ADB

# Extended Annual Review Report

Project Number: 34909
Reference Number EI 7166 - PAK
September 2014

# Equity Investment
# Pakistan Export Finance Guarantee Agency Limited (Pakistan)

In accordance with ADB's public communication policy (PCP, 2011), this extended annual review report excludes information referred to in paragraph 97 of the PCP.

Asian Development Bank

## CURRENCY EQUIVALENTS

Currency Unit – Pakistan rupee/s (PRe/PRs)

| | | At Appraisal | At Project Evaluation |
|---|---|---|---|
| | | 13 November 2000 | 30 June 2014 |
| PRe1.00 | = | $0.0179 | $0.0105 |
| $1.00 | = | PRs56.00 | PRs95.60 |

## ABBREVIATIONS

| | | |
|---|---|---|
| ADB | – | Asian Development Bank |
| ECA | – | export credit agency |
| EROIC | – | economic return on invested capital |
| L/C | – | Letter of Credit |
| NPSBP | – | New Private Scheduled Banks in Pakistan |
| OCR | – | ordinary capital resources |
| PEFGA | – | Pakistan Export Finance Guarantee Agency Limited |
| PRG | – | partial risk guarantee |
| PSOD | – | Private Sector Operations Department |
| ROIC | – | return on invested capital |
| TEPI | – | Trade Export Promotion and Industry Program |

## NOTE

In this report, “$” refers to US dollars.

| | |
|---|---|
| **Vice-President** | L. Venkatachalam, Private Sector and Cofinancing Operations |
| **Director General** | T. Freeland, Private Sector Operations Department |
| **OIC** | M. Barrow, Portfolio Management Division, PSOD |
| **Team leader** | C. Teo, Principal Investment Specialist, PSOD |
| **Team member** | A. K. Gaza, Investment Officer, PSOD |

## CONTENTS

**BASIC DATA**
**Pakistan Export Finance Guarantee Agency Limited (34909/7166–PAK)**

| Key Project Data | As per ADB Equity Documents ($ million) | Actual ($ million) |
|---|---|---|
| Total equity investment | 0.375 | 0.375 |

| Key Dates | Expected | Actual |
|---|---|---|
| Board approval | 2000 | 7 December 2000 |
| Facility agreement | 2001 | 26 February 2001 |
| Disbursement | 2001 | 27 March 2001 |

| Financial and Economic Return on Invested Capital | Appraisal (%) | XARR (%) |
|---|---|---|
| Financial return on invested capital | None indicated | Negative |
| Economic return on invested capital | None indicated | Negative |

| Project Administration and Monitoring | No. of Missions | No. of Person Days |
|---|---|---|
| Fact-finding | Several | (…) |
| Appraisal (including due diligence) | Several | (…) |
| Project administration and risk assessment | Several | (…) |
| | | (…) |
| Extended annual review | 0 | |

ADB = Asian Development Bank, RRP = report and recommendation of the President, XARR = extended annual review report.
(…) = data not available

## EXECUTIVE SUMMARY

On 7 December 2000, the Asian Development Bank (ADB) approved a $2 million equity investment equivalent to a 20% shareholding in Pakistan Export Finance Guarantee Agency Limited (PEFGA). Of the total approved amount, ADB disbursed $375,000.

PEFGA is a privately owned export credit guarantee company that provided credit guarantees to small and medium-sized enterprises (SMEs) in Pakistan. It was set up to address collateral problems of the SME sector that were hindering its growth.

ADB's investment in PEFGA was part of an assistance package in support of the Government of Pakistan's Trade, Export Promotion, and Industry (TEPI) program. The package had four components and was designed to support the development of new export markets and products and to increase the export contribution of SMEs. PEFGA's role in the package was to cover pre-shipment performance risks and issue bankable collateral to SMEs.

The initial plan was for PEFGA to break even within 3–4 years of operations, with an annual guarantee volume of $100 million or about 1% of Pakistan's exports. The target was for PEFGA's shares to list on the stock exchange within 5 years and for ADB to divest its shares after listing.

However, PEFGA was not able to meet its targets. It started commercial operations in 2001 and incurred losses annually. By mid-2004, it had accumulated losses of PRs20.6 million. In a bid to reverse PEFGA's situation and steer the company into profitability, ADB commissioned and funded a diagnostic study.

The study cited problems with PEFGA's business model and structure, product line, operating and marketing strategy, capitalization level and approach, shareholding structure, management, and staffing as reasons for PEFGA's failure. It recommended that PEFGA secure government support since most export credit agencies (ECAs) are either government owned or have significant government support, given their developmental role in a nation's economy.

