KfW Development Bank

# Ex post evaluation
# Development of the microfinance sector, Bosnia and Herzegovina


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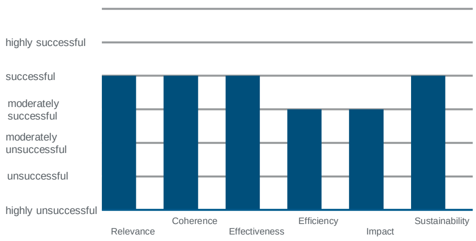
|---|---|---|---|
| **Title** | Consolidation of the microfinance sector | | |
| **Sector and CRS code** | Formal sector financial intermediaries (CRS code 2403000) | | |
| **Project number** | BMZ no.: 2011 65 265 | | |
| **Commissioned by** | German Federal Ministry for Economic Cooperation and Develop- | | |
| **Recipient/Project-executing** | Bank | | |
| **Project volume/ Financing instrument** | EUR 2,000,000; mezzanine loan (budget funds) | | |
| **Project duration** | 18 December 2013 until 2021 (planned end date) | | |
| **Year of report** | 2020 | **Year of random sample** | 2018 |

## Objectives and project outline

The project helped to consolidate the microfinance sector in Bosnia and Herzegovina through a fiduciary holding in a bank. The project objective at outcome level was to contribute to improving access for micro and small enterprises to loans, with a stronger focus on private micro and small businesses in all sectors, including agriculture. The FC project included strengthening the bank's equity and supporting the expansion of its financing business. In this way, the FC project was intended to contribute to strengthening the target group's economic development.

## Overall rating:
**Successful**




## Key findings

The project had a high degree of developmental relevance and effectiveness. The promotion and strengthening of the bank made it possible to significantly improve access to financing for the target group in the MSME sector.The project has been rated "successful" for the following reasons:

– The most important reason for the successful rating for relevance is the strengthening of the bank's capital base through the fiduciary holding, which ensured the bank's ongoing successful transformation and, as a result, the sustainability of the project.

– The project's effectiveness is positively reflected in the strengthening of MSEs' economic development and the protection of jobs and income thanks to increased economic activity and a rise in employment in the SME sector.

– The close coordination and external coherence of the project with other donors, such as the Dutch bank FMO, EBRD and EFSE, encouraged synergies in the bank's strategic direction.

– For a long-term and sustainable improvement in access to financial services for MSEs, a larger investment would have made sense, enabling the achievement of significantly larger market shares. Nevertheless, interest from new investors underlines the sustainability of the bank's ongoing growth.

– From an overall perspective, the bank worked efficiently at a production level. With regard to the allocation level, the cost-intensive work needed to supervise the bank was disproportionately high in view of the small commitment.

### Conclusions

– The lack of access to financial services for MSMEs and the financing gap for the customer segment originally targeted by the project remain a problem to this day. The relatively small DC commitment restricted the comprehensive improvement to financial-service access as well as the development and growth of the financial sector. For similar projects, it should therefore be examined whether other approaches or the consolidation of measures would be better suited for achieving the desired widescale impact.

1 = highly successful, 2 = successful, 3 = moderately successful, 4 = moderately unsuccessful, 5 = unsuccessful, 6 = highly unsuccessful

# Rating according to DAC criteria

## Overall rating: 2

### Ratings:

| | |
|---|---|
| Relevance | 2 |
| Effectiveness | 2 |
| Coherence | 2 |
| Efficiency | 3 |
| Impact | 3 |
| Sustainability | 2 |

### Relevance

One of the most significant problems in Bosnia and Herzegovina's (BiH) financial sector was the provision of an adequate supply of loans to the MSME segment (micro, small and medium-sized enterprises). In particular, the client segment that had outgrown the microfinance sector but did not deliver enough volume for the commercial banking sector was heavily undersupplied. That is because larger banks focused on larger clients for reasons related to cost and risk, while small micro-enterprises were covered by MFIs. The financing gap for the customer segment between these two was broadly unfilled.

