Bulgaria: SME Programme implemented through the Bulgarian National Bank

Ex-post evaluation

OECD sector	24030 - Financial institutions of the formal sector	
BMZ project number	1998 05 003	
Project-executing agency	Bulgarian National Bank (BNB) – until 04/2001 Encouragement Bank – from 04/2001	
Consultant	Internationale Projekt Consult GmbH/Frankfurt (IPC)	
Year of ex-post evaluation	**2003**	
	Project appraisal (scheduled)	**Ex-post evaluation (actual)**
Start of implementation (outflow of funds)	1998	12/1998
Period of implementation (outflow of funds)	24 months	36 months
Investment costs	no information available	EUR 10.0 million
Counterpart contribution	EUR 0.0 million	EUR 0.0 million
Financing, of which Financial Cooperation (FC) funds	EUR 4.35 million	EUR 3.27 million
- **Complementary measure BMZ Project ID 1998 05 029 / 2000 40 501**	EUR 0.77 million	EUR 1.51 million
Other institutions/donors involved	n.a.	n.a.
Performance rating	**Rating 3**	
• Significance/relevance	Rating 3	
• Effectiveness	Rating 3	
• Efficiency	Rating 4	

Brief Description, Overall Objective and Project Purposes with Indicators

The project comprised the provision of financial resources to be transferred by an Apex unit to selected Bulgarian commercial banks to refinance loans to small and medium-sized private enterprises (SME). The project objective was to provide SMEs with a long-term access to financial services. By reducing the existing deficits in the financial services which the Bulgarian banking sector offers to this group of clients, their income situation is to be improved, additional jobs are to be created and existing jobs to be safeguarded (overall objective). The target group are private SMEs (up to 100 employees) in all sectors, including companies active in the processing of agricultural products.

The following indicators were determined for the achievement of the project purpose:

a. The APEX unit accomplishes its tasks (proper assessment and selection of the commercial banks and transfer of the funds).

b. All the funds will be utilized within a period of two years.

c. The personnel of the partner banks (PB) participating in the programme will review the sub-loans in accordance with banking standards and in line with the needs of the target group.

d. The partner banks have increased the number and total volume of loans outstanding (portfolio perspective) with SMEs to an above-average extent, and

e. the default rates for this sub-portfolio average no more than 5 % per year ("portfolio-at-risk" perspective).

Major Deviations from the original Project Planning and their main Causes

Originally the credit line was managed by an Apex unit with the Bulgarian National Bank (BNB) and later – at the request of the Bulgarian side – it was transferred to the Encouragement Bank (a state-owned promotional bank) by contract dated April 2001.

Two years after the implementation of the project only 75% of the loan (EUR 3.27 million) had been disbursed to the commercial banks. Since the Encouragement Bank did not adhere to certain provisions of the loan agreement with KfW regarding the timely utilization of FC funds the loan was reduced by EUR 1.07 million at the end of 2001 and the respective amount was returned to the German federal government.

An amount of EUR 0.77 million was provided for an accompanying measure to the project. This measure was concluded on schedule at the end of June 2000. To ensure a sufficient financing of the advisory services until the end of 2001 the funds for the accompanying measure were increased by another EUR 0.74 million as from July 1, 2000 to a total of EUR 1.51 million. Due to problems with the partner banks (see below), however, the cooperation was in fact terminated at the end of April 2001 and the consulting agreements were cancelled. But the advisory services to the Apex unit of the Encouragement Bank were continued as scheduled until mid-2002. The remaining funds of EUR 0.22 million were made available, except for EUR 2,000, for advisory services to ProCredit Bank, which had been newly established in 2001. At that time it was assumed that ProCredit Bank, which is specialized on SME loans, would act as partner bank and would use the refinancing tranches provided under the present project. At the time of the final evaluation ProCredit Bank had not yet requested any funds under the refinancing tranche.

Key Results of the Impact Analysis and Performance Rating

The implementation of the SME programme started with delay in April 1999 and from November 1999 onwards it was carried out together with three partner banks, namely Banka DSK, Union Bank and Eurobank. Due to implementation problems on the part of the partner banks no new refinancing tranches were paid to the banks in the period from December 2000 to November 2002. This means that funds repaid under the tranches were not used in a revolving manner. A new partner bank, Bulgaria Invest AD, was contracted at the end of 2002, to which EUR 1.48 million were disbursed in December 2002. Moreover, Eurobank received a new refinancing tranche in 2003. Thus, at the time of the final evaluation in the third quarter of 2003 two partner banks were operating actively with fund provided under the present project.