Based on the study, PEFGA's board looked into the feasibility of converting PEFGA into a full-fledged export agency and approached the government for support and additional equity to recapitalize its operations. In July 2006, PEFGA's board met with the governor of the State Bank of Pakistan (SBP). It requested that PEFGA be formally converted into an ECA and for the government to contribute equity capital of $5 million to $20 million. The SBP was in favor of the idea but suggested that PEFGA approach the Ministry of Commerce and Ministry of Finance, as PEFGA was under their jurisdiction. Several meetings at ministerial level followed but produced no result.

In 2010, after several unsuccessful attempts to obtain government support, PEFGA's board decided that the best option was to liquidate the company. All employees were terminated and a liquidator was hired to oversee the liquidation process and to resolve or settle outstanding legal cases.

PEFGA is still in the process of liquidation and has not been operating for 3 years (2011–2013). ADB and the other shareholders continue to contribute to PEFGA's liquidation expenses. ADB contributed $7,972 in 2010 and $4,290 in 2013 as its share of PEFGA's liquidation costs.

In evaluating PEFGA, the criteria in ADB's *Guidelines for Preparing Performance Evaluation Reports on Nonsovereign Operations* (2014) and the related *Project Administration Instructions* (July 2008) were used. These criteria are development impact, ADB investment profitability, ADB's work quality, and ADB's additionality. However, because of PEFGA's situation, this report focuses on the lessons from the investment rather than development impacts.

The project's development impact is rated *unsatisfactory.* Insufficient data exist to assess the project's development impact properly, as PEFGA has been under liquidation for 4 years (2010–2013) and the management and staff who could have given a view on this issue had left the company.

Business success, contribution to economic development, and investment profitability are all rated *unsatisfactory.* PEFGA was a financial failure and made no measurable contribution to economic development. ADB did not receive any return on investment, and continues to contribute to liquidation costs.

PEFGA's compliance with environmental, social, health, and safety issues was rated *satisfactory*. The report and recommendation of the President (RRP) classified the whole assistance package, of which PEFGA was a part of, as category B. However, it gave no specific indicators and did not prescribe any mitigating measures for the investment to follow. The RRP indicated that the Government of Pakistan would address the relevant environmental, social, health, and safety issues of the project.

ADB's work quality is assessed *partly satisfactory*, with component ratings of *unsatisfactory* for screening, appraisal, and structuring; *satisfactory* for monitoring and supervision; and *partly satisfactory* for role and contribution.

ADB's additionality is rated *satisfactory*. ADB was instrumental in organizing PEFGA. It was also PEFGA's largest shareholder and contributed in helping set the direction of the company.

Overall, the project is assessed *unsuccessful.*

The lessons learned from this project are (i) to be realistic in the assessment of the sector ADB is entering, and to put an appropriate and sustainable business model in place; (ii) to select the right product to enter the market; and (iii) to partner with a strong sponsor shareholder who has a direct, urgent, and commercial interest in, and the ability to ensure, a project's success.

Although PEFGA failed, by investing in and helping initiate Pakistan's first quasi-ECA, ADB was able to demonstrate the benefits of having an ECA. In future, lessons learned from this project may help the Government of Pakistan set up and operate a better ECA.

Going forward, ADB will continue to monitor PEFGA to ensure its proper liquidation.

# I. THE PROJECT

## A. Background

1. On 7 December 2000, the Asian Development Bank (ADB) approved a $2 million equity investment equivalent to a 20% shareholding in Pakistan Export Finance Guarantee Agency Limited (PEFGA).[1]

2. ADB's investment in PEFGA was part of an assistance package in support of the Government of Pakistan's Trade, Export Promotion, and Industry (TEPI) program. The package consisted of (i) a new US dollar-based export financing facility, the Foreign Currency Export Finance Facility; (ii) a partial risk guarantee (PRG) for letter of credit (L/C) confirmation of imports, required for export production; (iii) an equity investment in PEFGA; and (iv) technical assistance for institutional strengthening of the Export Promotion Bureau.

3. The assistance package was designed to contribute to higher growth, employment, and an increase in exports by supporting the development of new export markets, products, and increasing the export contribution of small and medium-sized enterprises (SMEs).

## B. Key Features

4. The report and recommendation of the President (RRP) envisioned PEFGA functioning as an export credit guarantee company—providing credit guarantees to exporting SMEs in Pakistan. It prescribed several key features.

