Ex post evaluation – Balkans and Caucasus

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Sector: Informal and semi-formal financial intermediaries (CRS code 2404000)
Programme:Support for the private sector (fiduciary holding) (ex European Neighbourhood Small Business Growth Fund) - BMZ no. 2008 65 030* and European Fund for Southeast Europe/ Western Balkans (EFSE) - BMZ no. 2010 36 664*
Project Executing Agency: European Fund for Southeast Europe (EFSE)

Ex post evaluation report: 2014

		Project A (Planned)	Project A (Actual)	Project B (Planned)	Project B (Actual)
Investment costs (total)	EUR million	11,00	11,00	25,00	25,00
Counterpart contribution	EUR million	0,00	0,00	0,00	0,00
Funding	EUR million	11,00	11,00	25,00	25,00
of which BMZ budget funds	EUR million	11,00	11,00	25,00	25,00

*) Random sample 2012

Description: This evaluation covers two shareholdings of the EFSE, the European Fund for Southeast Europe (EUR 11 million in C shares for the new Caucasus programme, and EUR 25 million in C shares for the existing Balkans programme and the sub regional window). Additional private and public investment was supposed to increase EFSE's capacity for lending to financial institutions. The financial institutions issue loans refinanced by EFSE to MSMEs and households. The target countries in these programmes are Armenia, Azerbaijan, and Georgia (the Caucasus) and Albania, Bosnia-Herzegovina, Kosovo, Croatia, Macedonia, Montenegro, Serbia and Turkey (the Balkans). The sub regional programme also covers Bulgaria, Romania, Moldavia, Ukraine and Belarus.

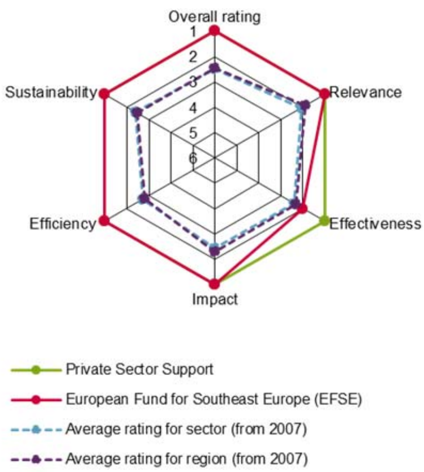
Objectives: Development objectives: To help deepen and broaden financial systems and foster private enterprise as well as assistance in increasing employment, raising incomes and improving living conditions for the target group. Objectives of the FC measures: To expand lending by financial institutions to medium, small and micro enterprises (MSMEs) and households in the target region on a sustainable basis, as well as leveraging FC funds through public and private investment in EFSE (i.e. a public–private partnership approach).

Target group: Qualified local partner finance institutions (PFIs) (direct); private MSMEs and households on low or medium incomes (indirect).

Overall rating: 1 (Balkans)
1 (Caucasus/sub regional)

Rationale: ---

Highlights: C shares help to refinance credit lines to PFIs. However, their leveraging function is more important - C shares bear the primary risk of default, thereby enabling EFSE to acquire further refinancing. In the past, financing and risk assumption / leveraging were regionally restricted to the Caucasus or the Balkans. Now there is also a sub regional window. In the Caucasus, the C shares have enabled EFSE to issue more highly leveraged and target-group oriented lines of credit to PFIs. The C shares earmarked for the Balkans have yielded equally good results. Furthermore, EUR 20 million out of the EUR 25 million was injected into a sub regional window. This has had a significant structural impact.



Rating according to DAC criteria

Overall rating: 1 (Caucasus) and 1 (Balkans/ sub regional)

In its 2012 evaluation, the European Bank for Reconstruction and Development (EBRD) awarded EFSE, which was established in 2005, a very high score for each of the DAC criteria. We view EFSE's overall model as highly innovative, structure-building and effective. As an aside, at the time the report was compiled, it was not yet possible to foresee the effects the civil war-like situation in Ukraine would have.

The present report evaluates the following two capital investments in these sub-funds, which both have comparable objectives:

1. EUR 11 million in C shares for the programme to promote private enterprise (fiduciary holding) – referred to hereafter as the Caucasus programme or the Caucasus sub-fund;
2. EUR 5 million in C shares for the existing programme European Fund for Southeast Europe / Western Balkans (EFSE) - referred to hereafter as the Balkans programme or the Balkan-sub-fund – and additional financing of EUR 20 Million for C shares to be used in a sub regional setting.