At the time of the final evaluation the cooperation of the partner banks in the SME programme could be described at follows:

The state-owned savings bank (Banka DSK): Inclusion in the SME programme in April 1999. From the start there was a lack of cooperation with the consultant and the implementation of the SME concept was little convincing. Since the fund were not utilised in due time the loan agreement was cancelled by BNP in November 1999. In the course of the six months of the agreement DSK had built up an SME loan portfolio of not even EUR 25,000 (16 loans). In autumn 2002 DSK refrained from participating once again in the programme because in the context of a privatisation process it was in contact at the time with several parties interested in buying the savings bank. As the participation of DSK in the FC project lasted only for a relatively short period it is not included in the further considerations of project success and impact.

Union Bank: Inclusion in the programme in November 1999. A first credit line of EUR 511,000 was disbursed, as was the first tranche of the second credit line in the amount of EUR 102,000. In contrast with the scheduled implementation of the first credit line the contractual on-lending provisions were not obeyed in the event of the second credit line. In the first three months only 76 %, instead of the agreed 80%, of the disbursed tranche were on-lent to sub-borrowers. Since at the time there were no real prospects for an acceptable expansion of the SME lending business the disbursement of the second credit line was discontinued. The bank cancelled the loan agreement and the outstanding loan amount of EUR 613,000 was repaid ahead of schedule. But Union Bank still continued SME lending with funds provided by the European Bank for Reconstruction and Development (EBRD) in the amount of EUR 6 million and by the International Finance Corporation (IFC) in the amount of EUR 5 million. In September 2002 the EBRD acquired a 15% stake in the equity of Union Bank. With a portfolio of approximately EUR 11 million Union Bank is today one of the leading banks in SME lending. The average amount of the loans extended by the Union Bank is roughly EUR 35,000. This includes also very large long-term loans, which Union Bank granted to few large companies in the past. Also taking the EBRD line drawn in 2002/2003 into consideration the average loan amount is much lower (EUR 12,770). This is evidence that Union Bank has clearly reached the target group. According to statements by the management of Union Bank the participation in the FC programme was decisive for the later orientation of the bank to SMEs. Due to the successful orientation of Union Bank to SME lending it will most probably receive a refinancing tranche of approximately EUR 600,000 under the FC project "APEX Fund for the Promotion of Small and Medium-Sized Enterprises (BMZ project number 2000 40 618) still in November 2003. In addition, Union Bank and KfW are currently negotiating an FC promotional loan in the amount of EUR 6.0 million to be used for the further expansion of SME lending.

Eurobank: Inclusion in the SME programme in November 1999. The very fruitful cooperation has produced a dynamic, growing portfolio of excellent credit quality and a first-class productivity. Then take-over negotiations were held with an international consortium of bidders (Commerzbank, EBRD, DEG, IFC, IMI/IPC) - led by the consultant - for the further development of Eurobank into a bank specializing on SMEs. But the negotiations failed because no agreement could not be achieved on the price. In consequence, in April 2001 KfW suspended disbursement from the, by then, fourth tranche in the amount of EUR 1.28 million. In parallel the consultant cancelled his contract. As contractually agreed Eurobank had built up an SME portfolio with the funds obtained until the end of 2000 (Tranches 1 -3) and had used the return flows on a revolving basis. By the end of August 2003 new loan agreements for more than EUR 2 million had been concluded from the return flows. After the timely repayment of FC funds to Encouragement Bank in 2003 Eurobank received another refinancing tranche in July 2003. According to reports provided by the bank the SME portfolio is continuously growing and amounted to EUR 31 million at the end of May 2003. As the bank also expanded its business in larger loans the share of the SME portfolio in the total portfolio has dropped to about 26 %.

Bulgaria Invest: The Bank belongs to the Allianz Group. Bulgaria Invest was included as a partner bank in the programme at the end of 2002. During the first six months of its participation in the programme Bulgaria Invest extended 56 loans with an average loan amount of EUR 21,160.

Until and including July 2003 sub-loans in the total amount of EUR 10.03 million were extended on a revolving basis. As regards the development of the portfolio of outstanding loans a peak was reached in March 2001 with 624 loans in the total amount of EUR 4.90 million (EUR 1.77 million from own funds). Since then the portfolio of outstanding loans refinanced from FC funds has declined. The reason is that at the end of 2001 an amount of EUR 1.07 million had to be paid back to KfW and the German government because the funds had not been utilized in due time and that the FC loan was reduced accordingly from EUR 4.35 million to EUR 3.27 million. At the end of July 2003 the loan portfolio refinanced from FC funds was EUR 2.33 million (174 loans). As Eurobank has received a tranche of EUR 1.0 million from the fund only this months, it was not yet possible to pass on the funds disbursed to the partner banks as actual loans. By mid-August 2003 the funds extended to the two partner banks amounted to EUR 3.48 million (EUR 3.27 from the fund plus capitalized interest). Thus, the remaining funds of the FC credit line amounted only to EUR 0.13 million. Thus, one can say that the Encouragement Bank used the fund available almost optimally.