5. PEFGA was expected to issue export trade finance guarantee certificates that would substitute traditional repayment collateral or other forms of borrowers' pledge. Such collateral or pledges are typically required by financial institutions in Pakistan as a condition for providing pre-shipment export trade credit to an exporter. PEFGA was to guarantee up to 80% of an exporter's performance risk, leaving 20% with the exporter's bank. After establishing its initial product in the market, PEFGA planned to act as an agent for post-shipment export credit insurance as well as offering PRGs and other export related services. PEFGA was expected to seek strategic alliances with international credit insurance providers and export credit agencies. It was envisioned to play a critical role in linking the pre- and post-shipment stages of the export financing cycle, and to help administer credit enhancement facilities under the TEPI, particularly the PRG.[2]

6. PEFGA was to be established as an unlisted public limited company under the Pakistani Companies Ordinance, 1984. It was intended to be a self-sustaining, independently managed entity with initial equity capitalization from the Pakistan banking sector.

7. PEFGA's subscribed equity was planned to be $10 million equivalent in Pakistani rupees. The initial paid-in capital was set at $2 million equivalent. The timing of subsequent closings to

[1] ADB. 2000. *Report and Recommendation of the President to the Board of Directors: Proposed Loan, Partial Risk Guarantee, Equity Investment, and Technical Assistance Grant for the Small- and Medium-Size Enterprise Trade Enhancement Finance Project in the Islamic Republic of Pakistan*. Manila.

[2] ADB's support package for Pakistan's TEPI program included a PRG to cover eligible L/Cs to facilitate imports by Pakistan exporters. Under the PRG, ADB had planned to guarantee the payment to international confirming banks by Pakistan issuing banks, the face value of an eligible import L/C, if such payment is not made as a result of a guaranteed risk, including restriction on foreign exchange convertibility and transferability. The RRP intended for the PRG and PEFGA, along with other components of the support package for TEPI, to work synergistically. Thus, PEFGA was also intended to act as an agent for the PRG to be issued by ADB.

achieve the full capitalization of $10 million was to depend on the volume of demand for PEFGA's products and the decision of its board of directors. The full investment was expected to be paid up within 3 years from the start of operations.

8. ADB planned to subscribe for 20% of the issued and paid-up capital of PEFGA for an investment equivalent of up to $2 million. ADB's initial subscription will be for a $400,000 equivalent.

9. The New Private Scheduled Banks in Pakistan (NPSBP)[3] were envisioned to be PEFGA's core investors and act as the sponsor group and hold up to 50% of PEFGA's equity. Two nationalized commercial banks, Habib Bank and National Bank of Pakistan planned to hold another 20% of the equity.[4]

10. Although ADB planned to initially be the single largest shareholder, it did not intend to be in a controlling position or act as the controlling or sponsor shareholder. It was NPSBP that was supposed to act as the cohesive sponsor group and take the lead in managing PEFGA. ADB was to be represented on the PEFGA board to monitor its investment, and to ensure that PEFGA operated in accordance with the policies promoted under the TEPI program.

11. PEFGA was expected to reach an annual guarantee volume of $100 million, or about 1% of Pakistan's exports, in 3–4 years. It was expected to have 25 staff handling 2,000 transactions per year, and to break even after 3–4 years of operation. In its fifth year, PEFGA was expected to list on the stock exchange, and ADB was to divest its PEFGA shares.

12. To achieve the $100 million annual guarantee volume target, PEFGA's sponsor banks or the NPSBP was to use their ties with the domestic industrial sector (particularly small to midsized companies) to promote PEFGA's product. The sponsor banks were also expected to promote PEFGA within their own organizations and to market PEFGA via fliers and brochures in their branches.

13. PEFGA's product was not expected to compete with the existing products of its sponsor banks. Its guarantee product was intend to focus on new or smaller exporters, and was expected to complement the sponsor banks' existing relationships with SME clients or to develop relationships with new SME clients.

### C. Progress Highlights

14. PEFGA started commercial operations in 2001. It established a branch in Karachi and offered its initial product, a pre-shipment, low-collateral guarantee facility to SME exporters.

15. However, after almost 4 years of operations, PEFGA was still only offering its initial pre-shipment product and had failed to expand its product line. It was also still operating out of its Karachi office and was not able to establish branches in other cities.

16. From 2001 to 2004, PEFGA issued 259 guarantees worth PRs515 million in guarantee value in support of export contracts valued at PRs1.5 billion. This level of operations was well below expectations, as its target was to reach the $100 million annual guarantee volume by its

[3] The RRP listed these as Askari Commercial Bank, Bank Alfalah, Bank Al Habib, Gulf Commercial Bank, Metropolitan Bank, Platinum Commercial Bank, Prime Commercial Bank, Prudential Commercial Bank, Soneri Bank, and Union Bank.

[4] The RRP did not specify the intended shareholder for the remaining 10% equity.

