Ex Post-Evaluation Brief

BOSNIA AND HERZEGOVINA: Credit Guarantee Fund for the Promotion of SMEs and Business Start-ups

Sector	3213000 Development of small and medium-sized enterprises	
Programme/Client	Credit Guarantee Fund for the promotion of SMEs and business start-ups / BMZ No.: 1999 66 011; Training and further training measure – BMZ No.: 1930 02 359	
Programme executing agency	Two partner banks and three MFIs in BIH	
Year of sample/ex post evaluation report: -/2013		
	Appraisal (planned)	Ex post-evaluation (actual)
Own contribution + financing	EUR 25.6 million	EUR 20.98 million
Own contribution	Undetermined	EUR 5.52 million
Financing, thereof investments (BMZ funds) **Investments (KfW funds)** **Training and further training measure (BMZ funds)**	EUR 25.6 million EUR 12.8 million EUR 12.8 million None	EUR 15.46 million EUR 12.8 million EUR 2.66 million EUR 0.81 million

Short description: Within the framework of the Credit Guarantee Fund (CGF) in Bosnia and Herzegovina (BIH), the German Financial Cooperation (FC) issued guarantees to international commercial banks (CBs) (phases I and II)** and local CBs (phase III). These guarantees guaranteed loans granted by the CBs to local partner banks (PBs, phases I and II) and microfinance institutions (MFIs, phase III). These guarantees totalling EUR 15.46 million guaranteed a loan amount of EUR 20.98 million. After the failure of an MFI in phase III of the project, one of the guarantees was exercised, giving rise to a liability for the FC equivalent to the guaranteed loan amount, less the proceeds from the insolvency proceedings (currently approx. EUR 800,000). In the wake of the training measure staff of the PBs was trained and further educated.

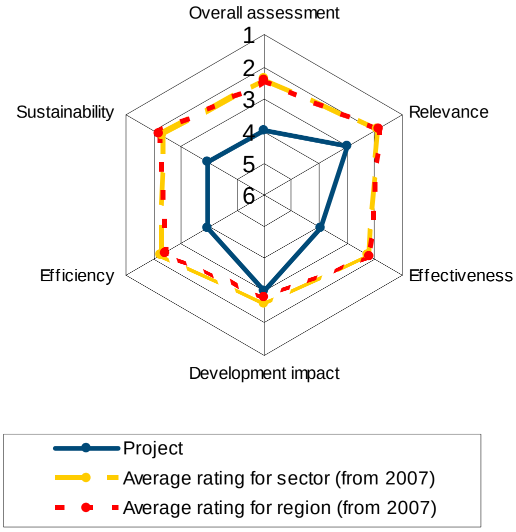
Objectives: The CGF aimed to improve the refinancing situation of local PBs and MFIs in order to facilitate access to funds for local, small and medium-sized companies (SMEs) as well as start-ups (project objective). This was intended to enable the CGF to make a long-term contribution to strengthening the local employment market. Moreover, the development of free-market structures in the financial sector in BIH was to be promoted by creating business relationships between the participants (overarching development goals).

Target group: The target group are SMEs in BIH as well as start-ups.

Overall rating: Note 4

Due to a lack of demand arising from less expensive alternatives for refinancing PBs/MFIs, it was only for a brief period that the funds available were used in full to issue guarantees. The fund operated below its leverage potential for the entire period. In the case of the guarantees provided, the CBs were only bearing a marginal share of overall risk during phases I and II. In phase III, the CGF funds were granted with greater involvement of the CB. The long-term, structural effect on the financial sector nonetheless remained low in all phases. Overall, considering the high transaction costs, the CGF BIH was not an efficient instrument for promoting refinancing.

