IMPLEMENTATION COMPLETION AND RESULTS REPORT
(IBRD-74610)

ON A

LOAN

IN THE AMOUNT OF US$100 MILLION

TO THE

PEOPLE’S REPUBLIC OF CHINA

FOR A

MICRO AND SMALL ENTERPRISE FINANCE PROJECT

December 19, 2011
CURRENCY EQUIVALENTS

Currency Unit = RMB Yuan

Exchange Rate at ICR, December 19, 2011
RMB 1.00 = US$0.15624
US$1.00 = RMB 6.35040

Exchange Rate at Loan Closing, June 30, 2011
RMB 6.46 = US$1

Exchange Rate at Appraisal, May 19, 2007
RMB 6.50 = US$1

FISCAL YEAR
January 1 – December 31

ABBREVIATIONS AND ACRONYMS

AAA Analytical and Advisory Activities
CAP Corrective Action Plan
CAS Country Assistance Strategy
CBRC China Banking Regulatory Commission
CCB City Commercial Bank
CDDB China Development Bank
CNAO China National Audit Office
CPS Country Partnership Strategy
EAF Environmental Assessment Framework
FIL Financial Intermediation Loan
FM Financial Management
FMR Financial Management Report
FFD Financial and Private Sector Development
FSL Fixed Spread Loan
GDP Gross Domestic Product
GOC Government of China
IBRD International Bank for Reconstruction and Development
IPC Internationale Projekt Consult GmbH
ISR Implementation Status and Results Report
KfW Kreditanstalt fuer Wiederaufbau
LOC Line of Credit
MBU Microfinance Business Unit
MoF Ministry of Finance
MSE Micro and Small Enterprise
MSME Micro, Small and Medium Enterprise
NGO Non-Governmental Organization
NPL Non-Performing Loan
OM Operational Manual
PBC People’s Bank of China
PIF Participating Financial Institution
PIE Project Implementing Entity
PIC Project Implementation Consultant
RCB Rural Commercial Bank
SDR Special Drawing Rights
SCB State-Owned Commercial Bank
SLA Subsidiary Loan Agreement
SME Small and Medium Enterprise
TCA Technical Cooperation Agreement

Vice President: James W. Adams
Country Director: Klaus Rohland
Sector Director: Tunc Tahsin Uyanik
Project Team Leaders: Wang Jun, Nancy Chen
ICR Team Leader: Nancy Chen

Acknowledgements: The ICR was peer reviewed by Aurora Ferrari, and Leyla V. Castillo, Financial Inclusion – Micro & SME Finance Practice Group
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DATA SHEET

A. Basic Information

<table>
<thead>
<tr>
<th>Country:</th>
<th>Project Name:</th>
<th>Micro and Small Enterprise Finance Project</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>Project ID:</td>
<td>P096285</td>
</tr>
<tr>
<td></td>
<td>L/C/TF Number(s):</td>
<td>IBRD 74610</td>
</tr>
<tr>
<td>ICR Date:</td>
<td>ICR Type:</td>
<td>12/19/2011 Core ICR</td>
</tr>
<tr>
<td>Lending Instrument:</td>
<td>Borrower:</td>
<td>FIL PEOPLES REPUBLIC OF CHINA</td>
</tr>
<tr>
<td>Original Total Commitment:</td>
<td>Disbursed Amount:</td>
<td>US$100 Million US$95 Million</td>
</tr>
<tr>
<td>Revised Amount:</td>
<td></td>
<td>N/A</td>
</tr>
<tr>
<td>Environmental Category:</td>
<td></td>
<td>F</td>
</tr>
</tbody>
</table>

Borrower: Ministry of Finance

Implementing Agencies: China Development Bank
No 29 Fuchengmenwai Street
West District
Beijing
China

Cofinanciers and Other External Partners: Kreditanstalt für Wiederaufbau (KfW) provided a loan of US$50 million and 3 million Euros (US$3.78 million equivalent) for the TA.

B. Key Dates

<table>
<thead>
<tr>
<th>Process</th>
<th>Date</th>
<th>Process</th>
<th>Original Date</th>
<th>Revised / Actual Date(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Concept Review</td>
<td>06/29/2005</td>
<td>Effectiveness</td>
<td>08/30/2007</td>
<td>07/10/2008</td>
</tr>
<tr>
<td>Appraisal</td>
<td>10/30/2006</td>
<td>Restructuring(s):</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Approval</td>
<td>06/19/2007</td>
<td>Mid-term Review:</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Closing:</td>
<td>06/30/2011</td>
<td>N/A</td>
</tr>
</tbody>
</table>

C. Ratings Summary

C.1 Performance Rating by ICR

Outcomes: Satisfactory
Risk to Development Outcome: Low
Bank Performance: Satisfactory
Borrower Performance: Satisfactory
### C.2 Detailed Ratings of Bank and Borrower Performance (by ICR)

<table>
<thead>
<tr>
<th>Bank Ratings</th>
<th>Borrower Ratings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quality at Entry: Satisfactory</td>
<td>Government: Satisfactory</td>
</tr>
<tr>
<td>Quality of Supervision: Moderately Satisfactory</td>
<td>Implementing Agency/Agencies: Moderately Satisfactory</td>
</tr>
</tbody>
</table>

#### Overall Bank Performance:
Satisfactory

#### Overall Borrower Performance:
Satisfactory

### C.3 Quality at Entry and Implementation Performance Indicators

<table>
<thead>
<tr>
<th>Implementation Performance</th>
<th>Indicators</th>
<th>QAG Assessments (if any)</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Potential Problem Project at any time (Yes/No):</td>
<td>No</td>
<td>Quality at Entry (QEA):</td>
<td>N/A</td>
</tr>
<tr>
<td>Problem Project at any time (Yes/No):</td>
<td>No</td>
<td>Quality of Supervision (QSA):</td>
<td>N/A</td>
</tr>
<tr>
<td>DO rating before Closing/Inactive status:</td>
<td>Satisfactory</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### D. Sector and Theme Codes

<table>
<thead>
<tr>
<th>Sector Code (as % of total Bank financing)</th>
<th>Original</th>
<th>Actual</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro and MSE Finance</td>
<td>95</td>
<td>90</td>
</tr>
<tr>
<td>Banking</td>
<td>5</td>
<td>10</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Theme Code (as % of total Bank financing)</th>
<th>Original</th>
<th>Actual</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro, Small and Medium Enterprise Support</td>
<td>67</td>
<td>100</td>
</tr>
<tr>
<td>Other Financial and Private Sector Development</td>
<td>33</td>
<td></td>
</tr>
</tbody>
</table>

### E. Bank Staff

<table>
<thead>
<tr>
<th>Positions</th>
<th>At ICR</th>
<th>At Approval</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vice President:</td>
<td>James W. Adams</td>
<td>James W. Adams</td>
</tr>
<tr>
<td>Country Director:</td>
<td>Klaus Rohland</td>
<td>David Dollar</td>
</tr>
<tr>
<td>Sector Director:</td>
<td>Tunc Tahsin Uyanik</td>
<td>Tunc Tahsin Uyanik</td>
</tr>
<tr>
<td>Project Team Leaders:</td>
<td>Wang Jun, Nancy Chen</td>
<td>Wang Jun</td>
</tr>
<tr>
<td>ICR Team Leader:</td>
<td>Nancy Chen</td>
<td></td>
</tr>
<tr>
<td>ICR Primary Author:</td>
<td>Hiran Heart</td>
<td></td>
</tr>
</tbody>
</table>
F. Results Framework Analysis

Project Development Objectives

To expand credit flows to Micro and Small Enterprise (MSEs) on a mass-market and commercially sustainable basis by strengthening the institutional and human resources capacity of Project Implementing Entity (PIE) within the China Development Bank (CDB) and the Participating Financial Institutions (PFIs).

Revised Project Development Objectives (as approved by original approving authority)

(a) PDO Indicator(s)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Baseline Value 2005</th>
<th>Original Target Values (from approval documents)</th>
<th>Formally Revised Target Values</th>
<th>Actual Value Achieved at Completion or Target Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Annual percentage increase in number of MSE loans</td>
<td>0</td>
<td>N/A 305% 146% 67% 65%</td>
<td>N/A</td>
<td>Growth in the initial years far exceeded the targets. In 2010, 65% of the anticipated target was met.</td>
</tr>
<tr>
<td>(ii) Maximum percentage of sub-loans overdue by more than 30 days (sub-loan repayment performance)</td>
<td>0</td>
<td>&lt;3% &lt;3% &lt;3% &lt;3% &lt;3%</td>
<td>Average sub-loans overdue more than 30 days by the end of the project was less than 0.7%.</td>
<td></td>
</tr>
<tr>
<td>(iii) Average profitability of MSEs in the treatment group compared with a control group.</td>
<td>0</td>
<td>tbd tbd Tbd tbd tbd</td>
<td>Comparison was not carried out. However, the average net profit of the PFIs for the credit component was 11%.</td>
<td></td>
</tr>
</tbody>
</table>

Note: At the project appraisal, there was no baseline because very few micro-lending existed.
**G. Ratings of Project Performance in ISRs**

<table>
<thead>
<tr>
<th>No.</th>
<th>Date ISR Archived</th>
<th>DO</th>
<th>IP</th>
<th>Actual Disbursements (US$ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>04/21/2008</td>
<td>Satisfactory</td>
<td>Satisfactory</td>
<td>US$ 0.00</td>
</tr>
<tr>
<td>2</td>
<td>04/30/2009</td>
<td>Satisfactory</td>
<td>Satisfactory</td>
<td>US$95.00 M</td>
</tr>
<tr>
<td>3</td>
<td>06/23/2010</td>
<td>Satisfactory</td>
<td>Satisfactory</td>
<td>US$95.00 M</td>
</tr>
<tr>
<td>4</td>
<td>06/23/2011</td>
<td>Satisfactory</td>
<td>Moderately Satisfactory</td>
<td>US$95 million have been fully disbursed. Undisbursed amount of US$5 million was canceled upon project closure.</td>
</tr>
</tbody>
</table>

---

1. After June 2008, the data pertains to the six PFIs mentioned above, as information on the other six banks was not available since IPC (Internationale Projekt Consult GmbH, the project’s consultant) left those PFIs.

