Ex Post-Evaluation Brief

REPUBLIC OF SERBIA: Credit Guarantee Fund

Sector	Financial intermediaries of the formal sector (24030)	
Project	Credit Guarantee Fund for the promotion of small and medium-sized enterprises (SME) as well as business start-ups – 2001 40 483*	
Programme-executing agency	Three Serbian commercial banks (partner banks)	
Year of sample/ex post evaluation report: 2013/2013		
Investment costs	**Appraisal (planned)**	**Ex post evaluation (actual)**
Own contribution + financing	EUR 10.22 million	EUR 8.90 million
Own contribution	Not planned	EUR 0.77 million
Financing, thereof	EUR 10.22 million	EUR 8.13 million
Investments (BMZ funds)	EUR 5.11 million	EUR 4.09 million
Investments (KfW funds)	EUR 5.11 million	EUR 4.04 million
Project support measures (BMZ funds)	none	none

* Project in random sample (2013)

Short description: In the scope of the Credit Guarantee Fund (CGF), guarantees were issued to international commercial banks by the Financial Cooperation (FC). These guarantees secured refinancing loans from international commercial banks to Serbian partner banks active in the SME sector. Guarantees for four loans to Serbian partner banks totaling EUR 8.13 million were issued in the scope of the CGF. The guarantees were hedged using the funds of the CGF, meaning if the Serbian partner banks had defaulted, the guaranteed loan amount would have been paid from the CGF funds to the international commercial banks at the time of the default. No guarantee was claimed in the course of the project. Given weak demand, the CGF funds were not used after 2007 for further guarantees, but rather gradually transferred to the European Fund for Southeast Europe (EFSE).

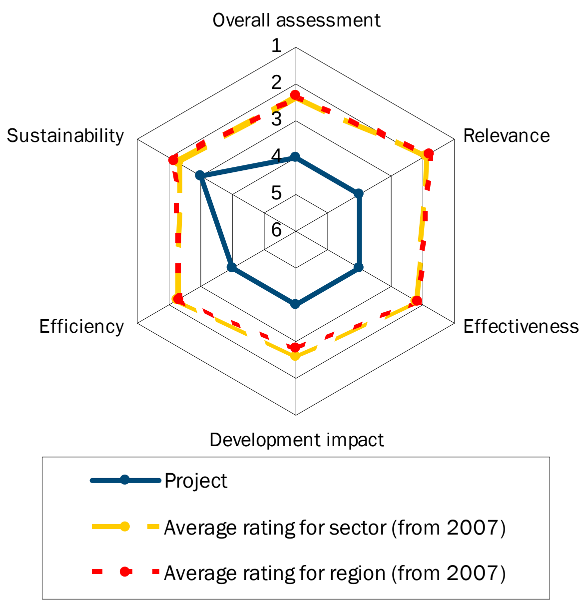
Objectives: The aim of the project was to mobilise capital market funds for select local banks by way of the CGF in order to guarantee lasting access to credit (project objective) for small and medium-sized enterprises (SMEs). The services of the CGF should contribute to creating and securing permanent jobs and additional income at sustainably viable small and medium-sized enterprises, as well as supporting the establishment of market-based structures in the financial sector (overall objective).

Target group: The direct target group were SMEs from all sectors with fewer than 50 employees.

Overall rating: Note 4

Given the rapid development of the financial sector in Serbia, the use of guarantees at the time of the first issue was no longer critical for the refinancing of partner banks and was less efficient than other instruments (loans, trustee participations, etc.). Serbia's Credit Guarantee Fund was therefore not a complementary product to other methods of aid, but instead competed directly with concessionary refinancing loans for local partner banks. One positive factor is that the funds were carried over to EFSE starting in 2007, generating further impact.

Rating by DAC criteria



EVALUATION SUMMARY

Overall rating: Note 4

Relevance

There was high demand for funding in the Serbian banking sector during the planning phase of the Credit Guarantee Fund (CGF) from 1999 to 2001. This was hard to come by, as the volume of savings deposits was small, given that the population had little trust in the banking sector and the local financial institutions (FI) had no access to international financial market funds, due to the high country risk and the very poor creditworthiness of the FIs by international standards.