In December 2013, a subordinated loan for EUR 2 million with a conversion option was issued to the bank. At the time of the FC investment, the bank was the only bank in BiH whose focused customer segment was the MSME sector. By reinforcing its equity capital base, the aim was to support the bank's targeted growth curve and, as a result, offer improved access to loans for the MSME sector. This measure included both expanding the financing business as well as growing the branch network. By improving access to financial services, the goal was to strengthen the MSME sector, secure jobs and create new ones.

At the time of the project appraisal in 2012, the MSME sector in BiH consisted of around 29,000 registered businesses, around 97 % of whom were micro and small enterprises, and it was the largest provider of jobs in the country. MSMEs contributed roughly 60 % of GDP and were, as such, significantly involved in the country's macroeconomic development. Almost five years later, there are now as many as 66,350 registered businesses. Making up 99.7 % of all Bosnian enterprises, MSMEs are still regarded as BiH's main employers. A large proportion of these businesses (90.3 % of all Bosnian businesses) are what are known as microenterprises (with fewer than 10 employees). Small and medium-sized enterprises made up slightly more than 7.5 % of all MSMEs. In 2016, the MSMEs in Bosnia and Herzegovina generated 66.3 % of total value added (GDP). Between 2010 and 2016, employment in MSMEs rose.[1]

Despite the leading role played by the MSME sector in the country's development, MSMEs received little support from the government at the time of the project appraisal. In particular, tax-related and structural/bureaucratic hurdles as well as significant difficulties with debt collection and shortages in liquidity restricted the growth of the MSME sector. The sector not only lacked specific support measures from the government, but the financing of business investments and activities also often presented a major challenge for many MSMEs.

Even today, poor access to formal financial services for MSMEs remains a central obstacle to the development and growth of BiH. For this reason, the underlying results chain – according to which support for private MSMEs through the provision of basic financial services stemming from the bank's promotion and reinforcement can lead to more investments, higher production and, as a result, to more jobs and additional income – remains valid.

[1] European Commission: 2019 SBA Fact Sheet BOSNIA AND HERZEGOVINA

The project's objective of strengthening the bank's financial power to expand its financing offer and thus improve widescale access to the formal sector's range of financial services for MSMEs was relevant at the time of the project appraisal (end of 2012) and is still rated as relevant today.

**Relevance rating: 2**

## Coherence

German development cooperation has been supporting the country since 2013, now with two priority areas instead of the previous three[2]. Within the scope of TC, Germany's involvement focuses on the area of democracy, civil society and public administration, as well as on the promotion of renewable energy sources and energy efficiency within the scope of FC. Outside of these priority areas, there have been some individual commitments in the sector of "sustainable economic development". FC's involvement in this area concentrated primarily on developing and strengthening the financial sector. In this context, the goal was to promote first and foremost MSMEs via the banking sector, as well as poorer population groups via the microfinance sector. By founding and developing the European Fund for Southeast Europe (EFSE), German FC took on a leading role in international donor coordination. A further approach used to support FC's objectives in this area was the credit guarantee fund (CGF). This aimed to provide guarantees for credit lines, which would facilitate refinancing for commercial banks and MFIs. As a complementary approach to promoting MSMEs, FC manages the European Fund for Bosnia and Herzegovina (EFBH) as part of a mandate. This fund is managed by KfW on behalf of the EU along with the German, Dutch, Austrian and Swiss governments. The fund provides targeted support to banks in the region.