2. Average loan was larger than originally envisioned. Please refer to footnote 4 for detail.
H. Restructuring (If Any)

<table>
<thead>
<tr>
<th>Restructuring Date(s)</th>
<th>Board Approved PDO Change</th>
<th>ISR Ratings at Restructuring</th>
<th>Amount Disbursed at Restructuring in USD millions</th>
<th>Reason for Restructuring &amp; Key Changes Made</th>
</tr>
</thead>
<tbody>
<tr>
<td>N/A</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

I. Disbursement Profile

![Graph showing disbursement profile with three lines: Original, Formally Revised, and Actual. The graph plots US $ Millions on the y-axis and 2006 Q1 to 2011 Q4 on the x-axis.](image)
1. PROJECT CONTEXT, DEVELOPMENT OBJECTIVES AND DESIGN

1.1 Context at Appraisal

1. **Country and Sector Background:** Spectacular achievements in China also brought about a host of challenges to the country, namely maintaining sustainable economic growth, protecting the natural resources and environment; and addressing the rising economic, social and regional inequalities. To meet these challenges, China needed to diversify its sources of economic growth and raise the efficiency of resource allocation, preferably to those that contributed to employment without exerting undue pressure on the already strained environment and heavy demand on natural resources. One potential source for growth was *micro, small and medium enterprises* (MSMEs), which contributed meaningfully to GDP growth, job creation and export earnings. Within the MSME sector, *micro and small enterprises* (MSEs) were expected to play an important role in addressing these challenges. Promoting MSEs, the majority of which were privately owned, was a Government priority in the drive to build a well-off and harmonious society. While MSMEs as a whole suffered from constrained credit, it was the MSEs that had over time became the forgotten segment, the one that bore the brunt of the lack of access to finance. Banks tended to consider enterprises in the upper end of the small and medium enterprises (SMEs) as bankable for investment opportunities, and microfinance (especially in the rural areas) had at least received attention from NGOs and donors for financial resources.

2. For MSEs, the reasons behind their lack of access to finance were numerous and complex. Government officials and banks in China shared an entrenched perception that lending to MSEs was inherently risky, in part because past attempts by banks at reaching out to MSEs had resulted in unacceptably high losses in their balance sheets. Another reason was a longstanding credit culture biased towards collateral and guarantees. Lacking the ability to process the soft information that is characteristic among MSEs, banks relied heavily on collateral and credit guarantees. Regulatory policies also perpetuated this tendency by insisting on collateral and guarantee arrangements while non-secured lending was discouraged. As most MSEs did not possess the kind of collateral required by banks and had difficulty arranging for guarantees, banks usually found that MSE lending became either an impossible or extremely costly proposition.

3. Commercializing the banking system meant that banks needed to differentiate themselves strategically. Most banks pursued lending to large and state-affiliated firms and the intense competition had led to under-pricing of credit risk in general. In the past when responding to political calls to serve the SMEs, banks tended to apply the same corporate lending techniques to micro and small lending, only to find their non-performing loans on the rise, which served to accentuate further the entrenched notion that MSE lending was risky. The overemphasis on collateral constrained the availability of credit to MSEs which in turn could not meet banks’ and supervisors’ collateral requirements, regardless of whether their cash flow was adequate to service bank loans at commercial rates of interest.
4. However, increased competition resulting from financial liberalization was expected to push many banks towards the lower end of the market and toward lending to MSEs. As a result, MSE lending was expected to serve as a key component of new business strategies for many banks in China. But to be successful in lending to MSEs, banks needed to adopt lending technologies more suited to MSEs while the entrenched attitude against lending to MSEs would need to evolve.

5. Given the above development and in line with the priority the government attached to MSE development, it was important to launch an MSE lending and bank capacity building project aimed at providing better access to finance by the MSEs in China, and at adopting tried and tested techniques. It was also important to imbed these practices and approach in an institutional framework that could enable eventual nationwide rollout and scaling up. The project was expected to provide this modality and to address the above constraints to MSE finance. At the same time, it was expected to contribute to reinforcing the government’s policy objective of encouraging flows of funds to emerging private entrepreneurs and small enterprises. The government therefore attached a high priority to the project.

6. **Rational for Bank Assistance:** The project was developed from the Bank’s financial sector work program, designed to assist China in reform and development of the financial sector. The Bank’s advocacy for commercially sustainable microfinance had been an integral part of this program. Furthermore, through intensive engagement and continued dialogue with the authorities, the Bank had established a substantial credibility and was ideally placed to play a major role in supporting a specific operation to promote bank lending to MSEs. The Bank’s involvement in the project was expected to further advance work in this area. Through the project the Bank was expected to help develop an appropriate mechanism for channeling funds; ensure access to high quality technical expertise; continue to engage relevant stakeholders in the policy dialogue necessary to create an increasingly facilitative regulatory environment; and work with partners to ensure adequate monitoring, evaluation and propagation of the lessons learned and experiences inherent in the project.

7. On the one hand, the proposed project was expected to support the government’s priority program to catalyze the expansion of commercial lending to the emerging segment of MSEs that were strongly competitive and privately owned, but in need of funds for working and investment capital. On the other, the project aimed to strengthen the capacity of banks to provide lending to MSEs on a mass-market and profitable basis. The ultimate objective was to promote expansion of private sector MSEs across China, which would in turn bring about potential increases in job creation, income growth, and poverty reduction as MSEs prospered and grew. These objectives were fully consistent with the Country Partnership Strategy for the People’s Republic of China for the Period 2006–2010,” Report No. 35435, discussed by the Board on May 23, 2006.
1.2 **Original Project Development Objectives (PDO) and Key Indicators (as approved)**

8. The project development objective was to expand credit flows to MSEs on a *mass-market and commercially sustainable basis*. It aimed to help China Development Bank (CDB) develop a new business line involving wholesaling of MSE subsidiary loans and provision of related technical support to Participating Financial Institutions (PFIs); and help the PFIs build up a high-quality MSE loan portfolio based on credit technologies that had been developed and validated under successful micro and small loan programs in transition economies, introduced through a downscaling approach to microfinance. Through this support, the project aimed to help introduce into China international best practices for providing efficient financial services to MSEs. As part of this effort, by strengthening the institutional and human resource capacity of PFIs, it was expected to contribute to laying the foundation for progressive, nationwide scaling-up of commercially sustainable MSE financial services.

9. Specific outcomes and result indicators for the project were expected to include:

   (i) an increase in the number of loans to MSEs;
   (ii) improvement in the portfolio quality (percentage of overdue repayments on loans);
   (iii) profitability of MSEs in a treatment group compared with a control group;
   (iv) the capacity of CDB to appraise and monitor commercial banks’ eligibility to engage in MSE lending as PFIs;
   (v) the number of MSE borrowers;
   (vi) the average size of the MSE sub-loans;
   (vii) the number of PFIs that adopt and implement the project-related credit technologies; and (viii) the number of CDB in-house experts able to provide advisory services to PFIs on MSE lending; and (ix) the number of new loan officers trained in the use of the new credit technologies.

1.3 **Revised PDO (as approved by original approving authority) and Key Indicators, and reasons/justification**

10. The PDO and key indicators were not revised.

1.4 **Main Beneficiaries**

11. The primary target groups under the project were the MSEs. The PFIs also benefited from the technical assistance provided under the project.

1.5 **Original Components (as approved)**

12. The project envisaged a two-tier structure consisting of *wholesale* and *retail* operations. CDB was chosen to be the wholesaler for this project and was expected to engage in lending to, and arrange technical support for, PFIs that were engaged in MSE
lending operations at the retail level. PFIs as retailers were initially to be selected from a pool of City Commercial Banks (CCBs). This pool was to be subsequently expanded to include nationwide banks, credit cooperatives, rural cooperative/commercial banks, and other credit institutions. To this end, the project consisted of two closely linked components: (i) a Credit Facility for on-lending to eligible PFIs; and (ii) a Technical Assistance Facility to support capacity-building in the CDB and PFIs.

Component 1: Credit Facility (US$699 million)

13. This facility was expected to cover the total project costs of US$699 million, which was to be financed by a loan of US$95 million from the Bank, a loan of US$50 million from Kreditanstalt für Wiederaufbau (KfW), and additional funding of US$554 million by CDB and PFIs. Under this component, CDB was expected to provide medium- to long-term subsidiary loans, with maturity of up to 10 years including a grace period of up to 5 years, to PFIs in domestic currency. The PFIs were expected to on-lend the funds to MSEs, on commercial terms and with a maturity not exceeding three years. The sub-loans were to be for long-term investments and working capital and were expected to range from RMB 100 to RMB 500,000. There was not going to be any sectoral targeting under the project, but an exclusion list was agreed upon between the CDB and the PFIs to avoid sub-loans going to socially and environmentally dubious activities. CDB was to assume the full credit risk on the PFIs and the currency risk on the Bank loan. CDB was not expected to lend directly to MSEs.

14. CDB had already prepared and reviewed an initial list of potential PFIs. It had entered into Technical Cooperation Agreements (TCAs) and Subsidiary Loan Agreements (SLAs) with five (5) PFIs, three of which had embarked on MSE lending under the project; had selected three (3) more PFIs by the end of 2006 and was expected to select an additional four (4) by project effectiveness. Additional PFIs were expected to be added in subsequent years. Selection criteria for the PFIs had been developed and tested with assistance from the Bank, and the adopted criteria were to form part of the Operations Manual.