Rating by DAC criteria



EVALUATION SUMMARY

Overall rating: 4

Relevance

At the time of the project appraisal (Dec. 1999), the banks' lending to MSMEs[1] in BIH was significantly limited due to the extremely high interest rates for MSME loans. According to the World Bank, the interest charged to end borrowers in 1988 was, on average, 75% p.a. and in 1999 41.5% p.a. In light of the macroeconomic framework conditions, it was plausible that there was a need for additional financing in the MSME sector during the project period. The MSME sector had undergone dynamic growth prior to the outbreak of the war in 1992. However, the focus of economic policy on major state companies prior to the declaration of independence in 1992 meant that the MSME sector was only able to a certain extent to play its role as an important driver in the creation of local jobs, despite its momentum. Thus BIH followed the pattern, customary in post-war years, of limited lending, resulting from a barely functioning deposit business (at that time there was no deposit guarantee scheme) and from a lack of confidence in the Bosnian banking sector on the part of international investors. At the time of the project appraisal, a strongly positive impact on the local MSME sector and therefore the local employment market as a result of the improved access to refinancing for the PBs/MFIs provided by a CGF, was to be expected.

At the end of 2002, as phases II and III were being prepared, BIH experienced a rapid increase in deposits in the banking sector. The exchange of German marks into euros or BAM (the Bosnian mark was pegged to the DM before 2002 and has been tied to the euro since 2002) and a growing confidence in the banking sector prompted many investors to immediately take the cash they had exchanged and deposit it with the banks. Since 2001, the rapid increase in deposits, low interest rates abroad and a higher volume of transfers of money from citizens living outside the country have led to a boom in the granting of loans by Bosnian CBs. Lending to private households rose by 119% in 2002 and 37% in 2003, and therefore more quickly than the volume of lending to the corporate sector, which exhibited growth rates of 32% and 30% respectively. This difference cannot be explained by the refinancing situation of the banks, but stems either from a lack of demand for loans in the MSME sector or from a lower willingness on the part of the banks to grant loans to MSMEs. In its 2003 annual report, the central bank noted that the reluctance to lend to companies was also caused by the poor repayment behaviour that was traditional in the corporate sector, uncertain legal framework conditions and an asymmetrical distribution of information among the PBs/MFIs and the MSME sector. The slow growth in the MSME sector and the lower level of lending to MSMEs can therefore also be attributed to institutional factors and is not just a result of a shortage of refinancing options.[2]

[1] For the purposes of the project appraisal, the target group is defined as SMEs, but in fact micro, small and medium-sized enterprises (MSMEs) are addressed. The target group is therefore referred to below as MSMEs.
[2] The figures given in the paragraph have been taken from the annual reports of the central bank: 2003, p. 38-39; 2007, p. 70.

In light of the growth rates referred to above, in mid-2003 the central bank adopted measures intended to counteract any further increase in lending. This was done in order to prevent an increase in the current account deficit and rising inflation (increase in the minimum reserve requirements for banks, more attractive conditions for holding excess reserves at the central bank and more stringent requirements for the maturity matching of PBs/MFIs). In this way, it proved possible to limit the overall economic growth rates in lending, although they remained at a high level of over 20% p.a. until 2009. Consequently, during the preparatory period of phases II and III (after 2002), a lack of refinancing funds in the banking sector probably did not constitute an insuperable barrier in relation to lending to MSMEs. In the course of the rapid development of the sector and the sharp rise in international interest in BIH as a financial centre, after 2002 the banking sector was supplied with sufficient liquidity by foreign parent banks and development finance institutions (DFIs). The project was implemented according to the BMZ sector strategy. As the CGF aims to lead PBs and MFIs towards commercial refinancing, enhanced donor coordination should have acted to try to reduce concessionary funding in the market. In practice, such a coordination process can nonetheless only be implemented with difficulty.

Conclusion: At the start of phase I of the CGF, it was to be assumed that local PBs in BIH were suffering from a considerable lack of refinancing. In the aftermath of the war, it would not have been possible to meet the demand for refinancing funds from domestic sources. Against this backdrop, it appears reasonable and relevant to have established the fund in 2000. The resources from the two increases of the fund in 2007 and 2008 should, in the wake of sector development and liquidity, have worked more towards the establishment of business relationships or adequate processes by means of corresponding measures and not just the provision of refinancing. Overall, nonetheless, the relevance has been rated as satisfactory.