3rd or 4th year of operations or from 2003 to 2004. PEFGA did not show any profit from 2001 to 2003, and cumulative losses by June 2004 had amounted to PRs20.6 million.

17. In June 2004, in an effort to reverse PEFGA's situation and steer the company to profitability, ADB commissioned and funded Venture Capital Partners (VCP) to do a diagnostic study (operational review, turnaround strategy, and action plan) to restructure PEFGA.

18. The study cited problems with the following factors as reasons for PEFGA's failure: (i) business model and structure, (ii) product line, (iii) operating and marketing strategy, (iv) capitalization level and approach, (v) shareholding structure, and (vi) management and staffing. It also pointed out the lack of significant government support and involvement, which is unusual in an export credit agency (ECA), considering the developmental role of ECAs in a country's economy.

19. In June 2005, PEFGA's board hired a consultant to analyze the feasibility of converting PEFGA into a full-fledged export agency. The consultant concurred with the first study, and recommended that PEFGA obtain government support and additional equity to recapitalize its operations.

20. In July 2006, PEFGA's board met with the governor of the State Bank of Pakistan (SBP). The board requested that PEFGA be formally converted into an ECA and for the government to contribute equity capital of $5 million to $20 million. The SBP was in favor of the idea but advised PEFGA to approach the Ministry of Commerce and Ministry of Finance, as PEFGA was under their jurisdiction. Several meetings at the ministerial level followed, but produced no result.

21. In 2010, after years of waiting for government support, PEFGA's board of directors decided the best option was to liquidate the company. All employees were terminated and PEFGA's board hired a liquidator to oversee the liquidation process and to resolve or settle outstanding legal cases.

22. PEFGA is still in the process of liquidation, which is expected to continue until the end of 2014 or later.

# II. EVALUATION

23. The project was evaluated using criteria defined in ADB's *Guidelines for Preparing Project Performance Evaluation Reports on Nonsovereign Operations*. [5]

## A. Project Rationale and Objectives

24. ADB's investment in PEFGA was made in support of the TEPI program. The goal of the TEPI program was to improve Pakistan's export financing system, develop value-added products, and penetrate new markets for Pakistani exporters. When TEPI was established, Pakistan had a very low share of international trade and the government wanted to increase Pakistan's exports to enlarge and stabilize the economy. The TEPI program was part of Pakistan's overall plan to reduce poverty by improving the performance of its export sector and increasing the role of SMEs in its export sector—thus increasing its per capita growth rate to about 5% annually on an equitable and sustainable basis.

[5] ADB. 2014. *Guidelines for the Preparation of Project Performance Evaluation Reports on Nonsovereign Operations*. Manila.

25. The program focused on SMEs as they tend to dominate labor-intensive sectors and their growth was seen as a major source of employment. By developing SMEs, it was hoped that Pakistan would increase its export market share and reduce unemployment.

26. However, most SMEs operate with insufficient capital, small profit margins, high financing costs, and heavy collateral requirements. This operating environment does not allow or encourage SMEs to upgrade their products to international export standards. In addition, many SMEs are not familiar with trade finance instruments and their benefits. The components of the TEPI program intended to provide SMEs a level playing field to enable them to compete effectively in local and international markets.

27. PEFGA's role in TEPI was to cover pre-shipment performance risks and issue bankable collateral to SME exporters.

## B. Development Results

28. The overall development result is rated *unsatisfactory* based on component ratings of *unsatisfactory* for private sector development; *unsatisfactory* for business success; *unsatisfactory* for contribution to economic development; and *satisfactory* for environmental, social, health, and safety performance.

### 1. Private Sector Development

29. Private sector development is assessed *unsatisfactory* after evaluating the project's direct company impacts and beyond company impacts. Appendix 1 contains the ratings for each type of private sector development indicator.

#### a. Direct Company Impacts

30. There is insufficient data to assess the direct company impacts, as PEFGA had been in liquidation since 2010 and management and staff had been terminated. However, records show that from 2001 to 2004, PEFGA guaranteed PRs515 million in support of export contracts worth PRs1.5 billion[6].

#### b. Beyond Company Impact

31. The project's contribution to an expanded SME sector, the growth of SME lending, and the SME sector's contribution to gross domestic product and total exports indicate its beyond company impact.

32. As PEFGA is in liquidation, no data support any assertion on beyond company impact. No resource persons were available to provide this information, as management and staff were terminated in 2010 and PEFGA's liquidator does not have this kind of information.

### 2. Business Success

33. A project's business success is usually measured by comparing its return on invested capital (ROIC) with its weighted average cost of capital (WACC).

[6] Data were incomplete for the years 2005 to 2010.