C shares help to refinance credit lines to PFIs. However, it is their leveraging function which is more important; in the first instance, C shares bear the sole risk of default, thereby enabling EFSE to acquire further refinancing from other sources. Financing and risk assumption/ leveraging are, to some extent, restricted on a regional basis. In the Caucasus programme, which was confined to the countries of Georgia, Azerbaijan and Armenia, these highly leveraged C shares have enabled EFSE to issue lines of credit to PFIs with a clear focus on the target group (a very good result). In the Balkans programme, which was confined to the countries of Albania, Bosnia-Herzegovina (BiH), Kosovo, Croatia, Macedonia, Montenegro, Serbia and Turkey, the additional C shares have proven equally effective. The PFIs' portfolio, which had already been refinanced prior to the EFSE programme, has expanded rather moderately due to the financial crisis of 2008; however, we think this is appropriate, bearing in mind the portfolio's maturity. In addition to the Balkans FC measure, a substantial contribution was also made to a sub regional window. This was not restricted by country, meaning it included Bulgaria, Romania, Moldova, Ukraine and Belarus, as well as the countries named above. Due to the current economic and political crisis in Ukraine, we envisage an equally good result for this programme overall, but with a slightly negative outlook.

Relevance

Both projects aimed to improve access to credit for MSMEs and private households through the provision of additional credit lines from EFSE to local banks and microfinance institutions (together identified as PFIs). In both of the regions considered here, MSMEs either dominate the economy as in the Balkans or they constitute the key sector for future, broad-based growth as in the Caucasus. The development objective is therefore highly relevant. EFSE is a well-established organisation. It is jointly managed by a large number of donors and development banks, and it conforms to the strategies of partner countries. EFSE provides liquidity to PFIs and to the indirect target group (MSMEs and households). Alternative provision routes, such as credit lines provided directly to PFIs by Financial Cooperation (FC), have not yielded any obvious advantages by comparison. In the Caucasus, MSME financing provided by EFSE – which first came into being as the result of an FC measure – addressed a core problem that had clearly been neglected in the past. Previously, it was mostly the EBRD (which principally provided lines of credit to larger SMEs) and, to a small extent, German FC (through funds in Armenia and Azerbaijan) that were active in this region. In comparison, the extended refinancing of PFIs undertaken in the Balkans has rather less relevance, because all the significant investors in this field (EBRD, International Finance Corporation, KfW and EFSE itself) had already launched comprehensive programmes in these countries. However, since the crisis, Italian or Austrian majority owned banks have had significant problems in obtaining long-term refinancing from their parent companies. Some donors have also become more cautious since the crisis.

Political partners also consider the EFSE to be highly relevant. They are engaged in the EFSE's Advisory Group, represented by their respective central bank. The Armenian government has contributed funds to EFSE via its central bank and Albania also participated in 2008, i.e. well before the launch of the FC measures evaluated here. These programmes represent an appropriate continuation of earlier initiatives by German FC in these countries.

The EFSE has a range of products which is tailored to the needs of end customers (MSMEs and households) and PFIs. Long-term senior credit lines represent 80% of the portfolio, with equity-equivalent loans constituting a further 18 %. The portfolio is dominated by credit lines for MSMEs and residential property (which constitute 68 % and 23 % respectively) as well as special lines for MSMEs in rural areas, which now make up 9 %. To protect customers against currency risks, EFSE not only offers financing in euros (75%) but also provides lines in US dollars (more usual in the Caucasus) and now even offers loans in four local currencies. EFSE gives full and proper consideration to cross-cutting issues of developmental importance (poverty reduction, responsible finance, gender equality and good governance), both in its lending and accompanying activities (e.g. studies and reports).

The Caucasus initiative is deemed to be extremely relevant. Despite high indebtedness ratios (e.g. in Serbia, Bosnia-Herzegovina and Montenegro), a high level of relevance is attributed to the Balkan initiative evaluated here. The sub regional C shares can be "deployed" in any of the EFSE target countries; for this reason, they too have been assigned a very high degree of relevance.

Relevance rating: 1 (Caucasus) and 1 (Balkans/ sub regional)

Effectiveness

The objectives of this measure were to expand sustainable lending by financial institutions to MSMEs and households and to leverage the FC funds through private and public financial investment in the Balkans and the Caucasus. The target achievement was to be measured against the following indicators: (1a) partner banks requesting funds to be disbursed within one year for the Caucasus and two years for the Balkans and the sub regional window; (1b) on-lending to end borrowers within a two-year period; (2) leveraging of FC funds by a factor of four (within three years for the Caucasus and two years for the Balkans and the sub regional window); (3) portfolio quality: arrears rate on sub-borrower loans issued by the PFIs in excess of 90 days (Portfolio at Risk or PAR >90) to be < 7 % for the Caucasus and < 8 % for the Balkans and the sub regional window; (4) MSME loans: Caucasus – 70 % of sub-borrower loans to be less than EUR 10,000; Balkans: average end-borrower loans to be approx. EUR 4,000; (5) Default rate (on EFSE credit lines issued to banks) to be < 5 %. An additional indicator was defined for the sub regional measure: (6) at least EUR 15 million to be disbursed by PFIs in local currency within three years.