Sub-Rating: 3

Effectiveness:

The project objective of the CGF in BIH was improved access for local PBs/MFIs to commercial refinancing through guarantees for loans granted by CBs. The following indicators were formulated for the purposes of measurement:

Indicators - project objectives	Status
The CGF over at least half of the overall term issues guarantees for loans in at least twice the amount of its original capital resources.	Not achieved
Declining coverage requirement for guarantees by the CGF over the project cycle	Partially achieved
After two years the MSME lending portfolio of the partner banks is above the current level.	Achieved (phases I and II) Not achieved (phase III)
Keeping the share of loans in arrears (> 30 days overdue) in the MSME lending portfolio of PBs under 5%	Not achieved

Indicator 1: The volume of guaranteed loans only exceeds the fund level from BMZ budget funds over a period of 5 years and never by double the amount. Although the funds for the issuing of guarantees were almost fully used over a certain period (including KfW's own funds[3]), there was only a marginal increase in the actual volume of loans granted compared to the guarantees due to the high coverage rates (ratio of guarantee to loan). Overall, neither the coverage rates of below 100% nor the increase in the original capital resources from BMZ budget funds with KfW's own funds were able to achieve the granting of loans in twice the amount of the BMZ budget funds over half the term of the fund. The leverage impact of the fund was thus inadequate.

Indicator 2: In phases I and II, the coverage rates by the guarantees of the fund were, as an (unweighted) average, about 90% of the loan volume. The coverage rate between one CB and a PB declined significantly (from 95% to 75%). Otherwise, the indicator is not applicable due to a lack of follow-up guarantees for the other PBs/MFIs. In phase III, the coverage by guarantees was 50% for all four loans that were granted. However, the trade-off between lower coverage and positive demand manifested itself in increased requirements for the remaining collateral of the participating MFIs in phase III. The coverage rates from phases I and II, on the one hand, and phase III, on the other, are therefore not comparable. Consequently, indicator 2 is regarded as having been partially achieved.

Indicator 3: The MSME portfolios of the PBs funded in phases I and II grew strongly during the project period (annual growth rates of up to 40%). While it is true that after 2008 the MSME sector also shrunk again quickly in the course of the financial market crisis, lending by PBs to MSMEs overall remained above its initial level. After initially high growth rates in the portfolios of the MFIs in phase III between 2006 and 2008, the external shock in the markets caused them to dramatically contract their balance sheets. Overall, the level here following the crisis is below the initial level before the crisis. Hence, indicator 3 is regarded as having been achieved in phases I and II of the fund, but as not having been achieved in phase III.

Indicator 4: The banking and microfinance sector in BIH has, despite the rather weak links of BIH to the global market, been greatly negatively impacted by the crisis after 2008. The key figures for non-performing loans (NPL, 30 days) in the banking sector in BIH stood at 2 to 3% before the effects of the international crisis in 2007 were felt. After the start of the financial crisis, the portfolio quality deteriorated sharply, with the exception of the PB 1 from phase 1. Some of the NPL figures for the second PB from phases I and II and the MFIs from phase III were substantially above the 5% benchmark. Although this benchmark is very conservative in the context of Bosnia, against the background of the benchmark being surpassed to a significant degree, the indicator of portfolio quality is regarded as also not having been achieved.

[3] In addition to the BMZ budget funds, the issuance of guarantees in the same amount from KfW's own funds was planned in order to double the guarantee volume. In the case of an exercise of a guarantee, KfW's own funds would only have been used after the BMZ budget funds in order to satisfy the claims.

Conclusion: Overall, the CGF BIH did not achieve its project objectives. The lack of demand for fund resources did not permit the full utilisation of the fund's capacities. In the course of the crisis, the portfolio quality of the participating PBs and MFIs deteriorated, meaning that ultimately it was not possible to induce positive demand with a simultaneously high quality of the portfolio.

