borrower/Implementing Agency. Government of Zimbabwe (Ministry of Finance)/Ministry of Industry and Commerce

Other Partners

STAFF	Current	At Appraisal
Vice President	Callisto E. Madavo	Callisto E. Madavo
Country Manager·	Yaw Ansu	Katherine Marshall
Sector Manager	Demba Ba	M. Ataman Aksoy
Team Leader at ICR:	Sherri Archondo	Mark Charles Dorfman
ICR Primary Author	Marilyn S. Manalo	

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· U

Sustainability: UN

Institutional Development Impact M

Bank Performance. S

Borrower Performance: U

	QAG (if available)	ICR
Quality at Entry·		S
Project at Risk at Any Time·	Yes	

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

3.1 Original Objective:

In 1991, Zimbabwe embarked on a significant structural adjustment and liberalization program to

accelerate and broaden participation in economic growth. Reforms were introduced and focused on liberalizing trade, reforming tax and tariff policies, phasing out import licensing, freeing up foreign exchange allocations, liberalizing domestic markets, relaxing transport regulations, removing price controls, improving public enterprise management, enacting civil service reforms, and implementing programs to minimize the costs to the poor due to unemployment and social hardship. Resource allocation became increasingly market-based and many legal barriers to enterprise development were removed. However, the supply response to these reforms remained modest because of recurrent droughts, instability in exchange rates and prices as some barriers were retained, and difficulties in sustaining fiscal discipline. Interest rates were high and volatile as government borrowed heavily and mopped up long-term funds depressing the demand for longer term financing (see section 3.5 below). The Zimbabwean private sector remained concentrated and underdeveloped. Although industry contributed about 35 percent of output, indigenous ownership and participation remained limited and production for exportS had not reached its full potential.

In the Staff Appraisal Report, the Enterprise Development Project (EDP) designers identified four key areas to improve the environment for private sector development. First, the macro-economic framework, stable in previous years, though fragile, required further reduction in fiscal deficits so as not to crowd out private investment through high interest rates. Second, reform measures were taken to improve the incentive framework for emerging enterprises but more work was necessary to make infrastructure sufficient and reliable for emerging exporters and to strengthen financial intermediation. Third, although the financial system was relatively developed, credit market failures had to be addressed to improve financial institutions' responsiveness to bankable financing opportunities. Fourth, Zimbabwean firms had basic production and manpower skills necessary for effective production but lacked the market knowledge or a coherent market strategy to position themselves and benefit from specialization in the local, regional, or global economy. The first area was being addressed as part of a wider dialogue between the International Development Association (IDA) and the Government under the Second Structural Adjustment Credit and the second area was largely addressed by the Government and the International Monetary Fund through the Economic Structural Adjustment Program. The latter two areas constraining enterprise development triggered the development of the EDP.

The EDP was designed to reduce poverty by supporting a stronger supply response by private sector enterprises to policy reforms already undertaken. Innovative approaches were designed to support two separate objectives: (i) to increase the growth of export-based output; and (ii) to broaden the participation of indigenous firms in economic activities. Overall implementation direction and support for the project were provided by a Steering Team (comprising the Permanent Secretaries of the Ministry of Industry and Commerce and of Finance, the Head of Planning at the National Economic Planning Commission, the Governor of the Reserve Bank, chief executives of the Zimbabwe Investment Center, ZimTrade, Confederation of Zimbabwe Industries, Zimbabwe National Chamber of Commerce, the Bankers Association, and representatives of the indigenous business community) and an Administrative Secretariat at the Ministry of Industry and Commerce. Where available, existing institutions were tapped to implement project components: the Reserve Bank of Zimbabwe for the export and small and medium enterprise financing facilities and the ZimTrade, a trade promotion organization assisting exporters, for the matching grant scheme. Management contractors and technical advisers, mostly funded by the Department for International Development (DFID, UK), were appropriately planned and put in place during project implementation for the business services component.

The project objectives reflected priorities for private sector development in Zimbabwe at that time, as identified in the strategies of both the Government and the Bank. They were consistent with the Government's strategy and the underlying themes of its program for economic and social transformation:

(i) accelerated growth in non-drought years; (ii) Government as a facilitator of private initiativeS; (iii) an outward orientation for the economy to realize growth in trade and investments; and (iv) indigenisation in enterprise development. They also reflected the priorities identified in the Bank's country assistance strategy, which called for promoting private sector investment and exports as the engine for employment generation and economic growth. The objectives were focused, supported building on reforms, and allowed flexibility in response to changing constraints and opportunities. However, they were optimistic in terms of the assumptions made on the business climate and reforms on the business incentive framework, Government commitment to reforms (for example, revising taxes on inputs for export processing zones (EPZs), maintaining positive lending rates), and existing institutional capacities.

The EDP was prepared after significant first generation policy reforms in the country were undertaken and were expected to continue with support under ongoing and planned structural adjustment projects. A separate privatization project was also being envisaged. Implementation of the EDP was targeted at second generation reforms to stimulate investments in, and exports of an emerging small and medium enterprise (SME) sector. However, during the implementation period, Zimbabwe was hit by a number of shocks leading to macroeconomic instability in the country and affected the demand for the project-financed services and the project impact objectives. The privatization project was also delayed. In addition, the Government eventually defaulted on payments of its outstanding obligations to the World Bank. The Bank suspended the Government's right to make withdrawals under all of its credits to the country, effective May 16, 2000, about half way through the EDP implementation

3.2 Revised Objective:

The objectives of this project were not revised.

