



FAST Report

Project Number: 51404-001
August 2018

Loan Facility MicroCred Nanchong Company Limited and MicroCred Sichuan Company Limited Financing Micro, Small, and Medium-Sized Enterprises in the Western Region (People's Republic of China)

This is an abbreviated version of the document approved by ADB's Board of Directors that excludes information that is subject to exceptions to disclosure set forth in ADB's Public Communications Policy 2011.

Asian Development Bank

CURRENCY EQUIVALENTS

(as of 10 June 2018)

Currency unit	–	yuan (CNY)
CNY1.00	=	\$0.1564
\$1.00	=	CNY6.3936
HK\$1.00	=	\$0.1274
\$1.00	=	HK\$7.8463

ABBREVIATIONS

ADB	–	Asian Development Bank
CEO	–	chief executive officer
CRO	–	chief risk officer
FAO	–	Finance Affairs Office
FOTIC	–	China Foreign Economy and Trade Trust Company Limited
GDP	–	gross domestic product
IFC	–	International Finance Corporation
MCL	–	MicroCred China Limited
NPL	–	nonperforming loan
MSMEs	–	micro, small, and medium-sized enterprises
PAR>30	–	30 days past due
PBOC	–	People's Bank of China
PRC	–	People's Republic of China
SMEs	–	small and medium-sized enterprises

NOTES

- (i) The fiscal year of MicroCred China Limited ends on 31 December.
- (ii) In this report, "\$" refers to United States dollars, unless otherwise stated.

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PROJECT AT A GLANCE

1. Basic Data		Project Number: 51404-001	
Project Name	Financing Micro, Small, and Medium-Sized Enterprises in the Western Region	Department /Division	PSOD/PSFI
Country	China, People's Republic of		
Borrowers	MicroCred Nanchong MicroCred Sichuan		
2. Sector	Subsector(s)	ADB Financing (\$ million)	
✓ Finance	Small and medium enterprise finance and leasing		20.00
		Total	20.00
3. Strategic Agenda	Subcomponents	Climate Change Information	
Inclusive economic growth (IEG)	Pillar 2: Access to economic opportunities, including jobs, made more inclusive	Climate Change impact on the Project	Low
4. Drivers of Change	Components	Gender Equity and Mainstreaming	
Private sector development (PSD)	Promotion of private sector investment	Effective gender mainstreaming (EGM)	✓
5. Poverty and SDG Targeting		Location Impact	
Geographic Targeting	No	Rural	Medium
Household Targeting	No	Urban	High
SDG Targeting	Yes		
SDG Goals	SDG1, SDG8		
6. Nonsovereign Operation Risk Rating			
Obligor Name		Obligor Risk Rating	Facility Risk Rating
MicroCred Sichuan			
MicroCred Nanchong			
7. Safeguard Categorization	Environment: FI-C	Involuntary Resettlement: FI-C	Indigenous Peoples: FI-C
8. Financing			
Modality and Sources		Amount (\$ million)	
ADB		20.00	
Nonsovereign LIBOR Based Loan (Regular Loan): Ordinary capital resources		3.00	
Nonsovereign LIBOR Based Loan (Regular Loan): Ordinary capital resources		17.00	
Cofinancing		0.00	
Others		0.00	
Others^a		0.00	
Total		20.00	

^a Derived by deducting ADB financing and Cofinancing from Total Project Cost.

I. INTRODUCTION

1. This is an eligible transaction under the Faster Approach to Small Nonsovereign Transactions framework.¹ The transaction involves a loan facility of up to \$20,000,000 (or its yuan equivalent) to MicroCred Nanchong Company Limited and MicroCred Sichuan Company Limited for Financing Micro, Small, and Medium-Sized Enterprises in the Western Region in the People's Republic of China (PRC).

2. The project entails the Asian Development Bank (ADB) providing longer-tenor financing to MicroCred Nanchong and MicroCred Sichuan to support the companies' lending operations to micro, small, and medium-sized enterprises (MSMEs) in the underdeveloped western region of the PRC. By improving access to finance, the project will support the expansion of small businesses and generation of additional employment opportunities, which will in turn contribute to poverty reduction.

