

**PROJECT INFORMATION DOCUMENT (PID)
IDENTIFICATION/CONCEPT STAGE**

Report No.: PIDC35728

Project Name	Liberia MSME & Rural Finance post Ebola Reconstruction
Region	AFRICA
Country	Liberia
Sector(s)	Banking (20%), Payments, settlements, and remittance systems (20%), SME Finance (20%), Microfinance (20%), Agro-industry, marketing, and trade (20%)
Theme(s)	Micro, Small and Medium Enterprise support (100%)
Lending Instrument	Lending Instrument
Project ID	P157797
Borrower Name	Ministry of Finance and Development Planning
Implementing Agency	Central Bank of Liberia
Environment Category	F - Financial Intermediary Assessment
Date PID Prepared	14-Dec-2015
Estimated Date of Approval	04-Mar-2016
Initiation Note Review Decision	The review did authorize the preparation to continue

I. Introduction and Context

Country Context

The Liberian economy has been hit hard by sharply lower commodity prices as well as by the Ebola epidemic and the related health crisis. Real gross domestic product (GDP) growth of 8.7 percent in 2013 and initially projected at 6 percent in 2014 fell to only 0.7 percent and for 2015, the IMF estimate growth of 0.3 percent (implying falling GDP per capita for both 2014 and 2015). Before the Ebola crisis, growth had been driven by the expansion in the mining sector (mainly iron ore) as well as increased activities in the construction sector spurred by both public and private investment. Rubber, iron ore and palm oil production and exports have slowed dramatically, reflecting lower international prices and developments in the forestry sector have been adversely affected by weak administrative oversight capacity. Prospective investments in these sectors, as well as nascent initiatives such as gold, have been canceled or delayed. Growth in manufacturing continues to be constrained by inadequate electricity and the generally weak business environment. The epidemic has resulted in disruption of production processes across several sectors, caused only partly by illness and death and mostly by fear associated with the outbreak. The services and commerce sectors have been particularly affected. Average inflation which increased from 6.8 percent in 2012 to about 7.6 percent in 2013, due to higher food prices and the depreciation of the exchange rate, peaked at 13.5 percent in September 2014 due to the impact of the Ebola crisis on agriculture and trade, but has since subsided (7.3 percent as of March 2015).

According to the Africa Governance Initiative, Liberia's potential workforce is likely to double by

2030, estimates suggest that Liberia will have a shortfall of some 600,000 jobs by 2030. The government therefore needs to promote economic activity towards more labor-intensive sectors, if it is to provide the jobs and the welfare its citizens need. Mining accounts for much economic growth but brings less than 15,000 jobs, in a workforce of 1.2 million people. By contrast, agriculture – which accounts for over half a million jobs – only grew by 2.8% per year in 2013, below the rate of population growth.

Sectoral and Institutional Context

MSMEs represent the bulk of employment opportunities in Liberia and provide a lifeline to the poorest parts of society and those most affected by the Ebola crisis. Various economic surveys conducted by the World Bank and others point to the significant fall in employment since the Ebola crisis and this is also reflected in a fall in financing provided to SMEs by commercial banks. Many World Bank Global Practices, notably Agriculture, Trade and Competitiveness and Education have flagged the requirement for financial support to sustain the operations of viable SMEs which have suffered an exogenous shock to their business due to the Ebola crisis. There are important business opportunities being generated by the substantial aid flows now entering Liberia; without access to finance, local firms will not be able to respond to these prospects. Limited local engagement will prolong donor dependency and the extension of opportunity across the local societies, including the less advantaged.

During the Ebola crisis, the major banks which serve the top end of the economy enjoyed record profits, largely due to the influx of donor financed imports (rice, vehicles etc.), in contrast those serving the MSME sector suffered very badly and the three largest institutions targeting this sector have required recapitalization from donor capital.