3 3 Original Components·

A. Business Services Component – US$ 7 million. (i) Sub-sector Business Associations Initiative (SBAI) Sub-Component that financed matching grants to business associations to strengthen the array of services for firms and increase the creation of company alliances; (ii) Improving International Competitiveness Sub-Component that supported the existing ZimTrade Matching Grant Scheme to enable individual enterprises to enter or expand into export markets; and (iii) Matchmaking Facility that financed the initial costs of creating linkages between established and emerging export-oriented enterprises and local and foreign partners.

B. Finance Component – U$60 million. (i) The Small and Medium Scale Enterprise Finance Facility supported permanent working capital and investment requirements of SMEs, and export financing for direct or indirect exporters. Features of the facility, passed on to SMEs by participating financial intermediaries (PFIs), included that: (a) loans were denominated in the local currency; (b) maturity was up to five years with grace periods up to 18 months; (c) at least 20 percent of the subproject cost was met by the sub-borrower; and (d) interest rate charged by the Apex to PFIs was the quarterly rolling average cost of funds of commercial banks and the rate charged to SMEs was freely determined by PFIs. (ii) The Export Finance Facility provided pre- and post-shipment export financing for emerging exporters unable to access foreign currency. Features of this facility included that: (a) eligible borrowers were limited to those with a maximum of 100 employees and total assets up to US$500,000 (exclusive of land); (b) maximum sub-loans size limit was US$150,000; (c) maturity period was from the time of drawdown to the time of the sight export letters of credit negotiation (or post-shipment export bill discount), but not more than six months (pre-shipment) or 120 days (post-shipment); (d) the borrowers would be required to present a

confirmed export letter of credit from a quality bank, export credit insurance, or, in the case of indirect exporters, a domestic back-to-back letter of credit; (e) post-shipment financing was provided by rolling over the pre-shipment maturity into the post-shipment phase; (f) PFIs onlent funds in the same currency and with the same maturity as received from the Apex; (g) at least 20 percent of the subproject cost had to be met by the sub-borrowers; and (h) interest rate was charged by the Apex to financial intermediaries at the quarterly rolling average cost of US dollar funding of commercial and merchant banks from overseas sources; and the rate charged exporters by PFIs was freely determined by PFIs.

Provisions for a SME Credit Guarantee Facility and Pre-Shipment Export Finance Guarantee Fund were planned in the project to be made through premiums collected by the Apex Unit from PFIs and deposited in interest-bearing accounts, interest earned on these deposits, funds raised from the disposal of collateral on guaranteed loans, and sub-loan repayments. These funds were established primarily to encourage financial institutions to lend to entrepreneurs with viable projects and good prospects of success, but whose perceived risk was greater than the actual risk because of insufficient collateral or credit history to prove creditworthiness. Under the SME Credit Guarantee Facility, eligible sub-loans could be guaranteed for 50 percent of the outstanding principal amount plus accrued interest up to 90 days, provided a PFI's losses for guaranteed loans did not exceed 15 percent of its guaranteed sub-loan total. Lower cover was available if the PFI exceeded this threshold but only up to a loss rate of 40 percent. The Pre-Shipment Export Finance Guarantee Fund had similar features except that sub-loans could be guaranteed for 80 percent of the outstanding principal amount. The Credit Guarantee Agency in the Reserve Bank of Zimbabwe (RBZ) administered both guarantee facilities.

C. Institutional Development Component (US$1.4 million) to strengthen institutions that were key to improving enterprise development and export competitiveness. This included: (i) a matching grant for financial intermediaries to build their small business appraisal and monitoring systems and capacity; (ii) support to the Small Enterprise Development Corporation to sharpen its financial administration and strategic focus; (iii) support to RBZ to improve financial institution regulation; (iv) administrative support for the RBZ to implement its Apex Unit and credit guarantee functions pertaining to this Project and improve financial institution regulation and supervision; (v) support of the Customs and Excise Department for its automation and administration of duty-drawback and inward processing rebate provisions; (vi) support to the Export Processing Zone (EPZ) Authority in the development of implementing guidelines for the EPZ provisions; (vii) support to the Ministry of Industry and Commerce to administer its economic policy; and (viii) support for the operations of the Administrative Secretariat (in addition to financing available from the Government and co-financiers).

3 4 Revised Components:

As project implementation was increasingly affected by the difficult macroeconomic environment and the reluctance of the private sector to invest and take on new debt, demand for support under some project components (see section 4 below) declined. Following the mid-term project implementation review conducted in May 1999, project restructuring plans were finalized and approved by the Bank's Board of Executive Directors in July 2000. Without adjusting the objectives of the project (although the emphasis shifted from finance towards capacity building in support of policy reforms), amendments to the Development Credit Agreement were made and resources totaling $18.7 million (in addition to an earlier transfer of about US$5 million) were reallocated from the Export Finance Sub-component to the Institutional Development Components. Adjustments were made to enhance economic stability, improve the business environment, and strengthen the implementation capacity of participating agencies. The following activities were to be funded: (i) improvements in tax administration and establishment of the National Revenue Authority to reduce tax-induced distortions and improve the business environment; (ii)

improvement of government debt and cash management; (iii) capacity building to address statistical constraints hindering effective economic management and monitoring; (iv) financial sector reform; (v) privatization and private participation in infrastructure initiatives; and (vi) other private sector reform initiatives including deregulation and alleviation of red tape, tourism development, support to the Competition Commission and the Attorney General's Office, and general efforts aimed at improving the public-private sector interface and related public service delivery. Approval for these revisions was sought and obtained from the Board of Executive Directors while the Bank's suspension of disbursements under all projects for Zimbabwe was in effect as the country continued to default in its debt service obligations to the Bank. Expectations were that circumstances leading to the suspension would be reversed within months and that project implementation would benefit from continued close monitoring by the Bank. However, financing under the EDP remained unavailable for these activities as the suspension of disbursements had not been lifted by the Bank until project closure.