Component 2: Technical Assistance Facility (US$20 million)

15. The total TA costs were estimated at US$20 million. KfW had provided 3 million Euros, or US$3.78 million equivalent, to defray the TA cost. The rest of the TA costs were to be financed by a loan of US$5 million from the Bank and an additional US$11.22 million from CDB, if necessary. The actual cost was expected to vary depending on the duration of engagement of the Project Implementation Consultant (PIC). This component was to provide specialized and comprehensive technical assistance to the PFIs to strengthen their institutional capacity and skills to effectively engage in MSE lending. An internationally recruited PIC had already been contracted for this purpose. Under the overall management of the CDB, the PIC was assisting in creating MSE lending departments in each PFI and in the adoption and application of international best practices.

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3 The actual TA cost was US$13.18 million, consisting of US$9.4 million from CDB and US$3.78 million from KfW.
practices and lending technologies/processes that have been successfully deployed in other countries. The CDB was to provide services from the PIC to the PFIs free of charge for at least six months, and up to two years during the initial project implementation period.

16. This component also included a provision for additional advisory services for CDB to strengthen its MSE business line, including its skills for commercial bank appraisal, assessment and monitoring, and building up its in-house advisory capacity for MSE lending, as well as other purposes relating to the project objectives.

1.6 Revised Components

17. The original components were not revised.

1.7 Other significant changes

18. There were no significant changes made to the project.

2. KEY FACTORS AFFECTING IMPLEMENTATION AND OUTCOMES

2.1 Project Preparation, Design and Quality at Entry

19. Lessons learned from lines of credit in China and other countries that have been taken into account in the design of this project include the following:

1. Weak borrower accountability and management capacity have contributed to unsuccessful projects in China and other countries. In previous lines of credit (LOCs) in China, intermediation through government agencies has not been successful in part because these entities lack the appropriate institutional and operational capacity. Importantly, they did not have the appropriate financial sector skills or incentives framework to support lending activities. CDB was assigned clear responsibility and full accountability for project implementation. It had strong management capacity. The project was also fully in line with CDB’s development objectives and overall strategy as a prominent development finance institution at the project’s appraisal.

2. Attention needed to be paid to the use of sound eligibility criteria that met Bank guidelines in selecting and monitoring the financial intermediaries to ensure their financial and operational quality. Drawing on lessons learned from past LOC projects in China, in which the Bank’s diligence tended to stop with the first-tier financial intermediaries, in this project, selection of PFIs was to receive special attention, because choosing the right PFIs was expected to be critical for the success of the project. Sample eligibility criteria and specific support were provided to CDB to strengthen its capacity to carry out the screening and evaluation of PFIs to ensure that they met requirements satisfactory to the Bank and CDB. In addition the Bank provided support to CDB in appraising the initial
PFIs. Monitoring of performance of the PFIs was an integral element of project implementation, and TA from the PIC was accepted to reinforce this task.

3. **Chances of success were expected to be enhanced by the incorporation of expert services to demonstrate how banks can meet the financial services needs of the targeted beneficiaries on a commercially sustainable basis.** This was the first Bank project in China to directly and broadly target the MSE sector. By design, it incorporated the conducting of a rigorously controlled pilot led by industry experts and the provision of extensive TA at the PFI level to build capacity, as well as to strengthen CDB’s capacity in selecting and advising PFIs in MSE lending.

4. **LOC should include clearly defined and transparent indicators for monitoring implementation progress and overall impact, and provide for an orderly exit mechanism.** Clear project indicators were defined for the MSE Finance Project. Monitoring was to be an important aspect of the project and was to reinforce PFI performance monitoring by CDB. The indicators were expected to help serve as an early warning system if remedial actions were deemed appropriate and needed. Also, sufficient flexibility was built into the project for an exit mechanism in the event that a PFI failed to comply with the project eligibility and implementation criteria.

5. **Inadequate demand from ultimate beneficiaries and lack of bankable sub-projects had, in the past, led to problems in the implementation of lines of credit in other countries.** In China, however, the problem was more on the supply side, as MSEs had almost no access to formal financial services and products from financial institutions. Project funding was expected to satisfy only a portion of the demand in China, which was largely underserved. The PIC was to help design a simple sub-loan appraisal system that was to be based on intrinsic business viability, risk-based lending rates and ability to repay (debt capacity) rather than complex financial analysis, guarantees and collateral requirements.

6. **Last but not least, to be successful LOC projects required careful planning and preparation.** The Bank and the Chinese government devoted substantial resources in studying the experiences and lessons from other countries and needed reforms for introducing commercial MSE lending. A study on the legal and regulatory environment at the outset of the project indicated that no binding constraints existed in China that would prohibit commercial MSE lending. The launching of the project received broad-based support from all relevant stakeholders, as it was preceded by extensive public awareness-building. To test the market and to accumulate experience, CDB had started the pilot with two PFIs with the assistance of the PIC.

In addition to the above, careful attention was given in the design of the project to the following features:
• PFIs that met the criteria in full were eligible for immediate participation in the project. PFIs that needed further operational and financial strengthening were expected to be able to participate following agreement to and compliance with a time-bound Corrective Action Plan (CAP). The CAP was to be agreed upon between the CDB and the PFI and be subject to the Bank’s review.

• Eligible MSEs were expected to be majority private sector owned and operated (more than 50 percent private ownership), active primarily in services and trade, but also in manufacturing. Sub-loans for working capital and investment were to range from RMB 100 to RMB 500,000. The upper limit had a built-in flexibility amount to RMB 1 million, subject to prior agreement of the Bank, in selected regions where income levels were higher than the national average. The average size of the MSE loans were expected to be around RMB 50,000 and consideration was to be given to link the average size to the local per capital GNP for it to reflect regional differences in loan demands.

• The subsidiary loan interest rates charged to PFIs were to be determined based on CDB’s costs of funding and its credit rating of the PFIs. At a minimum, these were to be positive in real terms and provide rates of return close to CDB’s current return on average loan assets.

• To benefit from the TA facility, the PFIs were required to enter into technical cooperation agreements (TCA) with CDB. Under such agreements, CDB, with the assistance of the PIC, was to provide TA to the PFIs free of charge for up to two years. Thereafter, if continued TA support was needed, CDB and PFIs would agree on an appropriate cost sharing arrangement. PFIs were to have access to the credit facility only if they entered into such TCA with CDB since the success of the credit facility depended on the application of modern MSE lending technologies and risk control procedures.

2.2 Implementation

(Including any project changes/restructuring, mid-term review, Project at Risk status, and actions taken, as applicable)

21. The major institutional and implementation arrangements of the project were the responsibility of the CDB, including the selection of PFIs, on-lending to these PFIs, organization of the TA and project monitoring. As a state-owned policy bank at the outset of the project, CDB was in a good position to implement the project, given its focus on SME lending, its policy orientation and its links with city commercial banks in China. CDB contributed to the successful implementation of the project by contracting the TA provider, selecting PFIs and providing them with on-lending and conducting project monitoring and technical support. At the same time, CDB improved its own capacities in the project’s implementation, the Chinese economy experienced high GDP growth rates of over 10 percent, reflecting a high level of economic activities. These fueled large investment and high lending opportunities with large-size loans. In the MSE sector, the average size of a loan easily exceeded what the project anticipated.
The CDB established a microfinance business unit (MBU), which had overall responsibility for project implementation and reporting to the Bank. The director of the MBU was the Bank’s main counterpart. The MBU had three sections, namely: (i) PFI selection and monitoring unit; (ii) financial advisory unit; and (iii) project management unit.\(^5\)

22. As the project’s implementation progressed, however, one characteristic pertaining to CDB, in as much as it was a policy bank, hindered the project’s feature on twinning TA with credit. CDB’s cost of funds is relatively high because it does not take deposits, but must raise funds through issuing debt instruments in the bond market. Thus its line of credits (LOCs) are not as competitive and attractive for MSE vis-à-vis those from PFIs with sources of cheaper funds.

23. The project was appraised in 2006, approved by the Board in June 2007 and was closed on June 30, 2011 as scheduled. From a development point of view, the project was close to achieving its intended target even prior to the declaration of effectiveness. A total of 35,000 micro loans were disbursed prior to project effectiveness. The funding was provided by CDB (which was reimbursed for that portion of the funds earmarked under the Bank loan upon project effectiveness). By the time of project effectiveness, 12 PFIs had received TA (under component 2) from an international consulting firm, hired for that purpose by CDB and funded under the project by a grant from KfW and CDB’s own funds.

2.3 Monitoring and Evaluation (M&E) Design, Implementation and Utilization

24. An important part of the PIC’s work was to ensure that a robust system was put in place and implemented to monitor and evaluate progress with the credit facility. This system was also expected to reflect the results and effectiveness of the TA facility. However, the TA facility was not drawn down since CDB used its own funds for this purpose due to the change in CDB’s mandate from a policy bank to a commercial bank following the Government’s directive during the implementation of the project. By the time the Implementation Status and Results Report (ISR) Number 3 (06/23/2010) was due, the World Bank’s Financial and Private Sector Development (FPD) Network had requested a new set of indicators to be collected for all LOC projects managed by FPD which was expected to enhance the effectiveness of projects implemented. The resulting changes based on this new set are reflected in Annex 2, Table 3. The data to monitor project outcomes and results was expected to be generated as an integral part of the day-to-day business of the PFIs. A set of outcomes and results indicators were developed that were to be monitored by CDB. Their results are presented in Annex 2, Table 1.