The aim of the CGF was to improve access to international financing for local FIs and thus mobilise additional funding for the granting of SME loans. It was intended to mitigate at least some of the risk for foreign investors and achieve an additional mobilisation effect to the point that these foreign investors would also use their own funds in issuing loans. The business relations established by the CGF between local FIs and foreign investors were, over time, also expected to help counter the insufficient sector knowledge (asymmetrical distribution of information) of the foreign investors to the point that they would also be prepared to invest in the Serbian banking sector in the future without guarantees from public donors. An expansion of the CGF into other countries in Southeast Europe was planned in the medium term for the purpose of better diversification of the fund.

Using this new portfolio modeling approach, the CGF represented an enhancement of CGFs for the collateralisation of end-borrower loans.

The CGF was seen as a complement to many other financial sector projects within the region (loans, trustee participations, etc.) The chain of effects described above was assumed to be valid since it was deemed unlikely that the additional public funds could meet the capital requirement of local Serbian FIs. At the time the first guarantee was provided (end of 2002), however, this assumption had to be reevaluated. By then the CGF had already become much less relevant due to the fact that the Serbian banking sector´s liquidity had greatly improved. This liquidity was provided to local banks primarily by their parent banks and Development Finance Institutions (DFI) in the form of low-interest loans. The lack of interest on the part of international commercial banks in becoming active as financiers in the local Serbian banking sector was also caused by their inability to compete with low-interest loans by foreign parent banks and DFIs, which made it impossible for the international commercial banks to negociate risk-adjusted interest premiums. For this reason amongst others, the CGF was not expanded into other countries in Southeast Europe.

The CGF was certainly relevant during the planning phase and its design is consistent with the sector concept of the BMZ. However, it quickly became less relevant after taking up business activities due to the heavily rising volume of other funding at the same time. Despite the innovative nature of the project, we can therefore no longer give a satisfactory rating.

Sub-Rating: 4

Effectiveness:

The aim of the project was to mobilise capital market funds for select local banks by way of the CGF in order to provide lasting access to credit for small and medium-sized enterprises (SMEs). The following project objective indicators were chosen for the purpose of measuring this objective: (1) Over at least half of the term, CGF will provide guarantees for loans[1] in at least twice the amount of the original capital resources; (2) declining coverage requirement through guarantees by the CGF for the borrowing of partner banks over the term of the CGF; (3) SME lending portfolio of the partner banks showing stronger growth than the total assets of the partner banks and (4) keeping the share of non-performing loans (> 30 days overdue) in the SME lending portfolio of partner banks under 5%[2].

Reaching the target is depicted as follows:

Indicator (1): The CGF in Serbia issued guarantees from 2003 to 2007 in twice the amount of its initial capital. In addition to the BMZ funds, guarantees for roughly EUR 4 million were issued at KfW's own risk to achieve this goal. Had a guarantee been claimed, these funds would only have been used after the BMZ funds were claimed from the CGF in order to satisfy the claims. The complex negotiation process still delayed the issue of guarantees until the end of 2002. Moreover, the CGF funds were transferred to the EFSE in 2008 (which was earlier than planned) due to a lack of demand. This shortened the period of time for granting guarantees overall from the base of ten years for indicator (1) to fewer than five years (2003-2007). We regard the indicator nonetheless as reached.

Indicator (2): Four guarantees were issued in the scope of the CGF. Only one local partner bank received a follow-up guarantee. The coverage ratios (ratio of guarantee/loan) amounted to 90-95 per cent for all loans. There is no discernible trend towards lower coverage rates due to the mostly lacking follow-up guarantees. The coverage rates are considered very high against the backdrop of adequate risk-sharing, also by international standards (roughly 50% is the norm here). We therefore rate this indicator as not reached.

Indicator (3): Because two of the three partner banks have now been taken over by foreign commercial banks, no detailed information on their SME portfolios for the period before the acquisition is available. This goes for both the structure and the quality of the SME portfolios.

[1] On indicator (1), it should be noted that the guaranteed loan portions were fully collateralised with deposits in a cash depot independent of the actual default risk of the local partner banks.
[2] A PaR of 7% was initially applied as a threshold. However, the indicator was adjusted in the course of the ex post evaluation, as 5% is now used as a standard indicator in the financial sector.

Two of the partner banks are still active today in the SME sector and use lending technology relevant to SMEs. Despite the absence of precise data on the change in the lending portfolio, we believe the indicator is reached for at least two partner banks due to the continued focus on the SME business.