3 5 Quality at Entry:

The project quality at entry was satisfactory. The positive quality aspects of the project components were that they were: (i) consistent with the sector strategies as defined by the country and the Bank; (ii) innovative in their approach to meeting the development goals; and (iii) built on earlier lessons, particularly the reliance on sound, effective, and market-oriented financial institutions The project risks stemming from macro-economic instability, lack of Government support for institution-building measures, availability of alternative below market funding that would undermine the Finance Component, anti-export biases inherent in the tariff and tax structure, and project administration difficulties, were accurately identified. Appropriate mitigating measures were built into the project: designing the project in modular form that included parameters for evolution during implementation and the redesign or elimination of sub-components without affecting other components; self-regulating features that limit commitment of resources when the interest rate structure became unsustainable and repayment rates were low; broad consultations with stakeholders; expressed Government commitments to the project objectives and design as provided in their Industrial Policy Statement; and inclusion of appropriate technical assistance in the project components. Measures to correct the conservative lending policies (which translated in high interest rates) by PFIs toward emerging enterprises for local and export markets included: (i) increasing PFIs' experience in lending based on enterprises' actual risks as measured by their cash flows rather than higher levels of perceived risks also requiring high collateral coverage; (ii) increasing PFIs' appraisal capability and information networks through their participation in the financing and guarantee mechanisms set up to support the target enterprises; and (iii) improvements in prudential regulations to permit an orderly entrance of more competition and an improved macro program so as to further reduce interest rates on a sustainable basis. The preparation team, however, did not predict that the Administrative Secretariat, initially staffed with civil servants, would be insufficiently equipped to fulfill its role as a project implementation agency. The project was not reviewed by the Quality Assurance Group and did not incorporate a project logframe, which became a Bank requirement post 1996.

4. Achievement of Objective and Outputs

4.1 Outcome/achievement of objective·

It will be noted from the summary on component outputs below that interesting results supporting increased private sector participation in economic activities, were achieved during the first half of project implementation. However, the potential for significant growth of export-based output and broadened participation in economic activity by indigenous firms was limited primarily by the difficult economic conditions prevailing in the country causing firms to hesitate to make additional investments in their firms.

Following important adjustments to the project components and implementation procedures at mid-term, project execution during the remaining project life could have supported the achievement of the project's development objectives had macroeconomic conditions not deteriorated substantially, the country continued servicing its debt obligations to the Bank, and the Bank not suspended disbursements for all projects to the country in May 2000. Thus, overall, the project failed to achieve its major objectives; its outcome rating is unsatisfactory.

4.2 Outputs by components:

A. Business Services Component. (i) Under the SBAI, business plans were completed for four eligible small business associations and requests for five other proposals were approved. A field visit to a horticulture association revealed that they benefited from a sector study designed to understand the constraints and policy changes required in their industry. As their constraints were addressed, the association sought to define additional support under this component. An impact assessment of the support to beneficiary associations had not been conducted while the project was being implemented. During the mid-term review mission, recommendations were made and accepted by the implementing agency to remove the constraints to implementation, including revising downward the cost-sharing formula and modifying institutional set-up arrangements.

(ii) Under the ZimTrade Matching Grant Scheme, 13 grants were approved and about US$1 million had been committed to exporters, SMEs and associations. Approximately 15 percent of the total commitments was disbursed. Support for travel and trade fairs accounted for 60 percent of the total allocation, as exporters normally seek to better assess the export market and later request technical assistance to improve their international competitiveness. While the impact on the firms assisted had not yet been determined, a visit to two beneficiaries by a supervision mission confirmed that there had been an impressive impact on the firms' quality of products and skills. ZimTrade also went through an organizational restructuring to turn it into a business sector membership organization that was flexible and service-oriented. The restructuring resulted in staff cost cuts, the hiring of an assistant chief executive officer, and the establishment of a matching grant scheme that would fund similar objectives and activities once this project component closed. The speed at which funds under this component were utilized does not differ significantly from similar schemes elsewhere because it generally takes time to establish such schemes and targeted firms tend to access the services at later stages of their own project development or after the scheme has existed for a while. Other contributing factors to the low uptake on this sub-component were the: (i) difficult macro-economic conditions which created uncertainties and discouraged private investment; (ii) unavailability of funds in the special account because of the Administrative Secretariat's lack of familiarity with Bank procedures, the absence of a dedicated special account, and foreign exchange regulations forbidding organizations and firms from having foreign-denominated accounts in commercial banks; (iii) limited promotion and low outreach levels because of competing demands by other ZimTrade-managed programs; and (iv) some processing procedures which discouraged prospective clients. Some start-up delays were also experienced in obtaining the management contractor resulting from the lengthy budgetary and procurement processes of DFID. Revisions to improve the performance of this sub-component were introduced at mid-term and focused on flexible financial support, simplified procedures, increased client focus, stepped-up and targeted marketing efforts, on-the-job training, and establishment of a computerized monitoring system.