Indicators (1 a/b and 2): In the Caucasus, the FC funds, which amounted to EUR 11 million, served as the "first loss piece" (C shares) and thereby enabled the EFSE to become active in the region. The funds were used quickly; they were leveraged by other funds of the EFSE by a factor of eleven, with the result that by the end of 2012, the portfolio already stood at EUR 127 million. The Balkan funds were also used within an appropriate period and a good leveraging ratio was achieved: the EFSE portfolio in the Balkans rose from EUR 461 Million in 2010 to EUR 476 million in 2012 and EUR 498 million in 2013. This gives a leveraging factor of 3 by 2012 and 7 by 2013.

Indicator (3): Average PAR>90 for the EFSE PFI portfolio stands at less than 7%. In the Balkans, however, almost a fifth of financial institutions show PAR values worse than 7 %.

Indicator (4): The refinanced sub-borrower loan portfolio in the Caucasus is deemed to be oriented towards the MSME sector, as over half of the EFSE's open credit lines are with PFIs whose loan business is very much geared to MSMEs, including micro enterprises. The indicator value for the Balkans (average end borrower loan value of approx. EUR 4,000) was not met; the figure achieved was actually higher. However, in our view the limit of EUR 4,000 was too low overall and, given the background – the experience of the financial crisis and the over-indebtedness of private households – we see this, taken altogether, as a positive trend.

Indicator (5): There were no payment defaults on accounts due to the EFSE in either region.

Most of the objective indicators were achieved in both the Caucasus and the Balkans programmes: the EFSE's outstanding credit portfolio reached a new high of EUR 826 million at the end of 2013. For the EFSE as a whole, the "ratio" of C shares to the credit portfolio in-creased slightly from 38 % at the end of

2012 to 39 % at the end of 2013. Against the back-ground of a financial crisis which has yet to be overcome, only the portfolio quality is below expectations at a series of financial institutions.

Although the period taken into consideration for the sub regional funds is still comparatively short (i.e. starting at the end of 2011), the following can already be stated. The total EFSE portfolio grew from EUR 735 million in 2011 to EUR 826 million in 2013. The FC funds were leveraged by a factor of 4. The outstanding PFI portfolio climbed from EUR 583 million in 2011 to EUR 768 million in 2013. Indicators 1 and 2 are thus fulfilled. Indicator 3 (default rate on sub-borrower loans, more than 90 days overdue [PAR>90] < 8 %) as with the Balkans measure, has only been partially fulfilled. Indicator 4 does not apply to the sub regional measure. Indicator 5, which relates to the default rate on payments due to EFSE is, as stated above, fulfilled. **Indicator 6,** which relates to the local currency proportion, is almost fulfilled, at EUR 14 million as against the planned level of EUR 15 million. Even so, the proportion of loans provided to end borrowers in local currency is significantly higher at 50 %, and we therefore consider indicator 6 as fulfilled. Consequently, we ascribe a very high level of effectiveness to these FC measures.

Effectiveness rating: 1 (Caucasus) and 2 (Balkans / sub regional)

Efficiency

EFSE operates without any ongoing subsidies and over the last four years, it has had an average return on equity of 3.7 %. This is good considering that EFSE is 82 % financed by equity capital (C shares) or quasi-equity funds (B and A shares) and therefore has very little financial scope to leverage income (increasing return on equity through the use of external capital). Between 2009 and 2011, the EFSE's cost-to-income ratio remained below 40 %. Although it surpassed the 40 % mark in 2012, it is still within an acceptable range. EFSE's credit risks are low. The income allocated to the C shares is small, because investors who invest on market terms are served significantly better. Nevertheless, the inflation-adjusted value of the C shares (the donor funds) in EFSE remains roughly the same. Even though this is difficult to measure, it is reasonable to assume that credit line programmes developed by EFSE in the target regions have lower transaction costs for German FC than individual credits or approaches using other partner structures. EFSE has a highly professional management team and effective processes for risk management and reporting. It is in a position to cultivate efficient customer relations (sound preparations undertaken before lending decisions, yet decisions made quickly enough, simple-to-use portfolio monitoring in place for PFIs, etc.)

It is therefore reasonable to assume a high level of efficiency for the EFSE as a whole, although it is not actually the subject of this evaluation; an assessment which is adopted with regard to these individual development measures. The creation of sub regional C shares and their financing by the BMZ in 2012 has raised the efficiency even higher. In this connection, it is important not to introduce any restrictions by country in the case of future commitments.

Efficiency rating: 1 (Caucasus) and 1 (Balkans/ sub regional)

Impact

Within their respective target regions, the FC measures both have the same overarching development objective – helping to deepen and broaden financial systems as well as promote the private sector, increase employment and incomes, and improve living conditions for the target group.