The FC project corresponded to the approaches used by other sector-relevant donor institutions. These are the European Investment Bank (EIB), the European Fund for Southeast Europe (EFSE) and the European Bank for Reconstruction and Development (EBRD). These donor activities complemented BiH's sectoral strategy since the Bosnian government was eager to support the country's MSME sector but saw few opportunities to promote it by itself. For this reason, donor involvement was expressly welcomed. In its support for the (micro) finance sector, German FC worked closely with other donors and organisations active in the sector, particularly the EFSE and the Dutch development financing bank FMO, both of whom are long-standing financiers and provide additional support in the form of complementary measures. Parallel to the conversion of the FC subordinated loan into an equity investment in 2016, the Dutch bank FMO also purchased an equivalent stake in the bank. The purpose of this capital increase was to directly facilitate the bank in raising additional equity and long-term external financing from other sources. The close coordination during the FC project, particularly with the Dutch bank FMO, and the advice, support and assistance provided for the bank during its growth under the supervisory mandate is achieving/has achieved successful synergies at the impact level in the bank's strategic alignment.

**Coherence rating: 2**

## Effectiveness

The project's outcome-level objective was to improve access to financial services, primarily for MSMEs. At the time of this evaluation, the following indicators were used to measure target achievement at outcome level:

| Indicator | Target value[3], status PA | Actual value at EPE[4] |
|---|---|---|
| (1) Average growth of 30 % p.a. in the MSME loan portfolio over a period of 5 years | Target value for the MSME loan portfolio (gross): EUR 67.58 million<br>At PA: EUR 18.2 million | Achieved<br>MSME loan portfolio (gross): EUR 131.8 million (2019) [5] |

[2] The third priority area was emergency relief measures.

[3] During the evaluation process, the target values were adjusted to the actual investment period of 2013–2018

[4] Source: Credit Risk File MF Banka 12/2019

[5] Source: Credit Risk File MF Banka 12/2019

| | | |
|---|---|---|
| (2) Average growth of 30 % p.a. in the number of MSME loan customers over a period of 5 years | Target value for number of MSME customers: 2,636<br>At PA: 710 customers | Achieved<br>Number of MSME customers: 3,925 (2019) [6] |
| (3) Reduction in the average loan amount within 5 years | Target value for the average loan amount: EUR 8,700<br>At PA: EUR 11,000 | Not achieved<br>Average loan amount: EUR 27,800 (2019) [7] |
| (4) Increase in demand deposits by an average of 20 % p.a. over a period of 5 years | Target value: EUR 12.4 million<br>At PA: EUR 5 million | Achieved<br>2019: EUR 25.7[8] million |
| (5) Increase in time deposits by an average of 20 % p.a. over a period of 5 years | Target value: EUR 57.23 million<br>At PA: EUR 23 million | Achieved<br>2019: EUR 129.6 million[9] |
| (6) Strengthening of the bank's capital | Equity target: EUR 10.4 million | Achieved<br>Equity: EUR 26.1 million |

The reinforcement of the equity base enabled the bank to set out on a clear growth path. For instance, it was able to almost quadruple its entire loan portfolio from EUR 42.4 million in 2012 to over EUR 160 million in 2019. As a result, the bank has been able to contribute to the improved, sustainable provision of financial services for MSMEs and thus to an improvement in their economic development. The bank's equity was also strengthened and its growth ensured on a sustainable basis.

**Indicator 1:** The quantitative requirement for the bank's loan portfolio for the MSME market segment to grow by an average of 30 % p.a. over a 5-year period[10] was consistently met and even exceeded. At the time of the evaluation, the average portfolio growth amounted to 104 % p.a. Strengthening the bank's equity base enabled the portfolio growth target to be achieved and allowed a larger financing range to be provided to the target customer segment.

**Indicator 2:** The number of the bank's borrowers in the MSME segment also increased significantly by around 40 % [11]p.a. over the 5-year period.

**Indicator 3:** The aim to reduce the average loan amount was intended to reflect the focus on micro and small enterprises (MSEs). Prior to 2016, the bank had managed to reduce the average loan amount to EUR 8,000. Since then, the average loan amount has risen again as an increasing number of MSME customers are requesting higher loan amounts. Despite the failure to meet the indicator's target, we do not see this as the bank turning away from the target customer segment, since the MSE segment makes up 75 % of the loan portfolio compared to 49.9 % at the project appraisal. Of this 75 % share, MSEs account for 62 %, emphasising the strong and ongoing focus on this customer segment. Rather, the gradual increase in the average requested loan amount underlines that customers also remain loyal to the bank as their credit needs gradually increase.