II. THE FINANCIAL INTERMEDIARY

A. Investment Identification and Description

3. Despite rapid economic growth since 1980s, the PRC continues to face regional disparity and income inequality. Provinces with the lowest gross domestic product (GDP) per capita are in the central and western regions. In 2016, GDP per capita in the western province of Sichuan was only 33% of that in Beijing. MSMEs represent a vital part of the PRC economy and, given their important role in employment generation, their development directly contributes to inclusive economic growth.² Small businesses with up to 300 employees account for 98.6% of firms in the PRC,³ contribute more than 60.0% to national GDP and about 50.0% to the country's tax income, and generate more than 80.0% of urban employment.⁴ More jobs associated with the faster growth of MSMEs in the central and western regions could help reduce regional disparity. MSMEs are a major contributor to economic growth in underdeveloped regions, but they remain constrained by limited access to finance. By the end of 2017, credit to micro and small enterprises represented only 24.7% of total bank loans.⁵ Compared with similar enterprises in the east, small and medium-sized enterprises (SMEs) in the central and western regions have more restricted access to finance and face average borrowing costs that are more than 70 basis points higher.⁶

4. **Microcredit companies.** Microcredit companies play an important complementary role in financing MSMEs. In 2005, the People's Bank of China (PBOC) approved the establishment of microcredit companies to promote inclusive finance development. The microcredit market has grown rapidly, but it remains fragmented. By the end of 2017, the PRC had 8,551 microcredit companies with total registered capital of CNY827.03 billion and total outstanding loans of

¹ Asian Development Bank (ADB). 2015. *Faster Approach to Small Nonsovereign Transactions*. Manila.

² The official definition of MSME depends on the industry category and is based on staff size, annual revenue, and total assets.

³ Organisation for Economic Co-operation and Development. 2017. *Financing SMEs and Entrepreneurs 2017: An OECD Scoreboard*. Paris.

⁴ Ministry of Industry and Information Technology. 2015. *Made in China 2025: Promoting Development of SMEs*. Ministry of Industry and Information Technology. 31 May.
<http://www.miit.gov.cn/n973401/n1234620/n1234623/c3843771/content.html>.

⁵ China Banking Regulatory Commission. 2018. 2017 MSME Lending Reached Regulatory Target. *China Banking Regulatory Commission*. 2 February.
<http://www.cbrc.gov.cn/chinese/home/docView/ECFEC8EDD5404B5EB309B7045B81799C.html>.

⁶ People's Bank of China (PBOC). 2017. *2017 China Regional Finance Operation Report*. Beijing.

CNY979.95 billion.⁷ Microcredit companies in the PRC are defined as credit-only companies that cannot take deposits and are regulated by local Finance Affairs Offices (FAOs).⁸ Current regulation stipulates that major funding sources of a microcredit company are capital contributed by its shareholders plus donated capital and additional finance from no more than two banks. Furthermore, bank funding to microcredit companies is generally capped at 50% of the microcredit company's net capital, which constrains expansion. Some FAOs later issued local policies to permit higher leverage limits for microcredit companies under their regulation. Microcredit companies are also allowed to operate only within their province of registration. As a result, while the number of microcredit companies has increased rapidly since 2005, individual growth is a challenge. In addition, banks are reluctant to lend to many microcredit companies because governance, internal controls, and performance standards vary across companies. The banking regulator has a cautious attitude toward lending to microcredit companies as well, leading to microcredit companies' heavy dependence on shareholder funding.

