ICR Review
Operations Evaluation Department

Report Number : ICRR10201

1. Project Data :	
OEDID:	C2340
Project ID :	P009454
Project Name :	Private Sector Industrial Credit Project
Country:	Bangladesh
Sector:	Financial Sector Development
L/C Number:	C2340
Partners involved :	none
Prepared by :	Laurie Effron, OEDCR
Reviewed by :	Patrick Grasso
Group Manager :	Ruben Lamdany
Date Posted :	08/26/1998

2. Project Objectives, Financing, Costs and Components :

(i) promote more rational decision-making by lenders and sub-borrowers; (ii) expand term lending in Taka and US dollars; (iii) support private sector development through line of credit for subloans for industrial investments; and (iv) develop and apply environmental guidelines and standards for industry .

3. Achievement of Relevant Objectives :

The first objective was to be accomplished by a gradual widening of the band of interest rates on domestic currency lending and to decontrol interest rates within that band and on foreign exchange loans . Interest rates were liberalized during the course of the project. The extent to which this resulted in more rational decision-making by lenders and sub-borrowers is not clear from the ICR, however.

Term lending did occur under the project to the extent anticipated, although no information is available on whether the lending was in Taka or US dollars. Private sector industrial investments were financed under the loan, so the third objective was accomplished as well.

Environmental guidelines were developed, although their application is slower than expected, so this objective was only partially accomplished.

4. Significant Achievements :

5. Significant Shortcomings :

The underlying rationale for the project was to support further financial sector reforms initiated by the Government of Bangladesh and supported by the Bank through a Financial Sector Adjustment Credit . By establishing eligibility criteria for participation in the line of credit that were consistent with the new prudential regulations issued by the Bank of Bangladesh, the project did reinforce the efforts to strengthen the banking sector, but only one bank in Bangladesh met the eligibility criteria throughout the project period . It is therefore difficult to assert that the project provided an adequate incentive to the banks to meet the prudential norms .

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Satisfactory	Satisfactory	
Institutional Dev .:	Substantial	Modest	Except for interest rate liberalization, other institutional impact was modest. Only one of the four banks initially thought to be eligible to participate in the credit remained eligible. Leasing companies were brought into the line, and the eligibility criteria were applied to them, but

			the prudential norms were intended for the banks and are not necessarily relevant for leasing activities. Environmental guidelines are not yet fully operational, so institutional impact of this component is partial.
Sustainability :	Likely	Likely	
Bank Performance :	Satisfactory	Satisfactory	
Borrower Perf .:	Satisfactory	Satisfactory	
Quality of ICR :		Satisfactory	

7. Lessons of Broad Applicability :
Bank appraisal should (a) establish realistic eligibility criteria for participation of financial intermediaries in a line of credit; and (b) review thoroughly, prior to loan negotiations, eligibility of potential participants, particularly when the financial intermediaries are subject to new prudential regulations. This avoids unpleasant surprises after the loan/credit is put in place, such as finding that no or few financial intermediaries are in fact eligible to participate in the line of credit.

8. Audit Recommended? ○ Yes ● No

9. Comments on Quality of ICR :
The ICR is satisfactory, and gives a fair description and judgment about the outcome of the project. But the ICR has several weaknesses. First, it is missing relevant information. The ICR asserts that project objectives were accomplished, of which one was "more rational decision-making by lenders and sub-borrowers." The fact that interest rates were liberalized and banks were permitted to charge differential rates to clients does not mean that they did. Information should have been provided to show that different interest rates were charged by banks to reflect different maturities and risks. Another objective was to increase Taka and US dollar term lending, but the ICR does not mention the currencies of the term lending financed under the project, so it is not possible to judge whether both Taka and US dollar term lending increased, or just Taka lending. Finally, the SAR highlighted risk of insider abuse and need for sectoral limitations on exposure by banks, but the ICR is silent on the extent to which the sub-loans financed under this line of credit respected exposure limits and were free of insider abuse.

Second, the ICR is kind in its judgment of the appraisal. It notes that the appraisal could have included a more thorough assessment of the banks, but that such in-depth analysis of financial institutions was "not normal Bank practice" at the appraisal stage. When new prudential regulations were put in place in other countries, the Bank did insist, in the context of qualifying to participate in Bank-financed lines of credit, that the banks undergo independent audits by recognized international auditors, of the financial statements applying the new prudential regulations. These audits enabled the appraisal mission to assess, at a minimum, the shortfalls in provisioning and capital adequacy. More than two years elapsed between preparation and appraisal, during which time the Bank of Bangladesh promulgated the new regulations, and another 10 months between appraisal and negotiations. The appraisal should have insisted that detailed audits be carried out to assess banks' eligibility prior to negotiations.

Third, the ICR is not clear on why three of the banks lost eligibility, two before and one during the project. The eligibility criteria included the possibility of the banks' having a plan and timetable for achieving the levels of provisions, suspensions and capitalization required by the Bank of Bangladesh. The fact that two of the banks turned out not to be eligible sugggest that they were so far away from having acceptable levels that they could not realistically reach them in a reasonable timeframe, but the ICR is not explicit about this. In addition, it is not clear why one initially eligible bank could not adopt a plan for achieving acceptable levels and thereby maintain its eligibility. It would have been useful if the ICR had been clear on these points.

A fourth point is that the section on "future operation" in the ICR is supposed to refer to the future operation of this line of credit and follow up activities and monitoring related to sub-loan repayments, recycling the funds, and implementing the new environmental guidelines, rather than other Bank-financed operations following the line of credit.