[6] Source: Credit Risk File MF Banka 12/2019

[7] Source: Credit Risk File MF Banka 12/2019

[8] Annual financial statements 2019

[9] Annual financial statements 2019

[10] Based on the very low figure in the base case, portfolio growth of 30 % in absolute figures was a completely realistic and acceptable target.

[11] See explanations under footnote 10

**Indicator 4:** The target for increasing the deposit volume (demand deposits) to at least EUR 12.4 million was intended to enable the bank to achieve moderate growth. This is regarded as achieved. The average annual growth rate was 39 %.

**Indicator 5:** The volume of time deposits also rose by an average of 77 %, thus significantly exceeding the target value. The bank's 2019 annual financial statements record time deposits at EUR 129.6 million, which is double the original target value. Consequently, this indicator is deemed to be met at the time of the EPE.

**Indicator 6** was not yet included in the original target system at the time of the project appraisal. It was added to the objectives when the subordinated loan was converted into an equity investment (2016). The bank's capital situation was comfortable at the time of the project appraisal. However, the plans for dynamic portfolio growth threatened to push capital adequacy towards the lower regulatory threshold fairly quickly. As such, the bank not only had to rely on additional refinancing but also on its capital base becoming significantly stronger over the medium term. Since the project planning phase, the capital situation has improved continuously, enabling this indicator to be achieved.

In summary, the support provided as part of the evaluated project contributed to improving the bank's equity base, and thus enabled it to attract more new customers and issue more loans to MSEs in BiH. As a result, the FC project enabled increased access (in terms of volume) and a sustainable supply of financial services for the MSME sector. There is a positive and direct link between the funds granted as part of the FC project and the achievement of the targets as this financial support not only helped to strengthen the bank's equity base, but also, as a result, it allowed the opportunities for providing loans to MSEs to be expanded. By attracting new customers, who then deposited their funds, the bank was able to increase its time and demand deposits, thus contributing to the expansion of refinancing. At the same time, the ongoing advice provided by the investors, FC and FMO, helped the bank's management to professionalise its internal organization and consistently gear its product range and work processes to serving the MSME segment in an efficient and focused manner.. Thanks to the investment decisions made by FC and FMO, the bank gained a great deal of knowledge about best practices and international standards, which were applied to enhance internal procedures and the bank's strategic alignment.

With its consistent focus on the MSME segment, the bank has a unique selling point on the Bosnian-Herzegovinian banking market, which is further underlined by the bank's nationwide setup. Without the FC measure, the financial shortage in the affected customer segment of the MSME sector would not only have increased, it would also not have been possible to service the still-present gap in supply. Nevertheless, the bank's small market share limits the impact, as it was not possible to provide the target group with comprehensive financial services.

**Effectiveness rating: 2**

## Efficiency

The financial support provided under the evaluated programme to improve access to financial services for micro and small enterprises in BiH is assessed as follows in terms of its production efficiency, in other words, achieving results at the minimum cost: the bank works efficiently. Despite the originally challenging market environment (shrinkage in the microfinance sector), the bank's growth trajectory and trust in the bank have remained intact, a factor which in turn is reflected in its profitability. The bank's profitability, measured by the rate of return on its total assets and the return on equity (ROE), was 9.5 % at the end of 2018 and can be rated as good, within the context of the finance and banking sector in BiH and taking into account the development mandate (servicing of the MSME sector). The Portfolio-at-Risk (PaR > 90 days) has reduced drastically from 6.9 % to 4.6 % since project appraisal[12] and is much lower than the industry average (8.8 %). Credits were issued with sub-borrower interest rates that were positive in real terms, and at market conditions.