34. PEFGA did not show any profit from inception to when it entered into liquidation. This makes it impossible to compute ROIC. Net losses that eroded PEFGA's equity could not offset its debt and equity capital investments to arrive at a ROIC figure. Appendix 2 contains the key financial data of PEFGA from 2001 to 2012.

35. Business success is rated *unsatisfactory*.

### 3. Economic Sustainability

36. Economic sustainability may be measured by using real economic return on invested capital (EROIC) as a proxy for the economic internal rate of return.

37. In computing the EROIC, the ROIC computation is adjusted for taxes paid. However, as ROIC could not be calculated, EROIC cannot be calculated either.

38. Thus, the project's contribution to economic sustainability is rated *unsatisfactory*.

### 4. Environmental, Social, Health, and Safety Performance

39. The RRP classified the assistance package of which PEFGA was a part of, as category B. It stated that the project would have no direct environmental impact, so no mitigating measures were required.

40. The main concern of the RRP related to the social aspects of the project, particularly labor laws, as Pakistan was known for not adhering to internationally recognized labor standards, especially for child labor and female workers. The RRP indicated that the government was taking measures to address these issues, so no specific indicators or mitigating measures were prescribed for the PEFGA investment.

41. Considering the business nature of this project, i.e., that of a financial intermediary, and the RRP's classification and lack of specific mitigating measures, the project's compliance with environmental, social, health, and safety issues was rated *satisfactory*.

## C. ADB Investment Profitability

42. ADB invested $375,000 for its 20% equity in PEFGA. ADB did not receive any dividends from this equity investment. ADB made additional disbursements to fund the hiring of a consultant in 2004, putting the company in liquidation and terminating employees in 2010, and covering expenses of the ongoing liquidation (together with other shareholders) in 2013. Table 1 details these disbursements. ADB's investment profitability is rated *unsatisfactory*.

**Table 1: Summary of Disbursements** ($)

| Description | Date | Amount |
|---|---|---|
| Purchase of 1,668,013 shares in PEFGA | 27 March 2001 | 275,000.00 |
| Purchase of 577,200 shares in PEFGA | 18 August 2003 | 100,000.00 |
| **Total Shares (2,245,213)** | | **375,000.00** |
| ADB share of the consultant's fee for the 2004 study of PEFGA | 16 October 2008 | 13,977.20 |
| ADB share of the initial liquidation expenses of PEFGA | 9 May 2009 | 7,972.20 |
| ADB share of the liquidation expenses of PEFGA | 12 December 13 | 4,790.16 |
| **Subtotal** | | **26,739.56** |
| **Total Cash Outflows** | | **401,739.56** |

ADB = Asian Development Bank, PEFGA = Pakistan Export Finance Guarantee Agency Limited.
Source: Asian Development Bank

## D. ADB Work Quality

43. ADB work quality is rated *partly satisfactory* based on (i) screening, appraisal, and structuring of the project; (ii) monitoring and supervision; and (iii) role and contribution.

### 1. Screening, Appraisal, and Structuring

44. In designing and structuring PEFGA, ADB held discussions with local banks and exporters. In May 2000, ADB met with several banks and exporters to discuss the possibility of establishing PEFGA and received favorable feedback.

45. In September 2000, ADB hired a consultant (VCP) to assess the feasibility of ADB's intended equity participation in PEFGA. VCP was asked to make a field visit to Pakistan, discuss the PEFGA concept with local banks, and submit an assessment report.

46. In its report dated 31 October 2000, VCP pointed out two key areas of concern: (i) the lack of direct government involvement or support; and (ii) the high-risk nature of PEFGA's planned initial product, a pre-shipment product.

47. VCP noted that ECAs are usually government owned or have a significant degree of government participation.

48. VCP also mentioned that ECAs usually build their business around credit insurance, a low-risk post-shipment product, while PEFGA intended to offer a high-risk pre-shipment product that is usually an add-on business for most ECAs.

49. ADB considered that the issues VCP cited could be dealt with in the structuring of the project. Specifically by having the NPSBP as the core sponsor group and by appointing a representative to PEFGA's board of directors.

50. ADB appointed M. Roodman as its first representative to the board of PEFGA. According to file documents, M. Roodman had the necessary expertise and relevant background to help lead PEFGA. He had worked for more than 15 years in trade finance in North America, the Middle East, and Pakistan; and had developed and successfully launched a precursor ECA in Jordan. He was also the lead consultant for TEPI, and had good relationships with and was respected by the other Pakistani banks that would participate in PEFGA.

51. Nonetheless, the screening, appraisal, and structuring of this project underestimated the importance of significant government support or direct government ownership. This failure to obtain government support, coupled with the decision to have PEFGA initially offer a high-risk product, may have contributed to PEFGA's eventual failure. Thus, the screening, appraisal, and structuring of this project are rated *unsatisfactory*.