5. ADB's nonsovereign operations target underserved customer segments and regions primarily through nonbank financial institutions. In its second private sector loan project supporting microfinance in the PRC, ADB provided \$50 million in debt to CFPA Microfinance Management.⁹ ADB identified MicroCred Nanchong and MicroCred Sichuan as strong partners in providing credit to MSMEs in the underdeveloped western region of the PRC. Both companies are fully owned subsidiaries of MicroCred China Limited (MCL) and are registered in Sichuan, one of the PRC's poorest provinces whose GDP per capita ranks 24th among all 31 provinces. MicroCred Nanchong was the first foreign microcredit company to enter the country and started its operations in Jialing, a district in the city of Nanchong in Sichuan that the central government has designated as a poverty-stricken district. MicroCred Sichuan was subsequently established in 2011. The two companies have built a long and successful record in providing unsecured microloans to MSMEs in Sichuan province. At an aggregate level, MCL has strong shareholders, sound corporate governance, an experienced management team, developed risk management systems, and satisfactory financial performance. MCL has experienced rapid growth since its establishment and has plans for further expansion. Longer-term ADB finance will provide critically needed funding to support its growth, which in turn will improve access to finance for MSMEs in the PRC, including female micro entrepreneurs in underdeveloped regions.

B. Business Overview and Strategy

6. Baobab, a microfinance holding company based in France and formerly known as MicroCred SA, established MCL in February 2007 in Hong Kong, China as a specialized MSME finance investment holding company focused on supporting the PRC. Operating through the two subsidiaries, MCL provides financial products and services to micro and small entrepreneurs excluded from the traditional financial system. MCL is the market leader among microcredit companies in Sichuan. Through MicroCred Nanchong and MicroCred Sichuan, MCL has disbursed 162,384 loans totaling more than CNY8.89 billion as of March 2018. The company has a strong presence in Sichuan, with a network of 28 branches and outlets under MicroCred Nanchong and 15 under MicroCred Sichuan,¹⁰ covering most cities and counties in the province.

⁷ PBOC. 2018. 2017 Statistics Report on Microcredit Companies. *People's Bank of China*. 25 January. <http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3470011/index.html>.

⁸ FAOs are local government divisions responsible for supporting the development of the local finance market, coordinating with the local finance supervisory body, and monitoring the stability of the local finance sector.

⁹ ADB. 2016. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to CFPA Microfinance Management for Microfinance in Poverty-Stricken Counties in the People's Republic of China*. Manila.

¹⁰ After obtaining a license to open a branch in a city, MicroCred Nanchong or MicroCred Sichuan can open more outlets without an additional license.

Its loan portfolio has grown rapidly over the years, registering a compound annual growth rate of 37% during 2010–2017. As of the end of March 2018, it had [CONFIDENTIAL INFORMATION DELETED] a loan portfolio of CNY1.18 billion. MCL plans to expand its operations to other cities in Sichuan and other western provinces of the PRC.

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C. Ownership, Management, and Governance

7. **Ownership.** Baobab has a majority stake in MCL. It also has a majority stake in MicroCred Africa, which operates in eight African countries. Baobab was established in 2005 to provide simple and affordable financial products to individuals and micro and small businesses underserved by traditional banks. Its main shareholders include the AXA Group, the European Investment Bank, Apis Partners, Maj Invest, and the Nordic Microfinance Initiative.¹¹ The second-largest MCL shareholder is the International Finance Corporation (IFC). IFC has been a shareholder since 2007. KfW and Developing World Markets, a private equity fund manager dedicated to socially positive investment, are the remaining shareholders. Integrity due diligence was conducted¹² and no significant or potentially significant risks were identified. Enhanced tax integrity due diligence was also conducted.¹³ The results of such analyses are set out in the disclosure document.¹⁴

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III. THE ADB ASSISTANCE

A. The Assistance

8. ADB will provide a senior secured term loan facility to MicroCred Nanchong and MicroCred Sichuan of up to \$20 million (or its yuan equivalent) with a tenor of up to 5 years. MicroCred Nanchong and MicroCred Sichuan will be coborrowers and be jointly and severally responsible for payment obligations under the loan facility. The loan facility will fund MicroCred Nanchong and MicroCred Sichuan lending operations to MSMEs in the underdeveloped western region of the PRC. The subloans are expected to primarily support the operation and expansion of small businesses in services, trade, and manufacturing, and help generate jobs in local communities.

B. Implementation Arrangements

9. **Legal documentation.** The loan facility will be governed by a loan facility agreement, which will contain terms customary for a loan facility of this nature and amount.