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\(^5\) MBU appraised commercial banks and was in charge of monitoring the TA that the consultants were providing to PFIs. During the implementation of the project, CBD was transformed into a commercial bank and MBU was merged into a division with broader responsibilities. CDB staff trained under the project continued to perform their responsibility as called for in the project: monitoring the project implementation, providing training to micro-credit companies by applying the MSE lending technology and carrying out project management and administration.
2.4 Safeguard and Fiduciary Compliance

25. The project was classified as Category “FI.” Given the focus of the project on MSEs, especially in the areas of trade and services, it was expected that the vast majority of the sub-projects would have minor environmental impact, if at all. However, CDB had established an Environmental Assessment Framework (EAF) to ensure the environmental soundness of the project as a whole. CDB undertook environmental due diligence under the project and put in place relevant policies, procedures and manuals on environmental assessment satisfactory to the Bank. CDB made a commitment to ensure that the PFIs built up their capacity to screen and evaluate sub-loan applications to prevent sub-loans with possible economic activity that would have had a negative environmental impact. CDB also prepared the section in the Operational Manual (OM) related to the environment and put in place the Environmental Management Group as described in the EAF. No environmental issues were encountered under the project.

26. The fiduciary aspects of the project (financial management (FM) and procurement) were rated as “Satisfactory” as implementation progressed. FM reports were submitted on time and no major issues were noted. The financial management system provided timely and accurate information required to manage and monitor the implementation of the project. The project audits also were submitted on time and were unqualified, with no major issues reported. The FM risk rating for the project has been considered low.

2.5 Post-completion Operation/Next Phase

27. As a result of the project’s achievements in this area, it creates a strong momentum whereby more and more banks are getting involved in commercially-oriented MSE finance. China has achieved a great deal in promoting MSE finance in this project, which has effectively demonstrated that not only was there no basis for the entrenched belief in inherent MSE financing risk but the opposite was true, and the principle of commercial sustainability has successfully taken root among banks. The MSE lending technology has also been successfully replicated in rural finance. Despite this initial success however, the Chinese authorities and the donors recognize that the project only represents a beginning; a great deal of commitment, efforts and actions would be needed to achieve the desired outreach and sustainability. Lack of capacity at all levels of banks, including management and credit officers, stands out as the first major target to overcome, with a systematic approach to training and advisory services. In recognition of the bottleneck and demand for training and capacity-building, the Bank has launched an initiative to create an academy for inclusive finance, with the objective of providing world-class training and advisory services in lending technology, management and leadership skills to credit officers and managers.
3.  ASSESSMENT OF OUTCOMES

3.1  Relevance of Objectives, Design and Implementation

28. The objective, design and implementation of the project remain highly relevant to China’s and the World Bank’s development objectives. The World Bank Group continues to play an important role in China with assistance in this area. The Bank has supported innovation that scaled-up projects provided benefits far beyond the direct benefits of the original project. Given China’s financial circumstances and its appropriate development program, the World Bank Group aims to be a client-driven knowledge institution that uses lending and other operations to pilot reforms and support institutional development. The 2006-2010 Partnership Strategy focused on five thematic areas of engagement that build on the World Bank Group’s international expertise, while maximizing the creation and dissemination of knowledge of China’s development processes inside and outside China. One of the five thematic areas was to “Deepen financial intermediation, by expanding access to financial services (especially among SMEs), developing the capital markets, managing systemic risks, and maintaining financial stability,” which was one of the core development objectives of this project.

3.2  Achievement of Project Development Objectives

29. The project successfully achieved the main objective to provide loans to the MSE sector on a mass-market and a commercially-sustainable basis and to strengthen the institutional and human resources capacity of the CDB and the participating PFIs. Further, all the major objectives for the two components were successfully completed, namely the targets for loan coverage, the number of borrowers, the number of loan officials trained, and the amount and number of micro-loans disbursed. In addition, the project has fulfilled the target for financial viability of the micro-loans, including the loan quality and financial performance for the operation of the micro-loans. The project has successfully and convincingly shown that it is possible for the Chinese banks to support MSEs in a commercially viable way. Overall, the project had a significant impact throughout the micro-finance industry in China. Before the project, there were virtually no banks in China that lent to MSEs. However, as its completion, the project has established a solid and sustainable ground for MSE lending and definitely dispelled the widespread belief on inherent risk in lending to this sector. The project strengthened the capacity of banks to provide lending to MSEs on a mass-market and profitable basis, and served as a key component of new business strategies for them. Most importantly, the project’s ultimate objective – to promote the expansion of private sector MSEs across China – was successfully realized, and thereby provides firmer foundations for projected potential increases in job creation, income growth and poverty reduction as MSE lending expands. The project helped to successfully mainstream the MSE lending technologies in a number of PFIs which have in turn built up their high-quality MSE loan portfolio, and completed the training for teams of cadres of MSE credit officers. 12 PFIs benefitted from the technical assistance under the project. While all 12 PFIs signed project cooperation agreements with CDB, 6 PFIs (Baoshang Bank, Taizhou Bank, Jiujiang Bank, Guiyang Bank, Maanshan RCB and Daqing Bank) signed sub-loan agreements and
participated under the LOC until project closure. The others were actually and successfully able to attract funds more cheaply and under better terms than what was being offered under the LOC component and therefore could afford to forego the sub-loan agreements and LOC as provided under the project, given the robust and stable macroeconomic environment in the country as a whole during the life of the project. The positive impact of the project went beyond what it intended to accomplish in so far as MSE lending was concerned.

**The achievement of the PDO is considered as Satisfactory.**

30. The project achieved a number of additional objectives above and beyond the project’s design and expectations: (i) some PFIs have extended the microfinance technologies learned from the project to other bank operations, mainly financing of agricultural businesses, households and medium and small size enterprises; (ii) a number of bank managers have applied the methodologies in the recruitment and management of micro-loan officials for other bank positions, including corporate and consumer loan officials; (iii) the inclusion of the micro-loan portfolio has helped the PFIs to diversify their loan portfolio and mitigate their credit risks; and (iv) last but not least, through the micro-lending operation the PFIs have attracted more deposits and valuable clients, which laid a basis for further expansion of these banks. Many city and rural commercial banks in China have quickly learned the value of the project’s pioneering examples and started establishing their own micro-lending operations, many with support from the ex-advisers of the project, or the advisers trained by the project.

31. The achievements of the components are discussed below.

32. **Component 1. Credit Facility:** The Bank loan of US$95 million and the KfW loan of US$50 million were fully disbursed. In addition, the CDB and PFIs disbursed US$2,986.8 million equivalent, including CDB on-lending to PFIs US$180.8 million equivalent and PFIs to MSEs US$2,806 million equivalent of their own funds, for a total disbursement of US$3,131.8 million equivalent for this component. Achievement of the project indicators agreed at appraisal is highlighted below:

33. **Increase in the number of loans to MSEs.** Since the first MSE loan of RMB 15,000 was disbursed in 2005, cumulative disbursement of the project reached RMB 18 billion (as compared to RMB 9.89 billion projected at appraisal) to approximately 175,908 borrowers (as compared to 119,600 projected at appraisal) by the end of the project.

34. **Improve the portfolio quality (percentage of overdue repayments on loans).** During the implementation of the project, loan portfolio quality at all PFIs remained excellent. Loans with payments overdue for more than 30 days amounted to a mere 0.2 percent in terms of volume and only 0.3 percent in terms of numbers. The actual level of

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6 The large amount of disbursements of about US$2.8 billion came from the PFIs, which were able to mobilize funding themselves.
non-performing loans was less than 1 percent, far below the 3 percent projected at appraisal. The average loan amount outstanding (including micro and small loans) amounted to RMB 98,332. These figures attested that a client-oriented, individual cash flow-based lending technology was suitable to the Chinese environment and that commercially viable MSE lending as regular banking business is positioned well towards a great future in China.

35. The profitability of MSEs in a treatment group compared with a control group was not implemented due to lack of resources from the CDB. However, the commercial viability and profitability of the PFIs can be demonstrated by the lending rates charged by the PFIs and the costs for providing the micro-loans. The average lending rate charged by the PFIs was around 14.6 percent, whereas the average total costs for providing the micro-loan was around 4.9 percent, a gap of almost 10 per cent of the loan portfolio existing due to the low cost of funds, a low loan-loss provision due to good loan quality, and low staff costs.

36. The capacity of CDB to appraise and monitor commercial banks’ eligibility to engage in MSE lending as PFIs. Upon the training by the consultants, CDB created a microfinance business unit, consisting of three special teams on MSE lending, with one team specializing in evaluation and monitoring of commercial banks, the other team specializing in the provision of technical support for PFIs, and the third specializing in project management. In total, 27 CDB staff worked on the project and provided technical support to the 12 PFIs.

Component 2: Technical Assistance Facility

37. Under the framework of this component, the MSE lending technologies were transferred to PFIs via the work of the PIC consultants who provided technical support on capacity-building for CDB and PFIs. The technical assistance service was to be provided for up to two years to the PFIs along with the sub-loan agreement. Two manuals were compiled by CDB: a Project and Monitoring and Evaluation Manual and the MSE Lending Operational Manual. CDB selected 12 PFIs for project implementation and it also participated with the PIC in the provision of technical support to the 12 PFIs. The TA mentioned above was funded by a grant from KfW and CDB’s own funds. The US$5 million allocated for this component under the Bank loan was not utilized. A crucial factor that had an impact on the utilization of these funds could have been the mandate by the Government to commercialize the CDB during implementation. With a new mandate, CDB was in the process of realigning its strategy for a commercial institution and the provision of free resources to PFIs was not consistent with its new strategy.

38. The number of PFIs that adopted and implemented project-related credit technologies. While only 12 (PFIs) were selected for participation under the credit facility, the micro-loan technologies introduced by the project have effectively been

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7 From the 18 PFIs identified, CDB determined that 12 were eligible to participate in the program in accordance with the eligibility criteria.
transferred to and adopted by many more financial institutions such as micro-credit companies, village and township banks and NGO micro-finance institutions in China, through the work and words of PFIs and the consultants, many of whom have been trained by IPC through the project. Thus, even though the anticipated (at appraisal) number of PFIs (18) was not reached, the results of the PFIs that participated far exceeded all projected targets as credit technologies spread farther and wider in this sector than the initial PFI numerical target.