### 2. Monitoring and Supervision

52. From inception, ADB was involved in the design and implementation of PEFGA and had a representative on PEFGA's board of directors.

53. ADB's representative on PEFGA's board went on missions to Pakistan for board meetings. Back-to-office reports and memos were submitted on the condition of the investment.

54. ADB's board representative is still deeply involved in PEFGA's liquidation process.

55. Monitoring and supervision is thus rated *satisfactory*.

### 3. ADB Role and Contribution

56. Although PEFGA did not succeed, it showed the need for an ECA to assist Pakistan's SME exporters.

57. The consultant that ADB hired in 2004 (VCP) cited anecdotal evidence from PEFGA's SME clients that PEFGA's guarantees were instrumental in the success of their business and were of great help, especially to those that did not qualify for regular bank guarantees. The participating banks interviewed by the consultant were also supportive of PEFGA, as PEFGA served a market segment the banks did not.

58. PEFGA's establishment opened up the possibility for the government to set up another ECA in the future and to incorporate lessons learned from the PEFGA experience.

59. Although a failure, PEFGA provided a good demonstration effect, so ADB's role and contribution are rated *partly satisfactory.*

### 4. Overall ADB Work Quality

60. The screening, appraisal, and structuring of this project are rated *unsatisfactory*; monitoring and supervision are rated *satisfactory*; and ADB's role and contribution are rated *partly satisfactory.* Overall work quality is rated *partly satisfactory.*

## E. ADB's Additionality

61. The evaluation of ADB's additionality is based on (i) whether ADB finance was a necessary condition for the timely realization of the project, either directly or indirectly, by providing sufficient comfort to attract private financiers; and (ii) whether ADB's contribution to the project's design and function improved the development impact.

62. ADB's participation was instrumental in initiating the project concept, organizing the shareholders, mobilizing government support during the concept phase, and putting in the necessary system such as corporate governance, human resources, and internal controls.

63. ADB additionality is thus rated *satisfactory.*

## F. Overall Evaluation

64. Overall, the project is rated *unsuccessful*. Table 2 provides a summary of the individual category ratings.

**Table 2: Summary Evaluation of the Project**

| Indicator | Unsatisfactory | Partly Satisfactory | Satisfactory | Excellent |
|---|---|---|---|---|
| **Development Impact** | √ | | | |
| Private Sector Development | √ | | | |
| Business Success | √ | | | |
| Economic Sustainability | √ | | | |
| Environmental, Social, Health, and Safety Performance | | | √ | |
| **ADB Investment Profitability** | √ | | | |
| **ADB Work Quality** | | √ | | |
| **ADB Additionality** | | | √ | |
| | **Unsuccessful** | **Partly Successful** | **Successful** | **Highly Successful** |
| **Overall Rating** | √ | | | |

ADB = Asian Development Bank.
Source: Asian Development Bank

## III. ISSUES, LESSONS, AND RECOMMENDED FOLLOW-UP ACTIONS

### A. Issues and Lessons

65. **Select the appropriate business model and structure**. During conceptualization, the consultant appointed by ADB pointed out that PEFGA's structure as a privately owned entity—without significant or direct government involvement—was unusual for an ECA. At that time, ADB considered that this could be mitigated by having the NPSBP act as the core sponsor and by appointing a capable and experienced board representative. In 2004, after 3 years of unprofitable operations, the consultant highlighted the same problem. The consultant stated that PEFGA's structure as a privately owned entity, with no government involvement or support, was not aligned with its developmental role or function. ECAs worldwide are government agencies or have government sponsorship through full ownership or a substantial equity holding. They serve the national interest by developing export capability, thereby expanding national income. The key lesson here is to obtain government involvement or commitment for pioneering projects, especially in a country with an undeveloped export sector and particularly for an ECA catering to SMEs, which is a high-risk segment.

66. **Select the right product to offer**. After 3.5 years of operation, PEFGA was still offering one product—a pre-shipment, high-risk, loss-making product that is usually an add-on business for most ECAs.[7] By offering this high-risk product without government support, PEFGA experienced high default rates and bad loan losses that eroded its equity. The key lesson here is to select the correct product as an initial offering. For a pioneering project, PEFGA may have succeeded even without government support had it offered a more profitable product.

67. **Have a strong sponsor shareholder.** The consultant pointed out that PEFGA lacked a sponsor shareholder with a direct, urgent, and commercial interest in, and the ability to ensure, PEFGA's success. This resulted in ADB, its largest shareholder, being the de facto lead, which is not a role ADB can fulfill given its nature and mandate.