<u>The indicators for the achievement of the project purposes were reached only in part</u>:

<u>(a)</u> The cooperation with the Ministry of Finance and the Central Bank was described in KfW's progress reports as insufficient and the fund administration as inefficient and not geared towards the achievement of the project goals. But after the management of the fund was transferred to the Encouragement Bank in April 2001 the situation clearly improved with regard to the monitoring and the selection of new banks. The evaluation of Bulgaria Invest proceeded very satisfactorily even without the advisory services rendered by the consultant. Bur still, Encouragement Bank also has to be considered as a bureaucratic institution. The indicator is fulfilled.

<u>b)</u> In the first two years only 60% of the FC funds were utilized. At the time of the final evaluation EUR 2.33 million had been extended to sub-borrowers (71% of the reduced FC funds). The indicator was not fulfilled.

<u>c)</u> a credit technology oriented to the needs of the target group was introduced at the Union Bank and the Eurobank and altogether 61 loan officers were trained. However, most of the staff trained in the context of the accompanying measure were taken on by ProCredit Bank (approx. 40 staff), which had been established in the course of the project as well as other banks (Raiffeisenbank, American Credit Bank). Due to the good results of the credit technology introduced (the credit quality of the FC portfolio of all partner banks was better than that of all other loan portfolios) it was possible, even after the services of the consultant had been terminated and despite the fact that part of the staff had left, to continue major elements of the credit technology with local staff and to use it partly also for other areas in the banks. The indicator is fulfilled.

d) In the context of the project all partner banks became for the first time interested in the SME segment and subsequently built up a sustainable portfolio. However, Eurobank developed its portfolio only below average. The indicator was not fulfilled.

(e) After the consultant had terminated his assignment the portfolio quality of Eurobank slightly deteriorated. At the end of July 2003 the portfolio-at-risk (default rate > 30 days) of the FC portfolio accounted for 4 %. No information is available about the quality of the SME portfolio of Eurobank as a whole. In the case of Union Bank the quality of the SME portfolio is very good with a portfolio-at-risk of 0.19 % (> 60 days) and clearly better than the credit quality of the bank's loan portfolio as a whole (5.6 %). Up to now Bulgaria Bank has not defaulted on any payments. Overall, this indicator is fulfilled.

Due to the sufficient number of Bulgarian banks and their poor financial intermediation for SMEs the design of the SME Programme on the basis of a downscaling approach has to be judged, also in retrospect, as appropriate. Given an average loan size of EUR 11,000 the SMEs serviced are rather smaller enterprises by Bulgarian standards, which often received access to the formal sector for the first time. The objectives and indicators defined proved to be appropriate.

No information is available on the degree of achievement of the overall objective. As the partner banks use an adequate credit technology and default rates are very low, there is reason to assume that the project brought about positive employment and income effects. Since all banks are further expanding the SME portfolio with own funds and funds from other donors the sustainability of SME financing is also ensured. However, it is difficult to assess to what extent the project itself has contributed to a sustainable supply.

The cooperation with the consultant has to be assessed from different angels. All partner banks stated that the quality of technical advice was positive and that they would continue to profit from the know-how acquired also after the termination of the consulting agreement. At Eurobank and Union Bank, for instance, the loan officers are still responsible for the entire lending process and for the administration and monitoring of the portfolio. Credit decisions are taken decentrally on the basis of cash-flow analyses. The incentive system implemented by the loan officers was continued. However, a potential conflict of interest arose due to the fact that the consultant acted at the same time as advisor to the project-executing agency and to the partner banks and later on also as chief negotiator of the consortium of bidders and co-owner of ProCredit Bank. This hampered a trustful cooperation in particular in the case of Union Bank. Though the allegations of conflict of interests could not be substantiated we agree to the proposal put forward in the BMZ evaluation report, which is to avoid such allegations from the very beginning by clearly separating the different tasks to be performed by the consultant ("Main report on the partial evaluation of the project "Bulgarian Financial Sector" conducted in the context of the evaluation of the impact of transformation projects", Bonn, April 2002).

Overall, the project served to introduce the project 'SME lending' in the Bulgarian financial sector. All partner banks have benefited from the credit technology introduced in the context of the programme. The project purposes were reached only in part. In the first years of the project this was mainly due to the lack of interest on the part of the partner banks. However, since 2001 interest increased markedly in the course of the overall economic stabilisation of the country and the growing competitiveness in other areas of business. At the time of the final evaluation Encouragement Bank had almost completely lent out all funds at its disposal to partner banks.