39. The number of new loan officers trained in the use of the new credit technologies. Over 1,079 personnel were trained under the auspices of the project, versus the target of 894 projected at appraisal. In addition, 148 back-office staff and over 200 middle-level managers were also trained. It is worth noting that this was the first wave of trained personnel; once these apply their experience and interact with their colleagues, the effect will be multifold.

40. The number of CDB in-house experts able to provide advisory services to PFIs on MSE lending. In addition to training of PFI staff, CDB selected 20 internal candidates for in-house training, who received classroom and on-the-job training.

41. To date, the project was the first (in the MSE sector) to be set up on a commercially sustainable basis. There have been other projects in China aimed at microfinance though not on a commercial basis. The project did not depend on subsidies for funding in the long-term; but it had an effective system of building up the experience of MSE finance staff, and it applied credit policies and procedures allowing MSEs which are without access to formal finance up to now to gain access to it. These were clearly recorded by the results completed, which are key indicators for sustainable institution-building measures at the PFIs.

42. Apart from the potential demand of the MSE credit market in China, the PFIs appreciated a higher degree of acceptance of the MSE clientele under the project as a strategically important client base. PFIs understood the need for reforms in their organizational structures, procedures and the approach to personnel to better address the requirements for a successful MSE lending strategy, and most importantly they were willing to implement these changes to make them operational. These financial institutions were truly committed to the project, and this commitment is reflected in the results discussed above. Furthermore, the PFIs were willing to accept and carry out institution-building measures aimed at improving their human resources and credit policies as well as risk control, staff training, marketing and internal audit capacities.

43. Another key factor was the single focus on one standardized approach and on implementing one basic product before attempting to expand to other segments of the MSE market. This approach enabled the concentration of resources in one activity to bring about tangible lending results and outreach quickly. In addition, training activities were well-focused with effective and timely results. All these actions contributed to a faster acceptance of MSE lending operations as a key banking business instruments and strategy among concerned institutions and to a faster reception and digestion of the new
lending technology. A number of the PFIs also adopted elements of the “new approach” to other operations of their banks.

44. Finally, regulatory authorities in China were supportive of the PFIs’ MSE credit operations and strove to simplify procedures in line with the project’s practices and allow for PFIs to establish MSE credit operations as a sustainable core business.

3.3 Efficiency

(Net Present Value/Economic Rate of Return, cost effectiveness, e.g., unit rate norms, least cost, and comparisons; and Financial Rate of Return)

45. The efficiency of project investment is rated Satisfactory. At appraisal, significant benefits were expected: (i) facilitation of credit expansion to the private sector; (ii) improvement in credit market efficiency and quality of credit decisions; (iii) improvement in credit culture and risk management systems in banks while expanding outreach; (iv) enabling diversification by PFIs away from lending to state-owned enterprises and other quasi-governmental entities. Based on these expectations, the project is considered to be efficient.

46. Further, consideration for a project’s efficiency should take into account resources allocated to preparation and supervision over the project’s life of four years. The question to be asked is whether the Bank, given the benefit of hindsight, would have proceeded with the MSE Finance project. The answer is that it would: the project initiated a new venue for MSE lending in China that is now well established and clearly sustainable, catalyzing the expansion of commercial lending to the emerging segment of MSEs (competitive and privately owned) in need of funds for working and investment capital. The results also justified the Bank’s advocacy for commercially sustainable microfinance.

3.4 Justification of Overall Outcome Rating

Rating: Satisfactory

47. The project development objectives were successfully achieved. The relevance and sustainability of the project were confirmed with the continuation of the PFIs and other financial institutions to provide loans to the MSE sector on a mass-market and a commercially-sustainable basis and to strengthen institutional and human resources capacity of the CDB and the participating PFIs. The project merits the “Satisfactory” rating by fulfilling its development objectives of increasing loans to the MSE sector on a sustainable basis, improving the quality of its loan portfolio and strengthening the institutional capacity of the CDB and the PFIs.
3.5 Overarching Themes, Other Outcomes and Impacts

(a) Poverty Impact, Gender Aspects, and Social Development

48. The project’s impact on poverty was positive as it helped MSEs gain access to affordable credit. As recognized at appraisal, it is very difficult to measure or assess the benefits to the population in general, but it is recognized that these would accrue indirectly. The MSEs with access to credit were able to invest, grow and create (direct and indirect) employment by expanding their production or services. The technical assistance program to the PFIs has also support the provision of better banking services, better management and operations of the financial institutions involved under the project. With well-organized and efficient PFIs, their customers and businesses would ultimately benefit from these improvements.

(b) Institutional Change/Strengthening

49. The project had a profound impact on the PFIs, bringing about fundamental institutional changes and strengthening management. PFIs were willing to accept institution-building measures aimed at improving the PFIs’ human resources and credit policy as well as risk control, staff training, marketing and internal audit capacities. The positive aspects brought about by the project which strengthened PFIs’ operations included: (i) use of new MSE lending technology, as well as a systematic approach to micro-lending; (ii) application of MSE lending technology to small business and agricultural lending by a few PFIs; (iii) introduction of a well-structured and efficient method in recruitment, training and management of loan officials and other MSE lending staff, with well-trained and experienced loan officials for MSE lending; (iv) achieving a significant increase in the MSE lending market share and profits from MSE lending (for some PFIs this was from a zero base), building up a good foundation for increased bank competitiveness in the local markets; (v) acquiring a diversified loan portfolio with reduced credit risk for the bank as a whole; (vi) achieving a good MSE client base, for which the PFIs provided not only MSE loans, but also deposits and other financial services; and (vii) establishing a reputation and brand name in MSE lending in the local markets, with the local governments and the bank regulators.

(c) Other Unintended Outcomes and Impacts (positive or negative)

50. The project’s impact went beyond the original project’s objective, mainly in two aspects. One is that it catalyzed a revolution in thinking and practice in banking operations in the China's banking system. Before the project, MSEs as compared with SMEs, were not recognized as an integral component of the enterprise sector in the nomenclature, but it is now explicitly mentioned on a daily basis. The other is the demonstration effect that has brought quite a number of additional financial institutions into the area of lending to MSEs. The Postal Savings Bank, for example, has more than 3 million MSE borrowers, an impressive achievement in outreach even by international standards.
3.6 Summary of Findings of Beneficiary Survey and/or Stakeholder Workshops

51. The PFI clients interviewed have been very positive about the project. In addition to the access to micro-loans enabled by the project, they have been deeply impressed by: (i) the fast response and services provided by the PFIs on micro-lending; and (ii) the efficient services provided by loan officials, although in some rare cases there was lengthy field investigation by loan officials. Overall, the clients clearly preferred a pure commercial relationship between them and their financial institutions than a personal relationship with loan officials or managers. They were willing to pay a higher transparent lending rate of interest instead of unknown and hidden costs in the form of kick-backs, offering of gifts, and banquets, etc. to loan officials and managers.

4. ASSESSMENT OF RISK TO DEVELOPMENT OUTCOME

Rating: Low

52. The risk for development outcome is considered Low. As noted, under the credit line component, funds were fully disbursed and the quality of the sub-loan portfolio was highly satisfactory. In fact, the contributions to the LOC component from the Borrower’s (both from CDB and PFIs) side far exceeded the amount projected at appraisal. On the TA aspect, the PFIs were committed and effectively carried out the agreed programs. The PFIs rated the TA programs as being highly useful in enhancing their daily activities.

5. ASSESSMENT OF BANK AND BORROWER PERFORMANCE

5.1 Bank Performance

(a) Bank Performance in Ensuring Quality at Entry
(i.e., performance through lending phase)

Rating: Satisfactory

53. The Bank responded in a timely manner to the need of the Chinese economy by designing an appropriate project to assist the covering a MSE gap in lending operations in the financial and private sectors. The Bank incorporated lessons learnt in implementing LOC operations in other countries to streamline the implementation of the project.

(b) Quality of Supervision
( Including of fiduciary and safeguards policies)

Rating: Moderately Satisfactory

54. The project supervision was Moderately Satisfactory. The Bank team had a high degree of continuity, with strong support from the country office. With the disbursement of the US$95 million at the beginning of the project, the Bank team concentrated on monitoring and supervising due diligence of the PFIs, ensured that the funds reached
them through system testing, sampling and visiting selected MSE borrowers. All PFIs which participated in the lending program were audited each year by the China National Audit Office with clean audit opinion. In 2009 and 2010, the Bank and CDB jointly hosted two forums to promote commercially sustainable MSE Finance with participation from the PFIs, People’s Bank of China, China Banking Regulatory Commission and a number of commercial banks. The forums were an opportunity for various concerned players in the micro-finance sector to exchange views on MSE lending strategy and challenges while facilitating cooperation among various stakeholders. In addition to project supervision missions, on-going dialogue was also facilitated with frequent missions by the Bank management to CDB to share the Bank’s knowledge and expertise in MSE Finance, bringing more added values to this project. Through these missions, the Bank’s management also encouraged the counterpart to continue the activities agreed in the project documents. However, the rating took into account the cancellation of the TA component due to the new developments discussed in paragraph 37. The ICR would argue that had the TA been used, the results would have been even more fruitful in building PFIs’ capacity for MSE lending.

(c) Justification of Rating for Overall Bank Performance

Rating: Satisfactory

55. The overall Bank performance is rated as Satisfactory with an appropriately designed project to meet the needs of the client, timely responses to the need of the Borrower and with close supervision of the project involving the Bank management team. In 2011, the project was chosen as one of the case studies by the FPD Global Practice Group in the Bank for the Financial Inclusion Practice Launch and also in the Bank’s dialogue with client countries.