[7] PEFGA's sole product—a pre-shipment low-collateral export guarantee facility—is a loss making product as its risks and costs are too high to be covered by fees acceptable to its intended market, i.e., SMEs. Its primary function is to help SMEs enter the export market and raise their competitiveness to an international level. ECAs in other countries offset losses from this product with funding support from government or by offering more profitable products such as longer period guarantees and post-shipment discounting facilities.

68. **Formulate the right capitalization level and approach**. PEFGA adopted a gradual capitalization approach.[8] This was a mistake as it prevented the company from building up its business and diversifying its product line. PEFGA originally planned to offer other types of products, but did not have adequate resources to do so. PEFGA's capitalization plan failed to anticipate the timing and amount of capital injection to support its projected business volumes. Hence, inadequate capitalization prevented PEFGA from meeting its targeted revenue volume of $100 million within the first 3 years of operation.

69. **Implement an independent operating and marketing strategy.** A major part of PEFGA's business plan was to rely on its shareholder banks to help market its products to the banks' clients. However, this was not practicable as the banks were unable to inform and train their staff to promote PEFGA's products. In addition, having its office and sole branch in Karachi limited PEFGA's market reach. The 2004 study recommended that PEFGA set up a branch in two other cities (Lahore and Gujranwala export hub) to widen its market reach.

70. **Maintain good staffing**. PEFGA also suffered from an exodus of staff. It was unfortunate that during the time that PEFGA's momentum slowed, the most senior staff left the company. An anchor shareholder that is actively involved in the running of PEFGA would have provided the necessary stability to maintain an effective management and operations team.

## B. Recommended Follow-up Actions

71. PEFGA has been in liquidation since 2010. The liquidator provides updates to ADB and the other shareholders. Going forward, ADB should continue monitoring the actions of the liquidator and liaising with its co-shareholders who are based in Pakistan.

[8] ADB's disbursement was contingent on the equity injection of the other shareholders. As the other shareholders did not put in additional equity, ADB was only able to disburse $375,000 out of its planned $2 million contribution.

## PRIVATE SECTOR DEVELOPMENT INDICATORS AND RATINGS: FINANCIAL INTERMEDIARIES

| Indicators | Ratings[a] | Justifications |
|---|---|---|
| **1. Beyond Intermediary and Subborrower Impacts** | | |
| **1.1 Private sector expansion and institutional impact**<br><br>1.1.1. Contributes to an increased private sector share and role in the economy, and to sustainable jobs<br><br>1.1.2. Contributes to expanded SME lending<br><br>1.1.3. Contributes to institutional change by improving supply and access generally to formal credit and banking service to SMEs<br><br>1.1.4 Contributes to the growth of viable financial institutions and financial market development | <br><br><br>Unsatisfactory<br><br><br>Unsatisfactory<br><br>Unsatisfactory<br><br><br><br>Unsatisfactory | |
| **1.2. Competition**<br>Contributes to new competition for SME businesses among local banks (including new product and service offerings, local currency products) | Unsatisfactory | |
| **1.3. Innovation**<br>Contributes to new ways of offering effective banking services to SMEs (including new products, services, and technologies) in ways that are replicated by other banks and in the financial system | Unsatisfactory | |
| **1.4. Linkages**<br>Contributes to local savings and deposits mobilization via a network of branches and contribution to notable upstream or downstream link effects to sub-borrower businesses in their industries or the economy | Not Applicable | |
| **1.5. Catalytic element**<br>Contributes to mobilization of other local or international financing to SMEs, and to positive demonstration to market providers of debt and risk capital to SMEs | Unsatisfactory | |
| **1.6. Affected laws, frameworks, and regulation**<br>Contributes to improved laws, regulation, and inspection affecting formal SME banks and banking services to SMEs in the local financial system | Unsatisfactory | No data to show that PEFGA contributed to better laws and regulations for the SME sector. |

| | | |
|---|---|---|
| **1.7. Wider demonstration of new standards**<br>Contributes to higher standards in corporate governance, transparency, and stakeholder relations | Unsatisfactory | |
| **2. Direct Participant Bank and Subborrower Impacts with Wider Potential** | | |
| **2.1. Skills with wider impact potential**<br><br>Contributes to an improved SME credit approach at all stages in the participant bank(s) in ways that can be replicated by other providers of SME finance and banking service<br><br>Contributes via the participating bank(s) to improved subborrower skills in operation of their businesses, e.g., via good appraisal, and monitoring by the bank(s) | Unsatisfactory | |
| **2.2. Demonstration and new standards-setting potential**<br><br>Demonstrates potential through improved and achieved standards in corporate governance and transparency, stakeholder relations, and environmental, social, health, and safety spheres | Unsatisfactory | |
| | | |
| **Overall PSD Rating** | **Unsatisfactory** | |

PEFGA = Pakistan Export Finance Guarantee Agency Limited, SMEs = small and medium-sized enterprises.