Sub-Rating: 4

<u>Efficiency</u>

In phases I and II of the fund, the volume of extended loans barely exceeded the funding available from it. In the total period of phases I and II, guarantees to the amount of EUR 11.5 million were issued, guaranteeing loans of approx. EUR 13 million. Overall, the efficiency of the funds used in phases I and II appears not to be satisfactory for three reasons. Firstly, the revolving potential of the fund at the CB – fund level was not fully utilised due to weak demand. Secondly, the guarantees exceed the BMZ budget funds to a far lesser degree than had been planned. Thirdly, owing to the high coverage rates, the amount of the loans granted is scarcely greater than the amount of the guarantees issued. An analysis of the leverage impact demonstrates that the fund is working below its maximum capacity. In phase III of the fund, budget funds totalling EUR 12.8 million were available on the CGF account from July 2008 for the issuance of guarantees, before the amount of these funds from phases I and II (EUR 7.68 million) was transferred to the European Fund for Bosnia and Herzegovina (EFBH) in 2011. In phase III, the fund collateralised loans to the value of EUR 8 million to MFIs. In phase III, the greater participation of the CB (lower coverage rates) led to an increase in the potential leverage of the fund. The utilisation of resources from phase III of the fund also increased significantly in comparison to phases I and II. Nevertheless, due to the delayed scaling back of the funds from phases I and II (a scaling back in 2008 had been planned, while in fact the funds were only transferred to the EFBH in 2011) efficiency at this stage also turns out to be low.

The guarantee for the MFI that failed in phase III results, up to this point in time, in a payment obligation of approx. EUR 813,000 to the CB that had extended the loan to the MFI.[4] This amount is equivalent to 3.9% of all granted loans or 5.2% of the issued guarantees. Even in the case of minor further successes in the winding-up process of the MFI, the default rate of the fund in relation to the guarantees will thus remain just below the customary 5% benchmark.

Conclusion: The efficiency of the project is impacted in particular by the very weak use of the leverage potential. The low leverage impact of the fund in BIH is accompanied by high transaction costs. While it is difficult to quantify the transaction costs, if one takes the fees paid by the PBs/MFIs as an indicator, in this category the CGF BIH involves higher costs than do more direct methods of refinancing. Although the loan conditions were adapted to market

[4] The MFI is still being wound up. The amount of the default may therefore decrease even more in future.

conditions during the course of the project, the CGF-guaranteed loans remain an expensive refinancing tool for the PBs/MFIs. Moreover, the BMZ budget resources of the fund were committed throughout the project period, since these had actually been paid, at the project start and in full, into the fiduciary account managed by KfW. Requests for disbursement of the funds were thus not based on the actual progress of the project (guarantees) or on acute need (defaults). It was not possible to take into account the idea of the diversification of a guarantee (the simultaneous claiming of all guarantees is very improbable, so less capital has to be retained). Overall, in respect of the efficiency criterion, the CGF is rated as unsatisfactory.

Sub-Rating: 4

Impact

In the wake of the project appraisal and the first increase in funds, no indicators for measuring the impact on the local employment market and on the structures in the financial sector were defined. As part of the second increase of funds, indicators were formulated to measure the project's impact. As there was no benchmark of the initial situation for the indicators, they cannot be explicitly assessed and are therefore not listed here. Instead, an assessment based on the indicators is included in the text.

The funded PBs and MFIs increased their exposure in the MSME sector during the course of the project. Thanks to a high portfolio quality, also beyond the crisis, a successful promotion of productive parts of the MSME target group may be assumed for PB 1 from phases I and II. The fund resources contributed to the penetration of previously unserved areas of the MSME sector. On the other hand, the strong growth of the MFIs in phase III in the MSME sector can be explained not only by the reduction of information asymmetries or a high growth potential in the MSME sector, but also by a great willingness to take risks (thanks to good refinancing opportunities and high liquidity). The high default rates following the crisis can be attributed both to the weak overall economic situation and poor risk assessment on the part of the MFIs. An adequate portfolio quality in relation to MSMEs was not achieved by all PBs and MFIs.

As regards the loans almost completely covered by guarantees in phases I and II, the use of a CGF only appears meaningful if it actually contributes to the reduction of information asymmetries between CBs and PBs, enabling favourable conditions to be implemented in future as the participants pursue their business relationship further. This applies even more, since at the same time the benefits of other modes of financing (the direct passing-on of more favourable conditions, lower transactions costs) were abandoned in the wake of the CGF. However, the CB that placed four out of five of the granted loans in phases I and II appears to also have been sufficiently established in the Bosnian market before the introduction of the CGF and was furthermore a shareholder of PB 1. The second CB in phases I and II was the parent bank of PB 2. The FC consequently had no informational advantage over the CB, which might theoretically justify the use of the CGF and the guarantee (a better informed entity vouches for the borrower).