In the case of the Caucasus measure, overall objective indicator 1 (increased lending by PFIs to MSMEs and households) is fulfilled. The EFSE PFIs have expanded their portfolio (which is geared towards the target group) substantially beyond the volumes refinanced by EFSE. EFSE has contributed significantly to this positive trend with a high proportion of the refinancing for these PFIs' lending business – 5 % overall, even as high as 7 % if the only major bank in the EFSE Caucasus portfolio is removed from the calculation. In Armenia, the EFSE PFIs constitute approx. 26 % of the total banking infrastructure (branches and ATMs) and thus make a further contribution in terms of financial inclusion. According to various calculation methods (e.g. that of the International Finance Corporation), it can be assumed that the credit business generated in this fashion has created and / or safeguarded more jobs than anticipated when this measure was appraised (overall objective indicator 3 also fulfilled). Having said that, all of these methods involve rough estimates, so there are limits to their validity. The role played by MSMEs in the Caucasus states is growing in numerical terms (demonstrably so in Armenia and Georgia); and in Azerbaijan at least the general conditions for MSMEs are being improved. Overall objective indicator 2 (the pro-portion contributed by MSMEs to gross domestic product [GDP] is rising) can also be considered fulfilled. In contrast to the Balkans, MSMEs in the Caucasus are less affected by the financial crisis and the euro crisis.

For the Balkans FC measure, overall objective indicator 1 has also been fulfilled. Since the FC funds were provided, the PFIs have been furnished with new refinancing, meaning they could significantly expanded their total volume of lending. Admittedly, this is mostly due to the arrival of Croatia and Turkey in the funding portfolio. The EFSE lines to PFIs in the countries targeted by the Balkans measure were also increased. If only the original six countries covered by the Balkans measure are considered (i.e. excluding Croatia and Turkey), only a moderate increase in business can be detected. Viewed against the background of the financial crisis and the over-indebtedness of households that went with it, these developments are seen as positive. The third overall objective indicator (the creation and/or safeguarding of jobs) is also considered as fulfilled. Overall objective indicator 2 (the proportion of GDP contributed by MSMEs is increasing) was not evaluated, as MSMEs are, in any case, a significant feature of Balkan economies.

In respect of the sub regional funds that were first deposited in 2012, no numerical assessment can yet be undertaken regarding achievement of the indicators for the overall objective. However, considering the current trend, we assume that they have been fulfilled.

As a whole, we endorse the Caucasus FC measure with a very high rating for developmental effectiveness. With relatively small funds deployed and the use of EFSE's effective leveraging mechanisms, a significant contribution was made to the financing of investments, the creation and/or safeguarding of jobs and the general development of the MSME sector.

The Balkans FC measure and the sub regional window have also been assessed as having very good developmental effectiveness. The creation of a sub regional window has specifically served to make EFSE's lending significantly more flexible and has thus had a positive structural effect.

Moreover, the dialogue undertaken with PFIs on issues around responsible finance is exemplary and has the potential to be disseminated across the entire finance sector.

Impact rating: 1 (Caucasus) and 1 (Balkans/ sub regional)

Sustainability

EFSE's financial sustainability is assured through a stable, growing shareholder structure, the active and successful acquisition of fresh capital and well-coordinated cooperation between funds management, the investment committee and the Board and this is manifested in positive operating results.

As mentioned, ownership by partner countries is considered high. They are represented from the outset by their central banks – these being the most important contacts for EFSE – in the Advisory Committee. Two partner countries have invested their own funds in the EFSE (in Albania, EUR 11 million and in Armenia, EUR 4.2 million). This sense of owner-ship is strengthened further by the fact that the EFSE's annual meeting takes place in different partner countries on a rotating basis and that, besides functioning as the annual general meeting, it also hosts a respected specialist conference.

In the Caucasus, the new FC funds were transferred into the PFI portfolios quickly and with substantial leverage. The PFIs' long-term demand for refinancing may well continue to be high. EFSE itself operates successfully and sustainably, and is thus able – subject to the existence of enough C shares – to continue guiding public and private funds into the financial sectors in this region. EFSE could play a similarly positive, structure-forming role in the Caucasus as in the Balkans in the first five years (i.e. from 2005 to around 2010). Sustainability is therefore judged as very high.

The EFSE has significant potential for further increasing its developmentally effective business in the Balkans. The Italian banks' parent companies, which are strongly represented in the Balkans, will most probably, focus even stronger on ensuring that their Balkan subsidiaries refinance themselves externally.

In addition, following some restructuring in the MFIs, the EFSE is once again becoming more active within the microfinance sector in Bosnia-Herzegovina. We rate the sustainability of the overall Balkans/ sub regional measure as very good.

Sustainability rating: 1 (Caucasus) and 1 (Balkans/ sub regional)

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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).