[12] MF Banka Credit Risk File 12/2019

Overall, we rate the production efficiency as satisfactory. The EUR 2 million granted as part of the FC project generated positive momentum in terms of strengthening the equity base, which amounted to EUR 10.59 million at the time of investment.

With regards to allocation efficiency, it must be noted that, in absolute terms, the investment measure in question is very small. While it contributed to implementing the targeted growth trajectory, the small market share of roughly 1.5 % made it impossible for the bank to provide extensive improvements to the access to financial services for MSMEs in BiH.

Following the conversion of the subordinated loan into an equity investment, FC deployed one representative to the bank's supervisory board. The ongoing support for the bank's business development that is part of this responsibility calls for a considerable commitment of resources. Relative to the very small commitment, this support effort appears disproportionately high.

**Efficiency rating: 3**

### Impact

The overarching developmental objective (impact) was to contribute to improving access to financial services for MSEs and, as a result, to broadening and consolidating the financial sector. Furthermore, the goal was to enable the defined target group to access a broad range of financial services offered by the formal banking sector.

Nationally effective financial services, such as savings products and small loans, improve access to adequate financial products for members of the rural and poorer population, as well as for MSEs This helps to encourage saving, and thus absorb risks, while better access to loans helps to secure income for MSEs and ultimately alleviates poverty as a result (MDG1).

No development objective indicators (impact level) were defined during the project appraisal. Due to the project's small scope in absolute terms, no impact indicators were formulated for the EPE either. Nevertheless, two proxy indicators can be used to confirm the plausibility of the project's contribution to the overarching objectives.

| Proxy indicator | Status PA | Ex post evaluation |
|---|---|---|
| (1) Bank's nationwide presence | Headquarters in Banja Luka plus 14 nationwide branches in RS[13] | 26 offices: 15 in RS, 1 in Brcko District and 12 in FBiH[14] |
| (2) Alignment with target customers | No indicator defined | Product range oriented towards target customers |

**Indicator 1:** At the beginning of the FC investment, the bank was only active in one of the two entities that make up BiH, Republika Srpska (RS). To achieve the goal of improving access to financial services for MSEs as well as broadening and consolidating the financial sector as a result, the bank's area of activity had to be expanded. This was achieved by significantly extending the branch network to all parts of the country.

**Indicator 2:** The bank developed internal segments for its target groups to help it address each customer group as effectively as possible. Customers were split into five groups in total, covering private customers and microbusinesses with an annual turnover of up to around EUR 50,000 through to corporate customers with annual turnovers of several million.

[13] Republika Srpska

[14] Federation of Bosnia and Herzegovina

At present, the bank offers eight core products, which have been specially tailored to the needs of MSME customers as the primary target group. These eight products cover 77 % of the total loan portfolio. They are improved and adjusted on an ongoing basis to meet the needs of the targeted customer segment as best as possible. Adjusted to the target group's debt serviceability, these products have flexible terms, repayment amounts and modalities. Just how well these products suit their target audience is also reflected in long-term customer loyalty: for instance, a significant proportion of the customer base is already in their third loan cycle or more with the bank[15].

Overall, this suggests that the target group, primarily private micro and small businesses, are well served by products suited to the target group and by loan approval processes. Thanks to the improvements to its processes and products and the resulting acceleration of the loan approval process, the bank is taking on a special position on the market. This is mitigated by the bank's small share of the market, meaning it can be assumed that there will still be a lack of extensive access to financial services for MSMEs in BiH.

**Impact rating: 3**

### Sustainability

FC made it known to the bank's main shareholder at an early stage that it would be attempting to sell its shares in the bank after a 5-year holding period. The main shareholder is currently in negotiations with other investors who have shown an interest in acquiring a stake in the bank. However, this development should not result in any significant change to the bank's strategic position as the vision of any potential investor must/should match the bank's strategy and its focus on the MSE segment.