Banks are reluctant to extend credit, particularly to the MSME sector, given weaknesses in the legal framework, weak property rights, limited collateral and credit reference systems, and weak capacity of commercial banks to appraise MSMEs and rural farmers (agriculture represents over 20 per cent of GDP but attracts only 4 per cent of bank credit). Even prior to the Ebola crisis, the World Economic Forum's 2013 Global Competitiveness Index showed that access to finance was the business obstacle most frequently cited by Liberian enterprise respondents to its survey (17.6 per cent of respondents). Similarly, the World Bank's BEEP Survey of enterprises (2009), showed access to finance as the number one business environment constraint of firms working in the manufacturing and services industries in Liberia, cited by 39.8 percent of respondents. In the 2015 "Doing Business" survey, Liberia ranked 160th for getting credit, down from 157th in 2014. Use of financial services by firms is low relative to the average for Sub-Saharan Africa. Of the firms surveyed in 2009, 66 percent had a checking or savings account and 12 percent of firms surveyed had a loan or line of credit. Only 2 percent of firms were using overdraft facilities. Sixty percent of surveyed businesses indicated a need for credit but only 20% of this number has been able to access a formal loan in the past. Demand for loans is driven by both short and long-term needs. The most frequently cited reasons for seeking financial credit include working capital financing (34%), equipment and machinery purchases (24%), funding business expansion (17%) and for contract pre-financing (16%). Sixty-four percent of surveyed businesses have dedicated business bank accounts, but only 39% are able to get a bank guarantee, which is often a pre-requisite for participation in bidding for large private sector tenders.

Liberia has 9 licensed and operating banks with total assets of some US\$870m in October 2014,

around 44 percent of GDP. Credit to the private sector had been rising steadily but fell slightly to around 17.3 percent of GDP in October 2014, similar to several other ECOWAS countries. The net interest margin (6.4 percent in 2013) is relatively low by African banking standards. As of October 2014, lending rates averaged 13.63 percent while time deposit rates averaged 4.60 percent. NPLs have fluctuated, having fallen to 14.5 percent in March 2014, a substantial reduction from 24.9 percent in December 2012, have now risen again to 18.7 percent in October 2014. Interest rate rigidity and the short maturities of bank liabilities and credit impede lending to productive sectors. The banking sector is chronically unprofitable, with return on assets of -0.7 percent in 2013, and return on equity of -5.7 percent. Losses probably continued throughout 2014. Liquid assets to total asset ratios have remained high, 29.8 percent as of October 2014, despite the relaxation in the Central Bank Requirement from 22 percent to 15 percent, reflecting inflows of donor and official funds. This increase in liquidity is not spread across the banking sector and liquidity has deteriorated in some banks.

High collateral demands, at 150% of loan value, constitute the greatest obstacle to local business access to formal credit. When available, credit tends to be short term in nature and, therefore, unsuited to the long-term capital investment needs of local businesses. Firms rely heavily on internal funds and retained earnings for working capital needs and investments, with 84 percent of working capital needs and 87 percent of new investments financed by internal funds and retained earnings. Bank finance makes up a relatively small fraction of working capital and new investment. Supplier credit is also very limited in Liberia and there is no leasing activity.

Although microbusinesses dominate the private sector in terms of numbers, their access to finance is limited. There are 78 retail bank branches, mainly concentrated in and around Monrovia. Five counties out of 15 remain completely unserved by bank branches. The commercial banks provide loans to fewer than 38,000 individuals and companies; even the traditional microfinance sector is reaching only around 24,000 borrowers with little more than \$1.2m in loans disbursed. There are clear signs that the financial sector is getting smaller, the banking sector has been shrinking as a percentage of GDP since 2011 and several commercial banks have reported closing retail accounts due to lack of profitability, while the microfinance sector has seen a fall in the number of borrowers, a reduction in the number of branches, and the exit of leading participants.

Microbusinesses suffer from a lack of physical assets to use as collateral and a lack of reliable accounts. Furthermore, the increase in nonperforming loans and the absence of enforcement mechanisms through the courts all serve to deter the banks from taking on the risk of loans to this sector (the Commercial Court, which came into operation in 2011, accepts cases above \$1m). As is the case in other countries, microbusinesses have limited access the capital markets. NPL ratios vary across banks both in level and in trend and it now appears that those banks exposed to the SME sector are suffering the most severe degradation in portfolio quality.

There are a series of directed credit initiatives available in Liberia, mostly launched by the Central Bank at different times in 2012. These initiatives target MSMEs and agricultural producers and are intermediated by select banks and credit unions, generally with below market interest rates. The performance of these facilities has been generally weak (for example, the Central Bank has provided \$3 million in financing to the microfinance sector, which greatly exceeds the total amount of loans now outstanding, despite additional funding from sources such as BRAC). These initiatives have been largely ad hoc and have generally included below market interest rates. The schemes have lacked identified objectives (beyond disbursement) and there has been no effort to measure the

effectiveness.