Despite the sometimes limited use of the FC funds the overall impact on the target group and the financial sector can still be described as sufficiently positive. As a result of the FC project local banks were enabled to offer new financial products (SME loans) on a sustained basis. Thus, the project made an important contribution to deepening and broadening the financial sector in Bulgaria. The desired demonstration effect on the local financial sector occurred only to a limited extent. Today, roughly six banks are active to a larger extent in the SME sector and, in particular in the larger cities there is a considerable price war because of the growing competition, but apart from Eurobank and Union Bank none of the leading banks in the SME sector has ever drawn on any FC funds. But banks not participating in the FC programme have also adopted parts of the consultant's technology and poached staff which had been trained from FC funds for the implementation. In particular the take-over of approximately 40 staff by ProCredit Bank had a positive impact on the refinancing offer of the Bulgarian commercial banks the SME sector. With about 17,000 customers and a portfolio of approximately EUR 44 million ProCredit Bank, which was established in 2001, is today by far the most active SME-oriented bank in Bulgaria and with an average loan size of EUR 6,000 it is very much oriented to the target group. Given this rapid success one can say that in the context of the Bulgarian financial sector the "downscaling approach" pursued under the present project turned out to involve more difficulties than the alternative of newly setting up a financial intermediary. Nevertheless, the „downscaling approach“ contributed essentially to broadening the offer of SME loans and, thus, to steadying the offer.

In a summarized assessment of all impacts and risks described above we have arrived at the following rating of the project's <u>developmental effectiveness</u>:

- Measured by the defined indicators the project objective was not fully achieved. The reasons are the originally low interest of the banks in the SME segment and the problems with the partner banks, which were partly also caused by the existing conflicting interests. But still, the project created a sustainable access of SMEs to formal financial services. For this reason we rate the project's **effectiveness** as **sufficient** (partial evaluation: rating 3).

- The project dealt with a problem which is still relevant today. As far as the target group is concerned it is reasonable to assume that the project had a positive impact on incomes and employment. The project helped to successfully implement a new product segment and a new credit technology. However, it cannot be stated today to what extent the project contributed to the sustainable supply of the target group and to deepening the financial sector. In terms of **significance/relevance** the developmental effectiveness of the project can be described as still satisfactory (partial evaluation: **rating 3**).

- Measured by the size of the loan portfolio (EUR 10.03 million) created with the FC funds, the cost-benefit ratio of the accompanying measure (EUR 1.29 million) is unsatisfactory. However, these high expenses for consulting services have to be relativized by the fact that the partner banks continue to sustainably finance the SME sector and almost all staff which have been trained are today successfully working in the SME lending business. However, currently only about 71% of the reduced FC funds are used for SME loans. Overall, we rate the project's **efficiency** as slightly insufficient (partial evaluation: rating 4).

Under consideration of its effectiveness, efficiency and significance/relevance we assess the project's **developmental effectiveness** as **adequate (rating 3)**.

General Conclusions applicable to all Projects

In the present FC project the consultant worked out the preparatory market study, designed the SME programme and selected the partner banks. In the context of the accompanying measure he advised the project executing agency and the partner banks, he represented the consortium of bidders in the takeover negotiations for Eurobank and finally he assumed responsibility for the management of the newly founded ProCredit Bank. The inevitably resulting conflicts of interest should in future be avoided through a separation of tasks.

The Apex unit has limited its monitoring function to the SME portfolio financed from FC funds. Under this project, as under similar projects, the monitoring should also include the development of portfolios financed from own funds and by other donors.

Legend

Developmentally successful: Ratings 1 to 3	
Rating 1	Very high or high degree of developmental effectiveness
Rating 2	Satisfactory degree of developmental effectiveness
Rating 3	Overall sufficient degree of developmental effectiveness
Developmental failures: Ratings 4 to 6	
Rating 4	Overall slightly insufficient degree of developmental effectiveness
Rating 5	Clearly insufficient degree of developmental effectiveness
Rating 6	The project is a total failure

Criteria for the Evaluation of Project Success

The evaluation of a project's "developmental effectiveness" and its classification during the final evaluation into one of the various levels of success described below in more detail concentrate on the following fundamental questions:

- **Are the project objectives reached to a sufficient degree (aspect of project effectiveness)?**
- **Does the project generate sufficient significant developmental effects (project relevance and significance measured by the achievement of the overall development-policy objective defined beforehand and its effects in political, institutional, socio-economic and socio-cultural as well as ecological terms)?**
- **Are the funds/expenses that were and are being employed/incurred to reach the objectives appropriate and how can the project's microeconomic and macroeconomic impact be measured (aspect of efficiency of the project conception)?**
- **To the extent that undesired (side) effects occur, are these tolerable?**

We do not treat **sustainability**, which is a key aspect of project evaluation, as a separate category (as the World Bank does) but instead consider it as a cross-cutting element that concerns all four fundamental questions of project success. A project is sustainable if the project-executing agency and/or the target group are able to continue to use the project facilities that have been built for a period of time that is, overall, adequate in economic terms or to carry on with the project activities on their own and generate positive results after the financial, organizational and/or technical support has come to an end.