[a] Ratings scale: Excellent, satisfactory, less than satisfactory, and unsatisfactory. The rating is not an arithmetic mean of the individual indicator ratings, which have no fixed weights. It considers already manifest actual impact (positive or negative) and the potential impact and risk to its realization.

Source: Asian Development Bank Evaluation Guidelines

## KEY FINANCIAL FIGURES OF PAKISTAN EXPORT FINANCE GUARANTEE AGENCY LIMITED

('000)

| Year | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Exchange rate of $1.0 to PRs at the end of each year** | 61 | 58 | 56 | 57 | 59 | 60 | 61 | 70 | 81 | 84 | 86 | 93 |
| **Key P&L Figures** | | | | | | | | | | | | |
| **Gross Revenues (Premiums + processing fees on guarantees)** | 131 | 7,183 | 9,120 | 5,804 | 3,386 | 1,839 | 1,034 | 610 | 0 | 0 | - | - |
| **Administration & Selling expenses** | 10,190 | 20,643 | 19,321 | 21,623 | 22,349 | 12,881 | 11,640 | 11,783 | 11,958 | 8,933 | 1,521 | 1,289 |
| **Net loss or Loss after Taxation** | (3,246) | (5,516) | (8,182) | (11,735) | (7,208) | (28,535) | (9,654) | (11,676) | (9,773) | (9,173) | (1,558) | (1,360) |
| **Key BS Figures** | | | | | | | | | | | | |
| **Total Assets** | 103,378 | 110,422 | 101,836 | 82,244 | 77,801 | 46,081 | 35,416 | 29,017 | 24,747 | 24,403 | 22,139 | 20,921 |
| **Total Liabilities** | 4,384 | 16,943 | 10,767 | 2,909 | 5,675 | 2,490 | 1,479 | 6,756 | 12,259 | 21,039 | 20,352 | 20,494 |
| **Net Equity** | 98,995 | 93,479 | 91,069 | 79,334 | 72,126 | 43,591 | 33,936 | 22,261 | 12,488 | 3,365 | 1,787 | 427 |
| **Key P&L Figures in US$** | | | | | | | | | | | | |
| **Gross Revenues (Premiums + processing fees on guarantees)** | 2 | 123 | 164 | 102 | 57 | 31 | 17 | 9 | - | - | - | - |
| **Administration & Selling expenses** | 167 | 354 | 347 | 382 | 376 | 214 | 192 | 168 | 147 | 106 | 18 | 14 |
| **Net loss or Loss after Taxation** | (53) | (95) | (147) | (207) | (121) | (475) | (159) | (166) | (120) | (109) | (18) | (15) |
| **Key BS Figures in US$** | | | | | | | | | | | | |
| **Total Assets** | 1,691 | 1,895 | 1,827 | 1,452 | 1,308 | 766 | 585 | 413 | 304 | 289 | 258 | 226 |
| **Total Liabilities** | 72 | 291 | 193 | 51 | 95 | 41 | 24 | 96 | 151 | 249 | 238 | 221 |
| **Net Equity** | 1,619 | 1,604 | 1,634 | 1,400 | 1,213 | 725 | 561 | 317 | 154 | 40 | 21 | 5 |

() = Negative; BS = Balance Sheet Statement; P&L=Profit and Loss Statement

Source: Pakistan Export Finance Guarantee Agency Limited

## LIST OF PAKISTAN EXPORT FINANCE GUARANTEE AGENCY LIMITED STOCKHOLDERS

| Shareholder | % Shareholding |
|---|---|
| 1. Asian Development Bank | 20.79 |
| 2. National Bank of Pakistan | 10.66 |
| 3. Habib Bank Limited | 10.55 |
| 4. Habib Metropolitan Bank | 10.52 |
| 5. Standard Chartered Bank (Pakistan) | 5.31 |
| 6. Bank Alfalah | 5.30 |
| 7. Bank Al Habib | 5.28 |
| 8. Soneri Bank | 5.28 |
| 9. Faisal Bank previously Royal Bank of Scotland | 5.27 |
| 10. Silk Bank previously Saudi Pak | 5.26 |
| 11. KASB Bank | 5.26 |
| 12. NIB Bank | 5.26 |
| 13. Askari Commercial Bank | 5.26 |
| **Total** | **100.00** |

Source: Pakistan Export Finance Guarantee Agency Limited Stockholders