Recently, a small number of demand side initiatives have been launched to provide technical assistance to SME borrowers and grants for the provision of business development services. Notable in this context are an engagement with Rabobank, financed by the Government of the Netherlands, which is to provide support aligned with an inter-ministerial task force on Agricultural Finance and which will focus on developing value chains in the cocoa, coffee, fishing and rubber sectors and one under development by the Trade & Competitive practice in coordination with the Ministry of Commerce and Industry which will provide technical assistance to SMEs to develop their businesses (and make them better borrowers).

Relationship to CAS/CPS/CPF

Improved enabling environment and increased access to finance for Liberian SMEs is a specific outcome sought in the 2013-2017 Country Partnership Strategy under Pillar I - Economic Transformation (the target of increasing commercial bank loans to \$216 million to \$500 million is some way from being achieved, standing at \$300 million at end 2014). The Outcome sought under the Country Partnership Strategy includes a target that 25% of loans should be to women, this project can seek to support this gender objective.

The Government of Liberia has highlighted SME finance to be a priority in its own Poverty Reduction Strategy, "The Agenda for Transformation", where it is stated "At the heart of Liberia's development agenda is the desire to grow the private sector, increase access to finance and create market access opportunities for SMEs". Liberia underscored its commitment to backing small business growth in 2011 by launching a National MSME Policy, targeting the thousands of businesses that provide the bulk of Liberia's employment and income.

Support for the MSME sector is also prioritized in Liberia's post-Ebola recovery strategy, The Economic Stabilization and Recovery Plan of April 2015 and finance initiatives to support MSMEs are specifically cited as components of the subsidiary strategies, Immediate Stabilization and Recovery (FY2014/15) and Recovery and Resilience (FY2015/16 and FY2016/17).

II. Project Development Objective(s)

Proposed Development Objective(s)

The Project Development Objective (PDO) is to support the development of a framework to provide MSMEs finance on sustainable terms, enhance the capacity of local private sector financial institutions to lend profitably to MSMEs and objectively measure outcomes.

Key Results

1. 500 new loans will be provided to MSMEs during the project period which will create or sustain at least 2,000 jobs.
2. Non-performing loans under the project will be below 10 percent.
3. At least one MSME lending initiative will be developed which makes use of mobile money.
4. An objective evaluation of all directed credit operations since 2010 will be compiled, assessing key outcomes such as disbursement, recovery, Non-performing status, and, where possible, data such as jobs created and/or sustained and gender breakdown.

It is to be emphasized that these objectives are to be achieved during the project period (to March 2018), the facility financed through the project will continue to generate results after that date.

III. Preliminary Description

Concept Description

Project background.

While there have been a number of government led financing schemes targeting SMEs, the unmet demand for finance remains significant. To date, none of the financing schemes have sought to address the weaknesses which have held back the development of sustainable financing, particularly with regards to the supply side of credit, making banks better lenders to MSMEs. As there has been no monitoring or evaluation of the past schemes, it is not possible to determine exactly what objectives have been achieved. These lending activities have been spread across the MFDP, Central Bank, Ministry of Commerce and Industry and the Ministry of Agriculture without coordination.

This activity will serve to improve the supply of finance available in the local economy through providing a demonstration to both Government and local banks of best practice in MSME lending. In the first instance, the project will seek to draw together all SME financing schemes into one facility, under the auspices of the MFDP but with advice from the Central Bank and implemented through local financial institutions. Rather than the directed approach followed to date, whereby parallel schemes have been directed to disperse to distinct sectors (commerce, agriculture etc.) the project will be agnostic as to sector but will focus on supporting MSME enterprises which have credible financing proposals and allow participating financial institutions greater freedom in terms of economic sector. Furthermore, the project will work with participating financial institutions to address the fundamental issues which have led to poor loan performance to date: high transactions costs, poor Contract Enforcement, a high level of Volatility in business outcomes (related to commodity prices, weather conditions etc.), poor Information as to both the willingness and ability of the client to repay loans, and reliance on collateral rather than ensuring business Cash Flows are well aligned to the terms of loans.