(iii) The Match Making Facility was cancelled when it remained undeveloped and unutilized.

Based on limited progress in meeting the capacity building needs of private enterprises, achievement under this component is rated unsatisfactory.

B. Finance Component.- (i) Under the SME Finance Facility, by end-May 2000 approximately Z$659 million was disbursed for 1,079 subprojects by the RBZ. The number of assisted SMEs compared favorably to the appraisal projection of 500 SMEs to be assisted, reflecting one of the few cases in Africa where a line of credit effectively reached the SME target group (average loan size was about US$25,000). This number was not higher because implementation of the component was suspended late 1998 for about a year. As confidence in the economy deteriorated and also as a consequence of the Asian crisis, the exchange rate rapidly depreciated and inflation rapidly increased from a 20-30 percent range to 30-50 percent. This led to retail and wholesale interest rates associated with the finance facility to become significantly negative in real terms threatening the sustainability of financial sector objectives. An operational audit of the component conducted in March 1999 documented the following aspects of implementation. About 82 percent of the outstanding loans had an average loan value of approximately US$27,000. A survey of only 42 companies attributed 490 new jobs created to the SME facility; thus, overall the number of new jobs created could be projected to be quite large once the remaining sub-borrowers are considered Turnover information supplied by the surveyed enterprises indicated that generally subprojects performed as expected or better. Negotiated interest rates from PFIs to sub-borrowers did not exceed 10 percentage points above the RBZ rate to PFIs (which increased from 9.84 percent to 16.73 percent); these rates were lower than the prime rate prevailing at that time. Also, based on information on 87 percent of the number of sub-loans disbursed and outstanding at March 26, 1999, about 40 percent of the number of loans were in arrears (amounting to about ZW$23 million), with 18 percent of the total number of loans in arrears by more than 3 months. The consultants conducting the operational audit estimated that the amount in arrears was about 19 percent of total disbursements by March 1999 (data excludes information on two PFIs, one that did not comply with the conditions of the facility and another that was liquidated). Under the adverse macro-economic conditions and consistent with projected increases in arrears for the banking sector as a whole, the value of arrears for project-financed sub-loans was expected to increase as additional repayments (including for projects still within their grace periods) became due. At and following the mid-term review process, the key recommendations made by the Bank to improve the outcome of this component included the need to: (i) utilize all reflows (interest and principal payments) to capitalize the guarantee fund in order to sufficiently cover sub-loans that were guaranteed; (ii) annually re-certify the financial health of all PFIs and review their portfolio limits by RBZ; and (iii) establish a consolidated report on the aging of all sub-loans funded by the facility. Additionally, the consultants that conducted the operational audit suggested: (i) RBZ recover outstanding funds from PFIs that were suspended from participating in the facility, did not have accounts with RBZ (so automatic debits from those PFIs' accounts wasn't possible), or reneged on its commitment (one PFI) and make full provisions against loans granted to these PFIs; (ii) RBZ utilize the 90-day treasury bill rate, reviewed quarterly, as the reference interest rate to PFIs; and (iii) training in loan application assessment, credit check procedures and loan supervision be provided to PFIs with high defaulting borrowers. Of the 15 PFIs that signed participation agreements, five were suspended from participating in the facility because of high default rates and non-compliance with the prudential requirements of the facility; one ceased operations; and one withdrew because it found the reference interest rate too expensive. During implementation, the dialogue between the Apex Unit, PFIs, and Bank supervision missions remained proactively focused on the mitigating measures built in the project design so PFIs would not be undermined by their participation in the facility and the financial objectives of this component, i.e. financial intermediation through a sound, efficient, and market oriented banking system, would be maintained.

(ii) Under the Export Finance Facility, as of March 2000 about US$1.5 million had been disbursed for 28 sub-projects. The impact of the assistance under this component had not been assessed during project execution. To increase the component's responsiveness to market needs, at mid-term review, it was agreed between the RBZ and IDA to broaden the eligibility requirements and allow firms with up to 500

employees to access the component resources.

On the credit guarantee facilities, while expectations were that these facilities would be called upon given the repayment problems, the extent of the utilization of these facilities had not yet been reported.

Overall, financial sector objectives were unsatisfactorily achieved.

C. Institutional Development Component. Important achievements facilitating enterprise development and export competitiveness were realized under this component. (i) The Customs and Excise Department was completing its automation and improvement plans for the administration of duty-drawback and inward processing rebate provisions; project support led to the Department's computer systems becoming Y2K compliant and for the many customs offices in the country to share computerized customs information; departmental staff also completed their training in the Global Trade Analysis Program. (ii) The role of the Ministry of Industry and Commerce in economic policy formulation has been strengthened and the consultative process between the public and private sector for economic reforms enhanced through the National Economic Consultative Forum. (iii) Utilizing innovative distance learning approaches, the Small Enterprise Development Corporation received consultant support for the preparation of its corporate plan and the upgrading of its computer systems. (iv) Improvements were registered in the EPZ business environment with the adoption of EPZ labor laws, preparation of financial regulations for EPZs, and the launching of a study on the feasibility of extending EPZ status to existing exports. However, EPZs still face the disincentive of being taxed on inputs while their domestic sales remain relatively uncontrolled and untaxed thereby distorting domestic competition. (v) Following the completion of a tariff study, tariff reforms were introduced by the Tariff Commission. (vi) RBZ upgraded its regulation and supervision functions and the Apex Unit strengthened its credit guarantee functions and its role in the project. The Matching Grant for Financial Intermediaries component remained unutilized. At the Implementation Completion Report (ICR) stage, the impact of most of the assistance extended under this component still had to be confirmed.