5.2 Borrower Performance

(a) Government Performance

Rating: Satisfactory

56. The Borrower worked closely with the Bank throughout project preparation, and negotiations and its performance was rated Satisfactory. The close collaboration demonstrated by the Borrower with the Bank during implementation was a primary factor in the overall success of the project. Another important factor leading to the successful implementation of this project was the willingness of the government to utilize/mobilize its own funds to procure technical expertise lacking in-country.

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8 Robert B. Zoellick and his management team, during a visit to China in 2010, participated in a forum entitled Promoting Commercially Sustainable MSE Finance through Innovative Policy Dialogues and Lending Operations.
(b) Implementing Agency or Agencies Performance

Rating: *Moderately Satisfactory*

57. The relevant units in the CDB provided efficient monitoring and reporting, allowing for better management and implementation of the project and facilitating the Bank’s supervision activities. The participating PFIs successfully carried out project activities and improved their capacities in MSE lending. The credit facility of the project was fully disbursed and the project in general exceeded expectations.

58. However, it should be noted that during the implementation of the project, the government directed that CBD become a commercial institution, an event not foreseen in the project’s program. This external factor affected CDB’s interaction with the project in many ways. As it was now given a new mandate, it was understandable that it could not complete the strategy and plans as called for in the project, was uncertain about the notion of providing free TA to the PFIs as a commercial bank (utilizing loan funds), and therefore was reluctant to draw down the funds under the TA component. For similar reasons, the TA facility was not fully utilized\(^{10}\) to continue capacity building of the PFIs. Implementing Agency performance is thus rated as *Moderately Satisfactory*.

(c) Justification of Rating for Overall Borrower Performance

Rating: *Satisfactory*

59. The overall Borrower performance is rated as *Satisfactory*. The Borrower concluded the project successfully in a challenging environment, especially in the financial sector which had weak financial institutions. The participating PFIs also implemented their activities successfully and effectively.

6. LESSONS LEARNED

60. A stable economy that would be conducive for business growth is one of the most important elements for a line of credit operation.

   i. From the perspective of the PFIs, it was important to learn first and then adopt later with good understanding. A number of interviewed institutions mentioned that they had adopted an attitude of learning from consultants, but did not make rapid changes to the technologies transferred by the consultants before fully comprehending their implications. It is therefore important for the bank’s top management to have direct dialogue with the consultants to facilitate this process on introducing changes.

   ii. Management was the key to the successful implementation by the PFIs. It is therefore important for the donors and implementing agency to select suitable

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\(^{10}\) Implementation Performance was rated “Moderately Satisfactory” in the ISR dated June 23, 2011 for similar reasons.
partner institutions. The selection should be based mainly on the understanding and commitment from top management on MSE lending and overall management of the bank, rather than focusing solely on the current performance of a bank.

61. The selection of IPC as the project consultant also contributed to project success. Many PFIs were very impressed by the technique and performance of the IPC consultants and adopted the methodology in their own operations. To ensure the success of a LOC operation, it is important that the PFIs have access to good TA (if needed) to provide them with the tools and procedures necessary to make the LOC a success, as shown under this project.

62. External factors could play an important role in a MSE project. In this project, the two factors are (i) the Government’s decision to make the CBD a commercial institution and (ii) the effects of the macroeconomic environment in which financial institutions operate. In the first instance, the government decision altered the role of the implementing agency with the resulting cancellation of US$5 million under Component 2 as well as non-delivery of a strategic plan which was called for in the project. The strong performance of the country’s economy, while exerting a positive effect, resulted in funding availability among the PFIs, which did not have the incentive to borrow from sub-loan with high funding costs of the CBD that hindered its ability to on-lend to these PFIs. While the first factor may not be anticipated, the second factor could, in hindsight, be taking into account at the design stage of the project, as one of the scenarios within which the project would be implemented.

7. COMMENTS ON ISSUES RAISED BY BORROWER/IMPLEMENTING AGENCIES/PARTNERS

(a) Borrower/implementing agencies

63. None

(b) Cofinanciers

64. None

(c) Other partners and stakeholders

65. None
ANNEX 1. PROJECT COSTS AND FINANCING

(a) Project Cost by Component (in USD Million equivalent)

<table>
<thead>
<tr>
<th>Components</th>
<th>Appraisal Estimate (US$ million)</th>
<th>Actual/Latest Estimate (US$ million)</th>
<th>Percentage of Appraisal</th>
</tr>
</thead>
<tbody>
<tr>
<td>Component 1 - Line of Credit</td>
<td>699</td>
<td>3,131.80</td>
<td>448%</td>
</tr>
<tr>
<td>Component 2 - TA programs</td>
<td>20</td>
<td>13.18</td>
<td>66%</td>
</tr>
<tr>
<td></td>
<td><strong>Total Project Costs</strong></td>
<td></td>
<td><strong>437%</strong></td>
</tr>
<tr>
<td></td>
<td><strong>Total Financing Required</strong></td>
<td></td>
<td><strong>437%</strong></td>
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(b) Financing

<table>
<thead>
<tr>
<th>Source of Funds</th>
<th>Type of Cofinancing</th>
<th>Appraisal Estimate (US$ million)</th>
<th>Actual/Latest Estimate (US$ million)</th>
<th>Percentage of Appraisal</th>
</tr>
</thead>
<tbody>
<tr>
<td>Borrower</td>
<td></td>
<td>565.22</td>
<td>2996.20</td>
<td>531%</td>
</tr>
<tr>
<td>IBRD</td>
<td>Loan</td>
<td>100</td>
<td>95</td>
<td>95%</td>
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<tr>
<td>KfW</td>
<td>Loan/Grant</td>
<td>53.78</td>
<td>53.78</td>
<td>100%</td>
</tr>
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</table>
ANNEX 2. OUTPUTS BY COMPONENT

1. **Component 1: Credit Facility:** The facility was in the amount of US$699 million (at appraisal), funded by a World Bank loan of US$95 million, a KfW loan of US$50 million and additional financing of US$554 million by the CDB and PFIs. Both the Bank and KfW loans were fully disbursed and the contributions by the CDB and the PFIs were US$2,986.8 million equivalent, far exceeding the amount projected at appraisal. Cumulative disbursement of the project reached US$3,131.8 million equivalent (as compared to US$699 million projected at appraisal) to approximately 175,908 borrowers (as compared to 119,600 projected at appraisal) by the end of the project. Some of the key indicators are listed below in Table 1.

<table>
<thead>
<tr>
<th>Key Indicators</th>
<th>Projected at appraisal at end of project</th>
<th>Actual at end of project</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of PFIs</td>
<td>18</td>
<td>12</td>
</tr>
<tr>
<td>Number of Loan Officers</td>
<td>894</td>
<td>1,079</td>
</tr>
<tr>
<td>Cumulative Number of Borrowers</td>
<td>119,600</td>
<td>175,908</td>
</tr>
<tr>
<td>Level of Non-Performing Loans</td>
<td>&lt;3%</td>
<td>&lt;0.7%</td>
</tr>
<tr>
<td>Average Sub-loan Size (RMB)</td>
<td>50,000</td>
<td>98,332</td>
</tr>
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</table>

2. A field visit to review the performance of six selected PFIs was undertaken in June 2011. Selected project indicators for these PFIs are shown in Table 2.

<table>
<thead>
<tr>
<th>Loan Officials</th>
<th>%</th>
<th>Branch</th>
<th>Cumulative Disbursement</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>%</td>
<td>Amount (Million)</td>
</tr>
<tr>
<td>Baoshang Bank</td>
<td>658</td>
<td>61.0</td>
<td>69,667</td>
</tr>
<tr>
<td>Taizhou Bank</td>
<td>256</td>
<td>23.7</td>
<td>82,409</td>
</tr>
<tr>
<td>Jiujiang Bank</td>
<td>59</td>
<td>5.5</td>
<td>8,697</td>
</tr>
<tr>
<td>Guiyang Bank</td>
<td>54</td>
<td>5.0</td>
<td>6,054</td>
</tr>
<tr>
<td>Maanshan RCB</td>
<td>13</td>
<td>1.2</td>
<td>3,964</td>
</tr>
<tr>
<td>Daqing Bank</td>
<td>39</td>
<td>3.6</td>
<td>5,117</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,079</strong></td>
<td><strong>100.0</strong></td>
<td><strong>175,908</strong></td>
</tr>
</tbody>
</table>
3. As mentioned in Section 2.3, by the time the Implementation Status and Results Report (ISR), Number 3 (06/23/2010) was due, the World Bank’s Financial and Private Sector Development (FPD) Network had requested a new set of indicators to be collected. This new set was expected to enhance the effectiveness of projects implemented. These changes are reflected in Table 3 below:

<table>
<thead>
<tr>
<th>Table 3: Additional Intermediate Outcome Indicators</th>
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</thead>
<tbody>
<tr>
<td>Indicator</td>
</tr>
<tr>
<td>Volume of Bank Support: Lines of Credit: Microfinance</td>
</tr>
<tr>
<td>Volume of Bank Support: Institutional Development Microfinance</td>
</tr>
<tr>
<td>Number of active loan accounts – Microfinance</td>
</tr>
<tr>
<td>Percentage of project-supported institutions (PFIs) that are reporting on these indicators</td>
</tr>
<tr>
<td>Outstanding Microfinance Loan Portfolio</td>
</tr>
</tbody>
</table>

4. The commercial viability of the six selected PFIs was demonstrated by the lending rates charged by the PFIs and the associated costs for providing the sub-loans. Table 4 shows that the average interest rate charged by the PFIs was around 14.6 percent, whereas the cost of providing the sub-loans was around 4.9 percent; a profit margin of about 9.7 percent existed, mainly due to the low cost of funds, low loan-loss provisions due to the quality of the portfolio and low staff costs.