There starting point will be that financing will be on sustainable terms, however, the facility will support participating financial institutions to provide terms which are not currently available in the market. In particular, the project will support the provision of loans beyond the 18 months tenor currently available (the exact term to be determined at appraisal, but probably to 5 years), and will allow for deferral of payments relating to objectively identifiable disruptions (such as poor harvests, commodity price variation etc) and will focus on cash flow rather than collateral. Through the innovation component, the project will also seek to take advantage of ongoing initiatives to extend

the use of mobile money in Liberia to lower transactions costs and improve the information held on borrowers (e.g. a record of payments made and received through mobile money can substitute for a lack of financial accounts and the use of biometric ID and/or the direct intercept of payments can be used to enhance loan recovery). If and only if there are identified public goods associated with providing finance to MSMEs (such as sustaining employment in the Post Ebola period in response to the systemic shock of the Ebola crisis), subsidized finance may be provided on an exceptional basis, but this will be explicit, transparent, targeted and limited both in amount and time of availability. The project will seek to ensure that populist demands for cheap money do not lead to the creation of new ad hoc schemes (and also that such funds, if necessary, are allocated on objective terms rather than as a product of clientelism).

The higher order objective of the project is to assist viable MSMEs to rebuild their businesses and maintain employment, particularly for the poorest, through enhancing their access to finance. The proposed assistance is to be catalytic in emphasizing activities which are complementary to those of the IFC, other Global Practices and other development partners. The desired immediate outcome will be to establish a development financing vehicle which will use private financial institutions and establish best practice in terms of evaluation and monitoring to replace government sponsored initiatives which have focused on disbursement and have been questioned for political motivation. In particular the activity will seek to guide the expertise of the Central Bank away from direct lending in the development finance sector.

A further objective will be to coordinate and provide monitoring for various directed lending activities of the WBG and other development partners to ensure consistency and adherence to best practices. Various sectors in the WBG, including energy and agriculture, are exploring credit lines to SMEs in light of the unavailability of finance at this level. These activities run through the respective ministries and are not centrally coordinated or monitored in terms of their design. The project would seek to facilitate these activities and ensure balance between availability of finance between sectors. The project will focus on the finance aspects of SME lending and would coordinate with parallel WBG, AfDB and other development partner activities which provide technical assistance, mostly to borrowers.

The project would comprise three components:

- 1 SME Financing Facility Funding and technical assistance to FIs (USD 4.0 million). This would comprise three subcomponents to support on-lending to micro and small entrepreneurs.
 - a. Line of Credit for viable MSMEs. Provide term finance in local currency (and US\$ where appropriate) to financial institutions for onlending to MSMEs. Identification of MSMEs and credit risk to be the responsibility of participating financial institutions (although sector support provided by relevant WBG units for agriculture, energy, education, trade etc.). Financing terms to be established so as to support rather than undermine market forces
 - b. Risk-sharing Instruments. Establishment of partial credit guaranty scheme; default risk to be shared 50/50 with participating banks for loans to MSMEs falling within agreed criteria.
 - c. WB/Consultant Technical Assistance assistance to participating financial institutions to improve the quality of lending by providing expertise in design and operation of credit and risk-sharing operations, loan supervision, credit screening, cash-flow modeling etc.

2 Innovations in MSME Finance. Technical Assistance to develop use of digital financial services and new lending instruments. Link with new initiatives such as Partnership for a Digital West Africa and the ERRTF funded payments systems project to make use of mobile money, biometric ID and other innovations to lower transactions costs and improve credit information. This activity would also explore increasing use of techniques proven elsewhere but not utilized in Liberia such as leasing, factoring and warehouse receivables.

3 Establishment of Monitoring & Evaluation Framework. Establish a process for tracking disbursements of funds from this project and other financial intermediation activities to determine objectives and monitor achievements (employment, poverty and gender targeting, as well as financial performance).

A key objective of the project is to provide Government sufficient incentive to revisit the way that it addresses MSME finance, and also present a sustainable solution to the populist initiatives seen in recent years.

IV. Safeguard Policies that Might Apply

Safeguard Policies Triggered by the Project	Yes	No	TBD
Environmental Assessment OP/BP 4.01	x		
Natural Habitats OP/BP 4.04		x	
Forests OP/BP 4.36		x	
Pest Management OP 4.09			x
Physical Cultural Resources OP/BP 4.11		x	
Indigenous Peoples OP/BP 4.10		x	
Involuntary Resettlement OP/BP 4.12		x	
Safety of Dams OP/BP 4.37		x	
Projects on International Waterways OP/BP 7.50		x	
Projects in Disputed Areas OP/BP 7.60		x	

V. Financing (in USD Million)

Total Project Cost:	4.8	Total Bank Financing:	0
Financing Gap:	0		
Financing Source			Amount
State and Peace Building Fund			4.8

VI. Contact point

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