10. **Reporting arrangements.** ADB will monitor the project. MicroCred Nanchong and MicroCred Sichuan will provide ADB with financial and other reports at predetermined regular intervals and as requested. These reports will include (i) semiannual unaudited financial

¹¹ Ownership, Management, and Governance; and Integrity and Tax Due Diligence (accessible from the list of linked documents in Appendix 2).

¹² ADB. 2003. *Enhancing the Asian Development Bank's Role in Combating Money Laundering and the Financing of Terrorism*. Manila. Further information is provided in Ownership, Management, and Governance (accessible from the list of linked documents in Appendix 2).

¹³ ADB. 2016. *Anticorruption Policy: Enhancing the Role of the Asian Development Bank in Relation to Tax Integrity*. Manila.

¹⁴ Integrity and Tax Due Diligence (accessible from the list of linked documents in Appendix 2).

statements, (ii) annual audited financial statements, (iii) semiannual compliance certificates for financial covenants, (iv) semiannual reports on the subloan portfolio, and (v) annual reports on the selected development indicators and the safeguards and social dimensions' policy agreed by ADB and the borrowers.

11. ADB's Private Sector Operations Department will prepare and submit monitoring reports at least annually and will submit the first no later than 12 months after the first disbursement.

C. Value Added by ADB Assistance

12. **Provide long-term finance.** As local FAOs supervise microcredit companies, MicroCred Nanchong and MicroCred Sichuan do not have access to deposits and face difficulties in obtaining finance from commercial banks. **CONFIDENTIAL INFORMATION DELETED.**

13. **Support finance sector development.** Microcredit in the PRC is still in the early stage of development and there is vast unmet demand for microcredit from the underdeveloped central and western regions of the country. The loan facility will support the development of a leading microcredit company in a poor western province of the PRC, thus contributing to the development of this underdeveloped province.

14. **Support effective gender mainstreaming.** The project has gender-specific loan targets and is expected to benefit more than 10,000 female borrowers. The project team has prepared a gender action plan to support the *effective gender mainstreaming* classification of the project.¹⁵ This includes measures to improve women's financial planning and awareness of consumer protection issues, increase MCL's outreach to potential female borrowers, and enhance service quality to women through staff training.

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IV. DEVELOPMENT IMPACT AND STRATEGIC ALIGNMENT

A. Development Impact, Outcome, and Output

15. **Impact.** The project will contribute to improved access to finance by MSMEs in the underdeveloped western region of the PRC as outlined in government plans to promote inclusive finance.¹⁶ ADB's funding will enable MCL, through MicroCred Nanchong and MicroCred Sichuan, to scale up its business, reach underserved customer segments, and provide urgently needed funding to MSMEs to support employment generation and poverty alleviation in the underdeveloped regions. This will help boost income opportunities, reduce poverty in the target regions, and contribute to economic development.

16. **Outcome.** The project's outcome will be the enhanced sustainability of MCL's MSME finance operations in the underdeveloped western region of the PRC. This will help boost income opportunities and reduce poverty in the target regions.

17. **Output.** The output will be MCL's increased lending capacity to MSMEs. Lending to female borrowers will be increased and service quality to women will be improved as a result of staff training focusing on the special needs of female borrowers.

¹⁵ Gender Action Plan (accessible from the list of linked documents in Appendix 2).

¹⁶ Government of the PRC. 2015. *Plans on Promoting Inclusive Finance Development (2016–2020)*. Beijing.

B. Alignment with ADB Strategy and Operations

18. **Consistency with ADB strategy and country strategy.** The project supports two priorities of the Strategy 2030: (i) addressing remaining poverty and reducing inequalities, and (ii) accelerating progress in gender equality.¹⁷ The Strategy 2030 highlights ADB's supports for SMEs and inclusive businesses to help generate quality jobs and support inclusive growth for all. It is consistent with ADB's country partnership strategy, 2016–2020 for the PRC¹⁸ and ADB's country operations business plan, 2018–2020 for the PRC, which prioritize promoting inclusive economic growth, reducing poverty and inequality, developing SMEs, and promoting private sector development by improving access to finance.¹⁹ The project also aligns with ADB's Gender Equality and Women's Empowerment Operational Plan, 2013–2020.²⁰

19. **Consistency with sector strategy and relevant ADB operations.** The project aligns with the Review of 2011 Financial Sector Operational Plan, which noted that ADB will promote enhanced financial access for the traditionally underserved, particularly SMEs.²¹ ADB's Microfinance Development Strategy called for tapping the increasing potential of the poor by expanding access to microfinance.²² ADB's enhanced Poverty Reduction Strategy also stated that ADB seeks to promote sound and efficient financial markets to improve access to finance and achieve pro-poor growth.²³ As noted, the project builds on previous ADB support for microcredit in the PRC.