Indicator (4): One partner bank has featured since its founding a high-quality portfolio with a lasting share of non-performing loans (NPL > 30 days) of less than 5%. In the case of one of the other partner banks, the non-performing loan portfolio rose sharply in the course of the financial crisis and is currently well beyond the 5% mark. There are no figures for the third partner bank on the non-performing loan portfolio. However, because this bank shows a weak overall performance (it closed out 2009 and 2010 each with considerable losses), it is expected to exceed the 5% mark. For tax reasons, many Serbian banks (also the partner banks of the CGF) are not writing off their NPLs at the moment. The current NPL values of the Serbian financial sector (average of 19%) are therefore probably inflated by a few percentage points. Nevertheless, it is assumed that this indicator has not been reached.

In sum, we rate the effectiveness as unsatisfactory.

Sub-Rating: 4

Efficiency

All available funds of the CGF were used over half of the term in order to issue guarantees to international commercial banks. The funds were thus used according to their actual purpose. The efficiency of the transactions in the scope of the CGF in Serbia, however, is rated as low. The complex contractual agreement, which predates a guarantee, involves three parties.

Given the high transaction costs, the guaranteed loan amount of the four guarantees is still regarded as too low. The main reason for this is that only a very minor leverage effect of the FC funds could be generated on the level of the commercial banks due to the high coverage rates of 90-95% and the 100% collateralisation of the guaranteed loan portions by cash depots.

The margins for the commercial banks on the nearly fully covered, i.e. risk-free loans, were still rather high, so it can be assumed that these banks benefitted from windfall profits The production efficiency of the CGF is therefore regarded as low.

The production efficiency of the partner banks has partly declined since the financial and economic crisis. However, most of the loans to partner banks (and thus the loans to the end borrowers as well) were repaid even before the financial and economic crisis was able to have a negative impact on the portfolio quality of the partner banks.

The allocation efficiency of the CGF is deemed more positive on the level of the partner banks. Today, the strategic orientation towards SMEs no longer seems to exist for all partner banks, but no guarantee was claimed for any of the loans backed by the CGF and in 2007 the funds were transferred to EFSE, where they continue to generate positive effects.

Still, we rate the overall allocation efficiency as relatively low since the CGF funds showed only limited effects on partner banks and SMEs due to the low level of demand for guarantees, the hedging of guarantees with cash and only minor leveraging effects. Continuously productive use of the funds was only achieved by transferring them to the EFSE.

Overall we therefore rate the efficiency of the project as unsatisfactory.

Sub-Rating: 4

Impact

As an overall objective of the project, the services of the CGF were to contribute to creating and securing permanent jobs and additional income at sustainably viable small and medium-sized enterprises, as well as supporting the establishment of market-based structures in the financial sector.

It can be assumed that the CGF in Serbia indirectly contributed to the development of the SME sector, since two of the three partner banks clearly addressed this sector. The loans issued by the partner banks secured jobs at the least, and may have even helped to create new jobs. A contribution to additional income cannot be proven and is considered rather low on the basis of plausibility considerations. Given the very minor leverage effect, the real economic effects are almost certainly less significant than hoped for during the planning stage.

Regarding the promotion of market-based structures, i.e. the establishment of long-term business relations between local banks and international commercial banks, the CGF's contribution was ultimately minor. The issue of guarantees by the CGF did not lead to such relationships between the parties. The CGF did not contribute to reducing asymmetries in information (if these existed at all). An asymmetrical distribution of information between the CGF and the international commercial banks is also only assumed to a limited degree, since at the time the guarantees were issued one of the international banks involved e.g. held equity in the corresponding Serbian partner bank, and was therefore well informed of the situation in the Serbian microfinance sector. The coverage rates also did not decline in the course of the CGF. One of the loans was repaid prematurely due to the conditions perceived as unfavourable by the partner bank.

We therefore rate the overall developmental policy effects as unsatisfactory.

Sub-Rating: 4

Sustainability

Because the issuing of guarantees did not result in any long-term business relationships between international commercial banks and local partner banks, the CGF has no sustainable effect on the development of partner banks. A sustainably positive contribution is assumed for the development of the local SME sector for two guaranteed loans to three partner banks. The CGF funds were carried over to the EFSE in 2007. The EFSE was rated very well in an ex post evaluation in 2008. As the funds continue to generate positive effects, we rate the sustainability as satisfactory.

Sub-Rating: 3

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).