4 3 Net Present Value/Economic rate of return:

A NPV/ERR has not been calculated based on the fact that a meaningful comparison between the projected NPV/ERR would not be possible given the very low outreach levels under the Business Services and Export Finance Facility during the first half of project implementation and that project implementation was discontinued for the second half when disbursements for all IDA-funded projects was suspended and remained so at ICR preparation stage. Under the present declining macro economic conditions, it is assumed many enterprises would be facing greater operational and economic difficulties today than when they first received assistance under the project.

4 4 Financial rate of return:

Under the SME Finance Facility, an operational audit confirmed that the effect of inflation and the devaluation of the Zimbabwe dollar contributed to the declining value of the revolving funds from loan repayments. A continued trend will mean that the Government will have to source funds other than from the revolving fund to service its EDP-related debt. A further calculation of the FRR was not done for similar reasons stated in section 4.3 above.

4 5 Institutional development impact·

The project's institutional development impact was modest. As discussed in 4.2 (C) above, important

capacity building achievements were realized by several government agencies contributing to the improvement in the business environment for private enterprises and exporters. Also, a large number of jobs were created as many private enterprises met or exceeded their sub-project objectives. However, in times of macro-economic instability, many enterprises increasingly faced greater operational and economic difficulties leading to non-repayment of their debts with the PFIs. Also, capacity building benefits to the private sector were limited by their low participation levels in the business services and export finance components. In addition, the inability of some PFIs to bring up their recovery rates and the availability of the loanable funds at interest rates that insufficiently covered inflation, currency devaluation, and operational risks has resulted in the depletion of term funding for the next generation of small and medium scale entrepreneurs and further hindered the development of the financial intermediation function of banks that could have utilized project reflows.

5. Major Factors Affecting Implementation and Outcome

5.1 Factors outside the control of government or implementing agency

Just as implementation of the project commenced, Zimbabwe's economy was hit by a number of shocks leading to the end of an economic boom. External factors which led to this included the slow supply response despite improvements in resource mobilization. The Asian crisis in 1998 and falling world prices contributed to more than anticipated declines in exports from Zimbabwe. The depreciation of the South African Rand in 1998 made imports from South Africa cheaper and put pressure on Zimbabwe's foreign reserves. These factors, along with those within the control of government (see section below), eventually led to a severe economic crisis making servicing of foreign debt increasingly difficult for Zimbabwe. As Zimbabwe defaulted on its payments to the Bank and the Bank suspended disbursements to the country in May 2000, the implementation of the project essentially stalled since then.

The macro-economic difficulties adversely affected the ability of some banks to find and support viable projects. Firms were also increasingly reluctant to take on new investment and debt when the industrial environment was volatile and the business environment did not facilitate the development of private SMEs and exporters.

5 2 Factors generally subject to government control·

During the project implementation period, Zimbabwe went through a severe crisis, the worst in its history since its independence in 1980. The levels of poverty and unemployment rose and the economy remained depressed. By 1998, the foreign exchange rate depreciated by 50 percent and by end-2000, inflation was over 50 percent, real GDP was shrinking, the fiscal deficit was more than 20 percent of GDP, and about 70 percent of the Zimbabweans were poor and surviving on less than US$2 a day. An acute shortage of foreign exchange and critical imports created serious supply bottlenecks. The internal factors that brought Zimbabwe in the throes of a broad and unprecedented financial and social crisis included: (i) the expectations of an increased fiscal deficit due to unforeseen payments of large lump sum payments and pensions to war veterans; (ii) social unrest as a result of price increases of key commodities; (iii) military involvement in the Democratic Republic of Congo in the latter part of 1998; and (iv) uncertainty surrounding the modalities of land reform. As macro-economic stability remained elusive, foreign exchange and input availability was negatively affected, aggregate demand in the economy was reduced, and uncertainty regarding property rights for agribusiness prevailed. Under these conditions, the private sector could not sustain, let alone broaden, its support for a stronger supply response, increase participation by indigenous firms in economic activities, or increase export-based output.

5 3 Factors generally subject to implementing agency control:

Ownership and commitment to the project's goals was displayed by the Steering Committee members. While the Administrative Secretariat carried out its functions, the quality of its support was hampered by its being under-staffed, insufficiently trained and prepared to carry out its role in project implementation, lack of familiarity with procurement guidelines, and its bureaucratic procedures. Also, difficulties in meeting development objectives in the financial sector were evident by the long-drawn process at reaching agreement between the Bank and the Apex Unit on an appropriate reference interest rate that took into account price increases, prevented the depreciation of the revolving fund, and did not increase moral hazard risks ranging from incentives for banks to use the facility as a subsidized float to arbitrary credit allocation decisions. Increasing advocacy and public campaign on the business services component would have increased outreach toward intended beneficiaries. Some audits were submitted late.

Some limitations in the project design and implementation procedures also led to difficulties in realizing project objectives. These included: (i) the absence of a separate special account to facilitate disbursements under the matching grant schemes (reflecting lessons learned from other similar schemes); and (ii) application requirements which discouraged some prospective applicants from utilizing the matching grants. While implementation review teams corrected these problems, the remaining project execution period was terminated; the effects of the recommended and accepted procedural modifications on project impact was not determined.