V. POLICY COMPLIANCE

A. Safeguards and Social Dimensions

20. **Category FI (treated as C).** ADB has categorized the investment in compliance with ADB's Safeguard Policy Statement (2009).²⁴ The business activities of MicroCred Nanchong and MicroCred Sichuan have minimal or no adverse environmental impacts and are unlikely to entail impacts on involuntary resettlement and indigenous peoples. The loan facility will fund the MSME finance operations of MicroCred Nanchong and MicroCred Sichuan in the underdeveloped western region of the PRC, but it will specifically exclude subloans that are classified *category A* or *B* for the environment, involuntary resettlement, and indigenous peoples. MicroCred Nanchong and MicroCred Sichuan aim to improve the living conditions of clients and their families and to contribute to the development of the local economy. MCL and its operating subsidiaries are also committed to implementing a fair human resources policy while respecting the environment they operate in. At the end of 2017, the average size of MCL's loans was CNY49,153 and 73% were business loans in trade and services. The size and nature of these loans present low environmental and no social safeguard risks. No land acquisition, physical or economic displacement, or impact on indigenous peoples' communities is foreseen in relation to any activities of the sub-borrowers.

¹⁷ ADB. 2018. *Strategy 2030: Achieving a Prosperous, Inclusive, Resilient and Sustainable Asia and the Pacific*. Manila.

¹⁸ ADB. 2016. *Country Partnership Strategy: Transforming Partnership: People's Republic of China and Asian Development Bank, 2016–2020*. Manila.

¹⁹ ADB. 2018. *Country Operations Business Plan: People's Republic of China, 2018–2020*. Manila.

²⁰ ADB. 2013. *Gender Equality and Women's Empowerment Operational Plan, 2013–2020: Moving the Agenda Forward in Asia and the Pacific*. Manila.

²¹ ADB. 2017. *Review of 2011 Financial Sector Operational Plan*. Manila.

²² ADB. 2000. *Finance for the Poor: Microfinance Development Strategy*. Manila.

²³ ADB. 2004. *Enhancing the Fight against Poverty in Asia and the Pacific: The Poverty Reduction Strategy of the Asian Development Bank*. Manila.

²⁴ ADB. Safeguard Categories. <https://www.adb.org/site/safeguards/safeguard-categories>.

21. MCL has its *Manual of Environmental and Social Classification of Loans*. The manual requires all loans to be screened against the IFC exclusion list and environmental and social criteria and to comply with national and international regulatory requirements. The manual does not prohibit funding projects classified *category A* or *B* under company criteria, but caps funding at 5% of the portfolio for *category A* projects and 40% for *category B* projects. The classification system appears conservative, with explicit criteria and default categories for different industries based on potential environmental and social risks. Through MicroCred Nanchong and MicroCred Sichuan, MCL will (i) apply ADB's prohibited investment activities list; (ii) exclude activities with *category A* and *B* environment and social safeguard impacts from the proposed ADB loan facility; (iii) ensure that investments using ADB funds comply with ADB's Safeguard Policy Statement (2009) and abide by applicable national laws and regulations, including labor laws, pursuant to ADB's Social Protection Strategy (2001); and (iv) take measures to comply with internationally recognized core labor standards. MicroCred Nanchong and MicroCred Sichuan will confirm this in their periodic report to ADB and need not apply any other specific safeguard or social requirements.²⁵

22. **Effective gender mainstreaming.** Following ADB's policy on Gender and Development (1998), MicroCred Nanchong and MicroCred Sichuan have incorporated measures to promote gender equality and/or women's empowerment in their business activities. The MCL Group estimates that the number of its female borrowers will reach 10,033 and its outstanding loan portfolio to female borrowers will reach CNY528 million by 2024. Measures to further empower and benefit female borrowers and staff have been identified and will be incorporated in the project design. MicroCred Nanchong and MicroCred Sichuan will submit periodic reports on implementation of gender measures to ADB.