The model practised in phase III with lower coverage rates and the participation of local CBs appears rather to have helped to develop structures in the financial sector. Due to the smaller size of the MFIs from phase III, it is likely that there were more opportunities to reduce information asymmetries here. Ex post, however, it can be seen that in phase III too the fund only managed to a limited extent to provide targeted support for the best MFIs in BIH in the sense of the "pick the winner approach". For this reason, one cannot necessarily assume an informational advantage of the FC. An analysis of the sources of refinancing of the two MFIs from phase III that are still in the market shows that, even after the crisis, they have access to different concessionary refinancing sources. No trend towards moving in the direction of non-concessionary sources of refinancing can be observed among the MFIs. Neither of these MFIs is currently financed via their CGF-CB.

Conclusion: By selecting suitable partner institutions in phases I and II, CGF BIH essentially succeeded in improving the MSME sector's access to capital. It may be assumed that the additional liquidity, in particular of the MFIs in phase III, was used to push forward into underserved parts of the MSME sector. However, the fund's development effect on the MSME sector is reduced by the weak demand and low leverage impact. The structural effect of the fund resources on the financial sector has two sides. In phases I and II, the fund did not contribute to the reduction of information asymmetries between the PBs and CBs. Although it is true that the participants "got to know each other" in phase III, there has been no targeted promotion of the most successful Bosnian MFIs. As the positive impact on the MSME sector partially compensates for the lack of a structural impact on the financial sector, the development impact is rated as satisfactory overall.

Sub-Rating: 3

<u>Sustainability</u>

A positive appraisal of the sustainability of a CGF with regard to capacity-building in the financial sector is primarily appropriate when it contributes to the development of long-term business relationships between CBs and PBs/MFIs (see achievement of the overarching development goals). Within the context of the fund in BIH, it may be stated that the participating CBs in phases I and II had already previously maintained business relationships with the PBs as parent bank or shareholder. Consequently, the fund has not brought about a short or long-term development of these relationships. As a result of the guarantee, the loan received from the CB was competitive with other concessionary sources of refinancing during the term. After the end of the guarantee, however, loans from other sources were again less expensive. Due to the crisis and crowding out by concessionary funding, there has been no capacity-building or structural effect so far.

One of the partner MFIs from phase III is still being wound up. Even if the distortions in the microfinance sector can be limited by the attempt to wind up the MFI in an orderly fashion, it can be assumed that the support for this MFI is having an adverse effect on the sector. The injection of liquidity into an MFI with little solvency delays the implementation of orderly winding-up processes. Moreover, it may be assumed that, in this case, responsible finance approaches towards the end borrower were not followed to the desired extent.

Due to the increased liquidity at the PBs and MFIs before the international financial crisis in 2008, an initial growth momentum in respect of the MSME sector can be assumed. During the course of the crisis, all participating MFIs and PBs again dramatically reduced their positions in the MSME sector (and their whole portfolio). Non-performing loans in the aggregated banking sector rose to almost 13% in 2012. The deterioration in portfolio quality does not concern PB 1, which received the largest part of the loans from phases I and II. The sustainability in respect of the support of MSMEs is rated as good for this PB, but as unsatisfactory due to the curtailment of the balance sheet total and the inadequate portfolio quality of the other PBs/MFIs.

Conclusion: The sustainability of the fund in relation to the support of PB 1 in phases I and II is essentially achieved. No long-term positive effect on the PB 2 and the MFIs and their exposure in the MSME sector is discernible after the impact of the financial crisis. As a result of the financial crisis, it did not prove possible to lead the Bosnian financial sector towards self-sustaining refinancing (from non-concessionary sources) by means of the CGF. Doubts must inevitably be raised in particular regarding the sustainability of the stimulus for capacity-building in the financial sector. Overall, sustainability is consequently given an overall rating of unsatisfactory.

Sub-Rating: 4

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:

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

Ratings 1-3 denote a positive or successful assessment while ratings 4-6 denote a not positive or unsuccessful 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. Ratings 1-3 of the overall rating denote a "successful" project while ratings 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" (rating 3).