5.4 Costs and financing:

Reallocation of resources from the Finance and Business Services components (approximately US$21 million) to the Institutional Development Component were being finalized when disbursements from the project were suspended. These reallocations were necessary to respond primarily to the lack of demand from the private sector for financial assistance for exports and for business support services, to account for lower disbursements because of the temporary suspension of the SME Financing component, and to address some of the macro-economic risks and emerging development opportunities. Of the SDR47.5 million original loan amount, approximately SDR22.6 (47.5 percent) was disbursed.

6. Sustainability

6.1 Rationale for sustainability rating:

The project achievements are unlikely to be sustained. While the Finance Component extended support to a large number of SMEs, this was not the same case for exporters, who were being targeted to contribute in a major way to meeting the development and economic growth needs of the country by diversifying the export base, diversifying the country's economic structure, and reducing its vulnerability to external shocks. Large sections of the Zimbabwean economy are still not integrated into the economy through extensive trade ties and thus are unable to continuously update their technology to stay competitive; skill levels have not been enhanced; key business associations have not shown significant decrease in reliance on external support. In addition, the operational audit of the SME financing facility documented the fact many SMEs are not servicing their debts with the PFIs. In addition, the facility was depleted in real terms and high default rates, including those of four PFIs whose default rate had surpassed 25 percent, compounded problems of sustainability. In utilizing project reflows, commitment to maintaining discipline in the financial sector has to be displayed by: (i) RBZ basing PFI's continued access to the credit line on an annual re-certification of their financial health and the definition of their portfolio limits; (ii) RBZ suspending all PFIs with high default rates; (iii) RBZ imposing interest rates that are sufficiently higher

than the default and devaluation rates and loan loss provisions; (iv) PFIs lending for viable SME and export-oriented projects; and (v) additional capacity building assistance being available to PFIs and sub-borrowers. In addition, Government commitment to macro economic stability, a key ingredient to private sector-led growth, is yet to be demonstrated.

6 2 Transition arrangement to regular operations:

Of primary importance to the advancement of the financial and private sectors is Government's commitment to a development strategy that focuses on policies that support a stable macro-economy and a business environment favorable to the growth of an efficient supply response that is based on high levels of private investment and exports.

The sustainability of the limited project achievements depends on PFIs judiciously implementing credit management policies and procedures, monitoring the performance of PFIs and sub-borrowers to minimize moral hazards in the credit facility, and making timely repayments to the Apex Unit. RBZ will have to closely supervise and monitor PFI conformity based on prudential regulations to prevent high levels of default and adverse effects on the financial system. These measures are required along with strengthening the legal and regulatory framework for banking and developing basic accounting, monitoring and reporting systems. Smaller and weaker PFIs would have to increase their capacity to effectively implement credit management and risk assessment policies and procedures to sustainably intermediate financial resources.

The Government and its development partners also need to continue their dialogue and focus their development strategy to the sustainable development of SMEs, micro and indigenous enterprises. SMEs are important economic agents that create wealth, absorb excess labor, reduce poverty, foster local and regional development, reduce economic inequalities, build new entrepreneurial culture, and develop a middle class as a factor of social and political stability. Development programs will have to include increasing the capacity of these enterprises to access funds for investment and working capital requirements, assistance to upgrade technical know how, and linkages with foreign investors, business partners, and external markets.

7. Bank and Borrower Performance

Bank

7.1 Lending.

Consistent with the CAS, the project designers correctly zeroed in on fostering economic growth through a strengthened financial system and the participation by broader segments of the population to increase the supply response and exports. Achievements would have been evident in the creation of income generating and employment opportunities and the alleviation of poverty. In addressing critical issues and responding to pressing needs, the project was prepared in close dialogue with stakeholders. As designed, various lessons from earlier projects in Zimbabwe and similar operations elsewhere were incorporated, such that it: (i) provided financing and business services to enterprises after most of the identified policy barriers had been removed; (ii) intermediated funds through multiple institutions certified as financially viable by external auditors; and (iii) supported an integrated series of measures which encompass financing, guarantees, business services and institution building.

7 2 Supervision.

The Bank's project and country teams (with specialized skills) provided relevant advice, considerable degree of continuity in Bank management of the project, and follow up on recommendations and agreed

actions. Implementation support, provided from the Bank's headquarters and regional office and during at least two field visits annually (until 2000), focused on the development impact of the project and the fiduciary aspects of the project (including complementary operational, product, and audit support). Within very difficult macro-economic conditions in the country, a team of skilled staff and consultants continued to face difficulties to provide the necessary catalyst to support the evolution toward a healthy, efficient, and market oriented financial sector and an increasingly productive private sector. Throughout implementation, proactive support was provided to resolve issues, support an effective public-private consultative process, finance policy studies, reforms, capacity building initiatives, and an operational audit of the SME Finance sub-component to provide stakeholders with an independent evaluation of its impact. After the mid-term review, the project was restructured and resources re-allocated to incorporate measures to correct the slow and problematic implementation of the project. Corrective actions introduced were designed to: monitor and evaluate the demand for services and the output and outcome of such services; merge implementation responsibilities where synergies and economies of scale existed between implementing agencies to achieve efficiency gains; modify procedures, eligibility criteria, and cost of funds and services (cost sharing formula) to simplify project implementation and increase its responsiveness to realities; introduce products, services, focused sector and policy studies, and further broaden participation of micro enterprise, SMEs, and multi-sector associations with strong SME and micro enterprise orientation. These measures notwithstanding, an over optimism on the part of the supervision teams prevailed in spite of the suspension of the Finance Component for over a year because of differences with the Bank on the basis of the wholesale interest rate, the suspension of some PFIs, and the protracted implementation of the Business Services Component. An early cancellation of some project resources would have better reflected a more realistic appreciation of the conditions of the macro economy, reluctance of the private sector to invest, and obstacles in the business environment.