The dynamic development in the Bosnian banking sector came to a halt from March 2020 after the government called a "state of emergency" due to COVID-19, resulting in several restrictions and causing a number of businesses to close temporarily. From then, Bosnian businesses experienced losses in revenue, liquidity problems and, in some cases, defaulted on payments. However, the state of emergency was lifted in May and a large proportion of the customers affected were identified. The bank offered support to these customers to help reduce the negative impacts caused by the COVID-19 crisis. At the same time, the government introduced a guarantee programme to support the most affected businesses and to protect jobs; these businesses receive a state payment guarantee to the banks for a portfolio of loans to affected MSMEs, which covers 70 % of the portfolio amount. Thanks to these general conditions in the sector, it appears likely that the MSME, SME, MFI and financial sector will slowly stabilise over the third quarter and will begin setting growth forecasts again following the recovery trend.

In short, it can be stated that the FC investment enabled the bank to create the structures needed to survive on the market over the long term, to keep growing, and to continue and expand its business activities without any further financial support from FC. The bank's success in recent years confirms this assessment. The project to strengthen the bank's equity base in order to finance the necessary and ongoing growth of its portfolio. The interest shown by new investors in the shares due to be sold by FC and FMO underlines that, even after the planned exit of FC and FMO, the bank can still manage to maintain the equity required for its ongoing growth trajectory. In this context, the granting of the KfW loan and its conversion option sent a positive signal to other investors. Under the group's overall strategy, it is important to the parent company that the new investors support the bank's current business model and the customer segmentation between both entities in order to continue to supply the MSME segment with comprehensive financing solutions.

**Sustainability rating: 2**

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[15] According to information provided by the bank itself

### Notes on the methods used to evaluate project success (project rating)

Projects (and programmes) are evaluated on a six-point scale, the criteria being **relevance, effectiveness, efficiency** and **overarching developmental impact**. The ratings are also used to arrive at a **final assessment** of a project's overall developmental efficacy. The scale is as follows:

| | |
|---|---|
| **Level 1** | Very good result that clearly exceeds expectations |
| **Level 2** | Good result, fully in line with expectations and without any significant shortcomings |
| **Level 3** | Satisfactory result – project falls short of expectations but the positive results dominate |
| **Level 4** | Unsatisfactory result – significantly below expectations, with negative results dominating despite discernible positive results |
| **Level 5** | Clearly inadequate result – despite some positive partial results, the negative results clearly dominate |
| **Level 6** | The project has no impact or the situation has actually deteriorated |

Rating levels 1-3 denote a positive assessment or successful project while rating levels 4-6 denote a negative assessment.

**Sustainability is evaluated according to the following four-point scale:**

Sustainability level 1 (very good sustainability): The developmental efficacy of the project (positive to date) is very likely to continue undiminished or even increase.

Sustainability level 2 (good sustainability): The developmental efficacy of the project (positive to date) is very likely to decline only minimally but remain positive overall. (This is what can normally be expected).

Sustainability level 3 (satisfactory sustainability): The developmental efficacy of the project (positive to date) is very likely to decline significantly but remain positive overall. This rating is also assigned if the sustainability of a project is considered inadequate up to the time of the ex post evaluation but is very likely to evolve positively so that the project will ultimately achieve positive developmental efficacy.

Sustainability level 4 (inadequate sustainability): The developmental efficacy of the project is inadequate up to the time of the ex post evaluation and is very unlikely to improve. This rating is also assigned if the sustainability that has been positively evaluated to date is very likely to deteriorate severely and no longer meet the level 3 criteria.

The **overall rating** on the six-point scale is compiled from a weighting of all five individual criteria as appropriate to the project in question. Rating levels 1-3 of the overall rating denote a "successful" project while rating levels 4-6 denote an "unsuccessful" project. It should be noted that a project can generally be considered developmentally “successful” only if the achievement of the project objective (“effectiveness”), the impact on the overall objective (“overarching developmental impact”) and the sustainability are rated at least “satisfactory” (level 3).