<table>
<thead>
<tr>
<th>Table 4: The Lending Interest Rates and Cost Structure for Micro-loans Made by the 6 PFIs (Unit: Percentage of the Loan Portfolio)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Charged</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>BSB</td>
</tr>
<tr>
<td>BT</td>
</tr>
<tr>
<td>JB</td>
</tr>
<tr>
<td>GB</td>
</tr>
<tr>
<td>MRCB</td>
</tr>
<tr>
<td>DB</td>
</tr>
<tr>
<td>Mean</td>
</tr>
</tbody>
</table>

Source: Field visit report by Enjiang Cheng, June 2011.

5. **Component 2: Technical Assistance Facility:** The total cost was estimated at US$20 million. KfW provided a grant of US$3.78 million equivalent to defray the cost.

---

11 JB was unable to provide the data.
The rest of the TA was to be financed by a World Bank loan of US$5 million and additional funds of US$11.22 million to be provided by the CDB. The CDB was able to utilize the KfW grant and its own funds of US$9.4 million to cover the TA costs, and as mentioned in paragraph 37 of the main text, the Bank TA component of US$5 million was cancelled. The CDB engaged an international consulting firm (IPC) to provide TA to help build the necessary capacity in the PFIs. The IPC worked with the PFIs to develop and execute plans for absorbing and applying international best practices and credit technologies. The new MSE financing departments that were set up under the PFIs were the main focus for the TA. The TA, among other activities, included assisting the PFIs to recruit and train new loan officers, strengthen lending policies and procedures and putting in place accounting, risk management and management information systems, supporting sub-loan application preparation, screening and decision making, and supporting sub-loan monitoring and collection.

6. The TA also combined an IT-based sub-loan and portfolio management software with intensive training of loan officers. The training component of the credit technology package enabled the loan officers to: (i) assess creditworthiness and credit risks of MSE borrowers and to structure sub-loans most appropriate to their needs; (ii) build relationships with borrowers; and (iii) apply the credit management software for due diligence on a mass-market, low-cost basis while minimizing arrears and implement a robust monitoring system. In order for the PFIs to access the TA, the PFIs had to sign a Technical Cooperation Agreement with CDB.

**PFIs Performance**

7. Out of the 12 PFIs, Bank of Taizhou (BT) and Baoshang (BSB) were the two biggest, accounting for about 83 percent of total loans disbursed and including approximately 54 percent of the loan officers trained. Details of these two banks’ activities and that of the Maanshan Rural Commercial Bank (MRCB) are shown below.

**Bank of Taizhou (BT)**

8. Bank of Taizhou (formerly named Taizhou Commercial Bank). Since the signing of cooperation agreement with CDB in November 2005, the Bank of Taizhou (BT) granted 82,409 micro-loans, totaling RMB 8,147 million to 23,820 MSE borrowers. The average loan size was RMB 98,863. The NPL for micro-credit business was below 1 percent. BT has internalized the MSE lending technologies, models, and philosophy, as well as defining a non-performing loan (NPL) as a loan that is more than 30 days past due, in line with the experience of successful international micro-credit practices. By sticking to the principles of market-oriented and commercialized operations, BT has established an operational system as well as a unique credit culture that fits the characteristics of the target micro-credit groups in Taizhou. This has served as a solid foundation for the sustainable business development of its micro-credit business. Furthermore, the senior management highly valued the MSE lending technology and has made an effort to replicate the system across the bank. As such, MSE lending technology is considered the standard lending technology in BT. With 95 percent of MSE loans
granted to rural borrowers, MSE lending is more profitable than the traditional lending business, demonstrating that lending to MSEs can be profitable and sustainable.

9. BT has scaled up its operations by increasing its branches in its network from 19 in 2009 to 27 as of December 31, 2010. While BT is in the process of planning to commercially scale-up its micro-credit operation nationwide, it has experienced some setbacks due to temporary regulatory constraints on expansion outside the province. Over the last five years since the project started, BT trained 256 micro-credit loan officers. BT recently established a MSE training institute. New recruits are required to go through a six month training, three of which are formal training on the MSE lending technology, including credit risk thinking. A structured and systematic training approach is of great significance in BT. BT is equipped with 15 in-house specialized trainers, expected to increase to 30 by the end of 2011, and 93 part-time trainers.

**Baoshang Bank (BSB)**

10. Upon the approval of the China Banking Regulatory Commission (CBRC), Baotou Commercial Bank was renamed Baoshang Bank (BSB) in September 2007. BSB has been developing rapidly since its establishment with fast-growing business operations, and consecutive large increases in both its asset size and its operational profit. The NPL ratio was less than 1 percent.

11. On November 23, 2005, BSB signed the *Agreement on Micro Credit Project Cooperation* (the Project) with China Development Bank (CDB). Based on the experience of this cooperation in the project, BSB established an operational system and a unique credit culture that fit the characteristics of the target micro-credit groups of China, which were expected to serve as a solid foundation for the sustainable business development of the BSB micro-credit business.

   (i) **Staff training and team building:** BSB established credit officer selection and training mechanisms, with established standards, procedures and regulations jointly developed by experts of BSB and the project. In terms of team building, BSB trained a total 658 micro-credit officers.

   (ii) **Business structure and organization development:** At early stages of the project cooperation and with assistance and guidance provided by experts and the consultant, BSB started to build its micro-credit business team and marketing team in Baotao. BSB has increased its branch network from 22 in 2009 to 45 as of December 31, 2010.

   (iii) **Risk pricing and product design:** From the beginning of the project, BSB developed a standard micro-credit project, with 18 percent annual interest rate, monthly constant installation and maximum maturity of two (2) years. The introduction of this product, which was different from the commercial loans based on the Central Bank’s interest rates and using bullet repayment, caused a stir in the market and among banks. As proved through practice, BSB’s risk pricing and product design were highly operable and adaptable. The installment repayment
could also be flexible and adjusted to the client’s business cycle and accounting cycle.

(iv) Efficient approval procedure and risk management: Under the assistance and guidance provided by the project, BSB developed and improved its matrix management and differentiated delegation management. With regard to risk management, an independent risk management committee was established. Meanwhile, the full time micro-credit internal auditors of BSB conducted independent internal audits of all the lending teams of all branches.

(v) Performance evaluation, incentives and restraints: BSB experimented with improving the micro-credit performance evaluation mechanism and approaches. The current evaluation mechanism and code of conduct follow the principle of “people-focused, efficiency first, and encouragement first.”

(vi) Independent accounting and profitability analysis: With assistance and guidance from the experts, BSB started annual results-based management for business development, staff and organizational development, cost and expenses, and revenue and profit.

(vii) Technological research and development, and theoretical researches on micro-credit financial models, schools of philosophies, and advanced experiences and practices both in China and abroad. Pilots were conducted and publications on micro-credit published.

(viii) Drawdown capacities of micro-credit: Within the targeted clients as identified in the Project Agreement, BSB had provided microcredit to almost all sectors (merchandise and trade, processing, manufacturing, transportation, logistics, food and beverage, information, community service, culture and entertainment, leasing, planting and cultivating, etc). The monthly drawdown ceiling had increased from maximum 300 loans per month in 2006 to over 1,000 loans per month.

12. The project to a large extent improved internal operation efficiency, and helped to establish a more independent business management system. BSB managed to develop an independent and standardized line of products and systems, and to be in line with client demand and market situation. The project also promoted BSB’s own capacity, especially in areas such as selection and training of BSB’s own professionals, and capacity to train management staff with expertise.
13. The rural credit coops in Maanshan were amalgamated to form the Maanshan Rural Cooperative Bank in 2005 during the Rural Credit Cooperative (RCC) reform launched by the State Council in 2003. In July 2009 the name was changed to Maanshan Rural Commercial Bank (MRCB), together with its corporate image and governance.

14. By the end of 2010, the bank had disbursed 3,964 MSE loans (defined as loans in the range of RMB 3,000-300,000) totaling RMB 311 million in amount with NPLs at 1.13 percent. MRCB is the first and only PFI that has successfully replicated the MSE lending technology to rural lending. It had done so with several innovative adaptations including:

- To pave the way for rural lending at a time when the rural market was still unfamiliar with the MRCB product, the bank rated 2,375 rural households and the rating was entered in the bank’s credit administration system as well as demonstrated in front of the rural house to inspire the rural borrower to remain creditworthy.

- To mitigate the credit and operational risks, a credit officer was equipped with three electronic devices. One was a laptop with a proprietary program that enabled the credit officer to enter and analyze the borrower information efficiently and to present it to the credit committee electronically; another was a digital camera that could efficiently photo all the essential evidence, including the borrowers themselves, which became part of the loan files; and finally a fingerprint-collecting device that served to prevent fraudulent applications (it used to be a widespread practice in the rural credit market where loan applications were made with borrowed IDs, sometimes in collusion with the credit officer).

- To better manage credit risks and to raise efficiency, the bank developed an in-house agricultural and rural production information system which captured the characteristics of various agricultural and rural economic activities, products and sectors. The information enabled the credit officers to quickly make judgments about the market and sector risks associated with a loan application within a reasonable amount of time.

- To make optimal use of the scarce MSE credit officers but also to give play to the existing and traditional credit officers, MRCB centralized evaluation of rural loans by the specially-trained MSE credit officers at the branch level, leaving credit administration to the existing cohort of traditional credit officers. Productivity of the rural loans almost doubled that of the MSE loans because of this arrangement.

15. Since its participation in the MSE Finance Project as a PFI, MRCB has conducted 8 rounds of recruitments and enrolled 72 credit officers. Around 90 staff have received the MSE lending business training, and now 13 of them are working in the MSE division.
in two branches of the bank. The HR manager clearly indicated that the hiring and training philosophy and methodology had exerted a big impact on the bank’s HR and training practices in the non-MSE business areas.