7.3 Overall Bank performance.
Overall, IDA's performance is rated satisfactory.

Borrower
7 4 Preparation·

The Government's commitment to the development of the financial and private sectors in general and the project in particular was demonstrated during the project development phase. Government counterparts were available to provide required technical, financial, economic, and institutional support when the project was being defined. Key officials and staff who were expected to play an active role in project implementation collaborated with the Bank's preparation team. Conditions for negotiation, project presentation to the Bank's Board of Directors, and credit effectiveness (relating to policy and institutional reforms, implementing agency set up, eligibility requirements for and subsidiary agreements with participating banks, and the project implementation plan and operational guidelines) were complied with.

7 5 Government implementation performance:

Government's wavering commitment to the project's objectives was evident during project implementation when it was unable to provide a stable macro economic environment and to meet its debt service obligations to the Bank leading to the curtailment of Bank financing for EDP activities. Although the Government collaborated closely with the Bank's implementation review missions, project execution was affected by insufficient staff supplement, weak procurement capacity, and bureaucratic disbursement and replenishment procedures followed by the Ministry of Finance.

7 6 Implementing Agency:

The implementing agencies displayed ownership and commitment toward the objectives of the project and its components as evident in their contribution to project implementation. However, maximizing the outreach opportunities presented by the project was sacrificed and frequently hampered by a number of factors. These included the suspension of the finance component because of delays in resolving interest rate issues by the Apex Unit; weaknesses in the financial management, procurement, and advocacy role played by the Administrative Secretariat; and, generally, inadequate communication of the project and its features to potential beneficiaries. While financial and audit reports were provided, these were delayed, sometimes qualified, and did not contain sufficient information to properly monitor the project.

7.7 Overall Borrower performance:

Overall, the Borrower's performance is rated unsatisfactory. Under the unstable macroeconomic conditions, the business environment deteriorated and the investment risks perceived by the private sector increased prompting them to limit their participation in the project. In addition, the Government's capacity to service its debt obligations with the Bank was negatively affected and led to the Bank suspending disbursements under all ongoing IDA-funded projects in the country. These changes and delays in resolving implementation issues minimized the ability of the Government to meet its development objectives of increasing the growth of export-based output and broadening the participation of indigenous firms in economic activities.

8. Lessons Learned

• Initiatives with objectives targeted at building capacity in the financial and private sectors have a better chance of success if these are conditioned upon sustained government support toward macro-economic stability and development of the business climate, incentive framework, and reliable infrastructure.

• The success of financial intermediary loans is dependent upon a disciplined credit environment. Experiences in the EDP implementation illustrate that it is essential that participating banks: (i) appropriately comply with banking sector prudential guidelines and maintain high repayment rates; and (ii) are sufficiently trained in credit and risk management, governance, and financial management policies so they are strengthened rather than undermined by participating in similar finance facilities.

• Business development services are more effective if implementation arrangements are simplified, do not tax an organization's capacity, and do not deter the participation of eligible applicants; they are managed by competent private managers; and they are strongly supported by the government and a public-private oversight committee. Generally, because it takes considerable time to build cost-sharing business support schemes and targeted firms tend to start using these schemes at later stages, project preparation and implementation timetables should take into account a longer development horizon and modest expectations of positive impact specially at earlier stages of development. Other lessons, particularly those experienced in this project and also documented by the Regional Program on Enterprise Development, include: eligibility for grants should have explicit criteria to ensure that grants are extended to those activities that have potential to generate high level of positive externalities and are used to fund activities in addition to those that private entrepreneurs will fund with their own resources. Matching grant performance indicators should measure these activities.

• The distribution of simple and straightforward guidelines and instructions to banks, matching grant implementers, and potential clients and the intensive delivery of promotional activities can improve project

outreach and performance if these are done during the project launch and the early years of project implementation.

∘ The opportunity to realize private sector and financial sector development goals are enhanced when the Government and the Bank are flexible and revert to strengthening first generation reforms as these weaken with the decline of macro-economic conditions and the economic and business environment is not conducive for the implementation of second generation reforms.

9. Partner Comments

(a) Borrower/implementing agency:

No comments received from Borrower and implementing agency.

(b) Cofinanciers:

No comments received from co-financier.