B. Anticorruption Policy

23. MicroCred Sichuan, MicroCred Nanchong, and MCL were advised of ADB's policy of implementing best international practice relating to combating corruption, money laundering, and the financing of terrorism. ADB will ensure that the investment documentation includes appropriate provisions prohibiting corruption, money laundering, and the financing of terrorism; and remedies for ADB in the event of noncompliance.

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C. Assurances

24. Consistent with the Agreement Establishing the Asian Development Bank (the Charter),²⁶ ADB will proceed with the assistance upon establishing that the Government of the PRC has no objection to the assistance to MicroCred Nanchong and MicroCred Sichuan. ADB will enter into suitable finance documentation in form and substance satisfactory to ADB.

²⁵ Summary Poverty Reduction and Social Strategy; and Safeguards and Social Dimensions Summary (accessible from the list of linked documents in Appendix 2).

²⁶ ADB. 1966. *Agreement Establishing the Asian Development Bank*. Manila.

VI. THE PRESIDENT'S DECISION

25. The President, acting under the authority delegated by the Board, has approved the loan facility of up to \$20,000,000 (or its yuan equivalent) from the ordinary capital resources of the Asian Development Bank to MicroCred Nanchong Company Limited and MicroCred Sichuan Company Limited for Financing Micro, Small, and Medium-Sized Enterprises in the Western Region in the People's Republic of China, and hereby reports this action to the Board.

DESIGN AND MONITORING FRAMEWORK

Impact the Project is Aligned with Access to finance by MSMEs in the underdeveloped western region of the PRC improved (Plans on Promoting Inclusive Finance Development) ^a			
Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
Outcome Sustainability of MCL's MSME finance operations enhanced	CONFIDENTIAL INFORMATION DELETED	a–g. Audited annual financial statements; annual development effectiveness monitoring reports	MCL's expansion is hampered by the change of legal and regulatory framework. Prolonged slowdown of the economies in the PRC MCL's asset quality deteriorates.
Output MCL's lending capacity to MSMEs increased	CONFIDENTIAL INFORMATION DELETED	a–e. Audited annual financial statements; annual development effectiveness monitoring reports	Demand for microcredit is less than expected.
Key Activities with Milestones Output: MCL's lending capacity to MSMEs increased 1.1 President's approval obtained in Q3 2018. 1.2 Legal documentation signed by Q3 2018. 1.3 ADB loans fully disbursed by Q1 2019. 1.4 ADB funds fully deployed by MCL by Q2 2019.			
Inputs ADB: \$20 million (loan)			
Assumptions for Partner Financing Not applicable			

ADB = Asian Development Bank; MCL = MicroCred China Limited; MSMEs = micro, small, and medium-sized enterprises; NPL = nonperforming loan; PRC = People's Republic of China; Q = quarter.

^a Government of the PRC. 2015. *Plans on Promoting Inclusive Finance Development (2016–2020)*. Beijing.

^b Microenterprises include sole proprietorships and enterprises that fall under the Government of the PRC's definition of microenterprises (*China Briefing*. 2011. China Issues Classification Standards for SMEs. 7 July. <http://www.china-briefing.com/news/2011/07/07/china-issues-classification-standards-for-smes.html>). More specifically, these include individually owned businesses and enterprises with staff numbers or operating revenues below segment-specific limits, e.g., agriculture: operating revenue of less than CNY500,000 (\$178,000); trade: up to 5 employees or operating revenue of less than CNY10 million (\$1.6 million); restaurants: up to 10 employees or operating revenue of less than CNY1 million (\$156,000); and unspecified segments: up to 10 employees.

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/FastReport/?id=51404-001>

1. Contribution to the ADB Results Framework
2. Country Economic Indicators