16. The experiences of MRCB shed important light on what stands behind success. First, the top executives recognized the critical value of the advisory services provided under the MSE Finance Project. After the IPC consultants withdrew, the bank hired them back with its own funding to continue the consultancy services, including developing the Fast and Easy Small Loans product. All the top executives were required from the outset to participate in the MSE lending program, including recruitment and training of credit officers and credit committee meetings. As a result, the management team understood the workings of the MSE lending program, its philosophy, principles, practices and benefits, and has collectively become dedicated to mainstreaming it in the bank’s operations. The initial achievements brought the bank visible benefits, including recognition by the bank regulatory authority, which paved the way for the bank’s conversion to a rural commercial bank and local governments’ goodwill, including from the provincial RCC Union. Those favorable developments in turn served to solidify the bank’s commitment to continuing on the course of focusing on MSE and rural lending. The experience of the MRCB has once again proven that commitment from the top is essential for the success of a downscaling program in MSE lending.
Annex 3. Economic and Financial Analysis

*(including assumptions in the analysis)*

N/A
Annex 4. Bank Lending and Implementation Support/Supervision Processes

(a) Task Team members

<table>
<thead>
<tr>
<th>Names</th>
<th>Title</th>
<th>Unit</th>
<th>Responsibility/ Speciality</th>
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<tbody>
<tr>
<td>Lending</td>
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<td></td>
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<tr>
<td>Wang Jun</td>
<td>Senior Financial Sector Specialist</td>
<td>EASFP</td>
<td>Task Team Leader (TTL)</td>
</tr>
<tr>
<td>David Scott</td>
<td>Adviser</td>
<td>OPD</td>
<td>Adviser</td>
</tr>
<tr>
<td>Johannes Zutt</td>
<td>Country Program Coordinator</td>
<td>EACCQ</td>
<td>Country Program Coordinator</td>
</tr>
<tr>
<td>Carlos Escudero</td>
<td>Lead Counsel</td>
<td>LEGEA</td>
<td>Legal Counsel</td>
</tr>
<tr>
<td>Margaret Png</td>
<td>Senior Counsel</td>
<td>LEGEA</td>
<td>Legal Counsel</td>
</tr>
<tr>
<td>Arvind Gupta</td>
<td>Lead PSD Specialist</td>
<td>EASFP</td>
<td>Project Preparation</td>
</tr>
<tr>
<td>Shi Jinan</td>
<td>Senior Procurement Specialist</td>
<td>EAPCO</td>
<td>Procurement</td>
</tr>
<tr>
<td>Li Haixia</td>
<td>Financial Management Specialist</td>
<td>EAPFM</td>
<td>FM Assessment</td>
</tr>
<tr>
<td>Yao Songling</td>
<td>Environmental/ Social Specialist</td>
<td>EASSD</td>
<td>Project Preparation</td>
</tr>
<tr>
<td>Rochelle Hilton</td>
<td>Consultant</td>
<td>EASFP</td>
<td>Project Preparation</td>
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<tr>
<td>Liu Hui</td>
<td>Consultant</td>
<td>EASFP</td>
<td>Project Preparation</td>
</tr>
<tr>
<td>Sun Limei</td>
<td>Program Assistant</td>
<td>EACCF</td>
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Supervision/ICR

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<th>Speciality</th>
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<tbody>
<tr>
<td>Wang Jun</td>
<td>Lead Financial Sector Specialist</td>
<td>EASFP</td>
<td>TTL/Coordinator/TTL</td>
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<tr>
<td>Nancy Chen</td>
<td>Senior Financial Sector Specialist</td>
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<td>TTL</td>
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<tr>
<td>Hiran Herat</td>
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<td>Li Haixia</td>
<td>Financial Management Specialist</td>
<td>EAPFM</td>
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<tr>
<td>Aira Htenas</td>
<td>Economist</td>
<td>EASFP</td>
<td>ICR</td>
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<tr>
<td>Thang-Long Ton</td>
<td>Economist</td>
<td>EASFP</td>
<td>ICR</td>
</tr>
<tr>
<td>Michael Figueroa</td>
<td>Information Assistant</td>
<td>EASFP</td>
<td>Project Management Support</td>
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</tbody>
</table>

(b) Staff Time and Cost

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<th>Stage of Project Cycle</th>
<th>Staff Time and Cost (Bank Budget Only)</th>
</tr>
</thead>
<tbody>
<tr>
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<td>Lending</td>
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</tr>
<tr>
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<td>0.45</td>
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<td>Total:</td>
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Annex 5. Beneficiary Survey Results

N/A
Annex 6. Stakeholder Workshop Report and Results

(if any)

N/A
Annex 7. Summary of Borrower’s ICR and/or Comments on Draft ICR

1. In order to provide loans to micro and small enterprises (“MSEs”) on a mass-market and commercially-sustainable basis and strengthening the institutional and human resource capacity of Participating Financial Institutions (“PFIs”) through whom those loans were issued to MSEs, CDB launched China Development Bank Microfinance Project (CMFP) in China together with the World Bank from the end of 2004. The CMFP consists of two closely linked components: a Credit Facility for on-lending to eligible PFIs and a Technical Assistance Facility to support capacity building in PFIs.

2. Over the course of the CMFP, 12 city commercial banks received technical assistance supported by IPC (Internationale Projekt Consult GmbH), the project consultant. While the pilot banks, Baotou City Commercial Bank (BCB—now Baoshang Bank) and Taizhou City Commercial Bank (TCB—now Taizhou Bank), benefited from approximately one and a half years of daily on-location assistance from the end of 2005, subsequent partner financial institutions received 12 months or less of daily on-location assistance. Although this presented challenges to CDB in implementation and personnel allocation, and especially more preparation and intensive involvement were required from the PFI, the fundamental approach stayed the same in principle, as experience to date and the situation had shown that the approach is suitable for the Chinese environment. Through serious evaluation, 6 of those 12 PFIs had also received RMB 1,149 million in long-term on-lending credit from CDB.

3. The project has performed well in terms of the number of MSE borrowers and the loan officials trained. Over the five years, the PFIs have trained more loan officials (including back-office and MSE management staff) and provided MSE loans to more borrowers than those targets set at the project agreement. By the end of 2010, for the 6 PFIs only, who had gotten long-term on-lending credit from CDB, more than 1,000 loan officials were trained, in addition, 148 back office staff and 203 middle level managers were trained. Over 175,908 MSE loans were provided in over RMB 18 billion through 85 outlets.

4. These PFIs have also expressed interest not only in expanding basic micro-lending operations, but also in receiving support on broadening the product range and in developing the expertise for other areas, such as “small” and “agro” lending. All results achieved to date clearly indicate that there is a huge demand for MSE lending in China, that Chinese financial institutions have recognized the potential of MSE as a commercially viable business, are willing to embrace necessary change, and that the technology—implementing a cash-flow based lending technology through intensive capacity and institution building in commercial banks—works in China.

5. The quality of MSE loans disbursed by the PFIs has been consistently excellent. The percentage of the loans overdue for over 30 days has been lower than 0.7 per cent of the total loan portfolio, which is well below 3 per cent of the portfolio set at the PAD stage.

6. A number of bank leaders pointed out to the mission that what they have gained most from the project is a change in their understanding and approach to the overall lending operation, training and management of loan officials and middle level managers, which has been much more
important than introducing a lending methodology alone.

7. The project has also impacted the micro-finance industry in China. The micro-loan technologies and management introduced by the project have been transferred to more and more microfinance institutions in China through the work and words of PFIs and the consultants, many of whom have been trained through the project.

8. In addition to the city and rural commercial banks, many MCCs and VTBs have also received similar technical support in micro-loans closely related to the project. A number of project consultants have been employed by the banks as high-level or middle-level managers in charge of MSE lending operation, such as Taizhou Bank and Quanjing Commercial Bank. It is expected that more city and rural commercial banks and other MFIs will follow suit, following the deepening of financial reforms in China.

9. At the national level, the project indicates strongly that micro-loans to urban and semi rural micro-entrepreneurs and small enterprises in China can be provided in a commercially sustainable way. By evaluation and in comparison to other downscaling projects, the CMFP has not only achieved results as stated in the PAD, but also surpassed any other IPC downscaling project implemented to date within the same time frame. Apart from the immense potential MSE credit market in China, the success of the project can be attributed to a number of factors.

10. The project success should be attributed firstly to the timing of the project and market-oriented reforms in rural finance and microfinance undertaken by the Chinese prior to the introduction of the project. Since the middle and late 1990s, the government and bank regulators have initiated market-oriented reforms, such as commercialization of state-owned commercial banks and reforms of urban and rural credit cooperatives, partial interest rate liberalization and opening up of the market for competition, etc. These reforms made commercial microfinance possible in China. The major contribution from CDB/World Bank/KfW is that these project institutions had promoted and initiated the project at the right time, a time when commercial microfinance was made possible in China and a time when the Chinese Government was anxious to support the development of small and micro-enterprises in China. Next, the World Bank and CDB have selected mainly city commercial banks as the partner institutions, based on the judgement that it is more likely for these banks to support MSEs in China. Thirdly, selection of IPC as the project consultant has also contributed to the project success. Last but not least, the regulatory authorities in China, including CBRC and PBC, have been supportive of the PFIs’ MSE lending and willing to accept or tolerate some micro-lending practices by the PFIs which were not entirely consistent with the current lending regulations.
Annex 8. Comments of Cofinanciers and Other Partners/Stakeholders

N/A
Annex 9. List of Supporting Documents


2. Project Aides Memoire, ISRs, FMRs, and various other documents.

3. Financial Reports for Implementing Agencies and PFI's.

4. Financial Management Assessment and Procurement Assessment Reports.