(c) Other partners (NGOs/private sector)

10. Additional Information

Annex 1. Key Performance Indicators/Log Frame Matrix

Outcome / Impact Indicators:

Indicator/Matrix	Projected in last PSR[1]	Actual/Latest Estimate
Increase in output of emerging exporters	In accordance with PIP projections	Not available
Increase in employment by SMEs, emerging exporters	In accordance with PIP projections	Not available
Strengthened capacity in financial intermediaries; higher lending by Small Business Unit	In accordance with PIP projections	Not available
Strengthened SEDCO (reduced administrative costs per loan, reduced arrears, SMEs graduating to commercial financing)	In accordance with PIP projections	Not available
Strengthened RBZ – prudential requirements issued, compliance monitored	In accordance with PIP projections	Not available
Customs and Excise Department – increased efficiency following automation and administration of Inward Processing Zone and Duty Drawback Systems; establishment and modernization of Input-Output Coefficients; establishment of Common Bonded Manufacturing Warehouse Scheme, Strengthened Ministry of Industry and Commerce	In accordance with PIP projections	Not available

Output Indicators:

Indicator/Matrix	Projected in last PSR	Actual/Latest Estimate
Appointment of SBAI administrator, establishment of operating guidelines and procedures	Mid-1996	November 1997
Establishment of ZMGS management team, guidelines and operational procedures	Mid-1996	November 1997
Appointment of Matchmaking Management Contractor, issuance of guidelines, operations	Mid-1996	Component cancelled
Matching grants for emerging exporters	In accordance with PIP projections	13 grants
Matching grants for business associations	In accordance with PIP projections	4 grants
Matches established under the Matchmaking Facility	In accordance with PIP projections	Cancelled
Apex Unit and credit guarantee functions established, guidelines issued for export and SME facilities, operations guidelines and procedures established	Mid-1996	April 1997
Sub-loans committed for emerging exporters	In accordance with PIP projections	28 sub-loans
Sub-loans committed for SMEs	In accordance with PIP projections	1,079 sub-loans

[1] End of project

Annex 2. Project Costs and Financing

Project Cost by Component (in US$ million equivalent)

Component	Appraisal Estimate US$ million	Actual/Latest Estimate US$ million	Percentage of Appraisal
Finance Component	88.20	33.00	37
Business Services Component	14.30	1.00	7
Institutional Development	2.20	4.20	191
Contingency	1.30		
Total Baseline Cost	106.00	38.20	
Total Project Costs	106.00	38.20	
Total Financing Required	106.00	38.20	

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)	0.10 (0.10)	0.10 (0.10)	0.00 (0.00)	0.20 (0.20)
3. Services	0.00 (0.00)	0.00 (0.00)	8.80 (8.80)	6.90 (0.00)	15.70 (8.80)
4. Miscellaneous Credit Facilities	0.00 (0.00)	0.00 (0.00)	60.00 (60.00)	18.10 (0.00)	78.10 (60.00)
5. Miscellaneous Guarantee Facilities	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	10.00 (0.00)	10.00 (0.00)
6. Miscellaneous Training	0.00 (0.00)	0.00 (0.00)	1.00 (1.00)	1.00 (0.00)	2.00 (1.00)
Total	0.00 (0.00)	0.10 (0.10)	69.90 (69.90)	36.00 (0.00)	106.00 (70.00)

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)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)
3. Services	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)
4. Miscellaneous Credit Facilities	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)

5. Miscellaneous Guarantee Facilities	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)
6. Miscellaneous Training	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)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)

[1/] Figures in parenthesis are the amounts to be financed by the Bank Loan. 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		
	Bank	Govt.	CoF.	Bank	Govt.	CoF.	Bank	Govt.	CoF.
Finance	60.00	5 00	16 00	26.40			44 0	0.0	0.0
Business Services	6.40	5.00	7.70	0.40			6.3	0.0	0.0
Institutional Development	3.60	0.50	1.80	3.80			105.6	0 0	0.0

Annex 3. Economic Costs and Benefits

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				
3/95	*6*	Task Leader, Economists, SME Specialists, PSD Specialists, Trade Specialist		
6/95	*10*	Task Leader, Economists, SME Specialists, PSD Specialists, Trade Specialist, Finance Specialists		
Appraisal/Negotiation				
10/95	*6*	Task Leader, Economists, SME Specialists, PSD Specialists, Lawyer,		
Supervision				
12/24/1996	*1*	Task Leader	S	S
03/10/1997	*1*	Task Leader	S	S
06/25/1997	*2*	Task Leader, Dep. Resident Rep/Economist	S	S
10/14/1997	*2*	Task Leader, Dep. Resident Rep.	S	S
03/18/1998	*4*	Task Leader, Economist, PSD Specialists (2)	S	S
06/09/1998	*2*	Task Leader, SME Specialist	S	S
12/15/1998	*2*	Task Leader, PSD Specialist	U	U
06/30/1999	*5*	Task Leader, Capacity Building Specialist, Financial Management Specialist, Procurement Specialist, Economist	U	S
12/22/1999	*3*	Task Leader, Operations Officer, Financial Management Specialist	S	S
06/22/2000	*4*	Task Leader, Financial Analyst, Financial Management Specialist, SME Specialist	S	S
12/27/2000	*1*	Task Manager	U	U
ICR				

(b) Staff

Stage of Project Cycle	Actual/Latest Estimate	
	No. Staff weeks	US$ ('000)

Identification/Preparation		26,100
Appraisal/Negotiation		456,400
Supervision		285,600
ICR		
Total		768,100

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

1. Country Assistance Strategy, May 1, 1997, Report No. 16541-ZIM
2. Development Credit Agreement and Project Agreement: Zimbabwe Enterprise Development Project (Credit 2851-ZIM)
3. Miscellaneous project documents
4. Ministry of Industry and Commerce: Enterprise Development Project – Operational Audit of the Finance Component, March 2, 2000

Project Staff Appraisal Report: Zimbabwe Enterprise Development Project, Report No. 15062-ZIM

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