Macedonia: Funding for Small and Medium-sized Enterprises, Phases I-III

Ex post evaluation report

OECD sector	24030 - Financial intermediaries in the formal sector	
BMZ project ID	1998 66 203 (sample), 2004 65 070, 2006 65 166 (sample), 1998 70 353, 2004 70 039, 2006 70 091(SP)	
Project executing agency	Macedonian Bank for Development Promotion (MBDP)	
Consultant	Frankfurt School of Finance	
Year of ex post evaluation	**2009**	
	Project appraisal (planned)	**Ex post evaluation (actual)**
Start of implementation	Q1 2000 (SME I) Q2 2004 (SME II) Q3 2006 (SME III)	Q1 2000 (SME I) Q4 2004 (SME II) Q2 2007 (SME III)
Period of implementation	25 months (SME I) 9 months (SME II) 7 months (SME III)	45 months (SME I) 1 month (SME II) 13 months (SME III)
Investment costs	EUR 20.48 million (SME I-III)	EUR 20.48 million (SME I-III)
Counterpart contribution	--	--
Financing, of which FC funds	EUR 20.48 million (SME I-III)	EUR 20.48 million (SME I-III)
Other institutions/donors involved	--	--
Performance rating	2	
• Relevance	2	
• Effectiveness	2	
• Efficiency	3	
• Overarching developmental impact	2	
• Sustainability	3	

Brief description, overall objective and project objectives with indicators

The project comprised the provision of financial funds to the German-Macedonian Fund (GMF), a revolving refinancing fund from which loans denominated in Euro are advanced to micro, small, and medium-sized enterprises (MSMEs) on market terms through selected Macedonian financial institutions. Amounts of EUR 6.64 million (SME I), EUR 6.18 million (SME II) and EUR 7.66 million (SME III) were provided together with grants for supplementary programmes of EUR 1.53 million (SME I), EUR 1.01 million (SME II) and EUR 0.52 million (SME III). The project's target group consisted of formal and informal MSMEs with up to 100 employees from all business areas. From Phase II onwards the owners, managers and employees of MSMEs were included as a target group for the housing modernisation loans. In Phase III, access to this credit product was expanded to all private households.

The overall objective established for Phases I and II of the project was to contribute to job and income creation and to deepen and broaden the local financial market by successfully integrating the target group into the formal financial system. The overall developmental objective laid down for Phase III of the project was to contribute to the creation of jobs and income, to improve the accommodation situation of private households, and to deepen and broaden the local financial market by successfully integrating the target group into the formal financial system.

For Phases I and II, no indicators for measuring the achievement of the overall objective were defined. For Phase III the following were included:

1. Creation of additional jobs in the MSMEs supported (sample to be drawn at the time of ex post-evaluation).
2. Additional banks have started lending to MSMEs on market terms.
3. Partner institutions offer additional financial services to MSMEs in addition to loans.

The project objective defined for FC activities in Phases I and II was:

A sustainable improvement in access to market-oriented credit for Macedonian (M)SMEs which are likely to be viable for a longer term. The following indicators were defined for this purpose:

1. Arrears in the business banks' MSME loan portfolio are not higher than 5 % (portfolio at risk [PAR] > 30 days).
2. Growth in the business banks' MSME credit portfolio is greater than average growth of the overall portfolio.

The project objective defined for FC activities in Phase III was:

A sustainable improvement in access to market-oriented credit for MSMEs and to credit for the modernisation of private housing. The following indicators were defined for this purpose:

1. All funding of the third phase of the German-Macedonian Fund will be utilised within two years.
2. Lending to MSMEs by the partner institutions has increased.
3. The product 'housing modernisation credit' is developed in the partner institutions and taken to market.
4. Arrears in the partner institutions' loan portfolio granted to MSMEs and to private households (for housing modernisation) is not higher than 5 % (PAR > 30 days).

Project design/major deviations from original planning and their main causes

The projects dealt with the MSME sector, the labour market as well as the lack of access to financial services, and thereby addressed important constraints to development. Their implementation proceeded as planned.

In SME Phase I, the state (represented by the Ministry of Finance) was the borrower. The ministry passed the credit on to the Macedonian Bank for Development Promotion (MBDP) which, as the project executing agency, managed the GMF. In SME Phases II and III the MBDP itself was the borrower, with the Republic of Macedonia as guarantor. The funds from the first phase and EUR 1.7 million of the funds from the second phase were provided to the MBDP (via the Finance Ministry in the case of the first phase) on

IDA terms (0.75 %, 10-year grace period, 40-year maturity), and the remaining funds on standard FC terms (2 %/10/30).
The MBDP then loaned these funds to the financial institutions participating in the project (NLB Tutunska Banka, IK Banka, ProCredit Bank, Savings House Moznosti and Invest Banka) at 3 month Euribor + 1 % with a maturity of up to four years (up to five years for housing loans). The pricing of loans to microbusinesses was left to the banks; in Phases I and II, the interest rate on loans to small and medium-sized enterprises demanded by the partner institutions was to be no more than 10 % above the cost of interest payable.
Funds generated from interest differentials were added to the Fund. In Phases I and II, the margin on loans made to small and medium-sized enterprises was limited to a maximum of 10 %. The maximum credit amount for individual borrowers was set at EUR 15,000 for microbusinesses (up to five employees) and EUR 50,000 for small businesses (up to 100 employees). Beyond that, there were no further lending guidelines. Capital and interest repayments flowed back into the GMF, from which further MSME refinancing loans were provided.
All three phases were accompanied by a supplementary programme (SP) which was implemented by the IPC until June 2003, and after that by the banking academy/Frankfurt School of Finance & Management until the SP ended in July 2008. Essentially, the SP comprised four packages:

1. Strengthening of the credit organisation and the MSME loan departments of the partner institutions.
2. Strengthening of lending processes / development and marketing of SME products.
3. Training for loan officers and other employees.
4. Strengthening of the monitoring and reporting for MSME and housing improvement loans.

All GMF funds were promptly issued to the partner banks and swiftly passed on to the MSMEs.

Key results of the impact analysis and performance rating

The GMF made an important contribution to the integration of the target group into the financial system, and thereby contributed to the improvement of their income and employment opportunities. With an average loan volume (for individual borrowers) of less than EUR 2,000, the fund serves the lower end of the MSME market and reaches disadvantaged parts of the population who previously had no access to credit.

Relevance: The project's conceptual design rightly identified the lack of access to financial services for MSMEs as a significant developmental constraint in Macedonia. With the exception of Savings House Moznosti, no financial institution was serving the MSME sector when the project started. Because of the importance of the MSME sector for the country's economic development, the promotion of the sector was a high priority for the Macedonian government. MSMEs produce 61 % of gross value added and 79 % of all employees work in this sector. Over the last decade, the MSME sector has become even more important for the Macedonian economy. The project objectives were in line with the developmental goals of BMZ. From today's perspective, the subsidy element within the credit lines provided to the partner banks was rather high, but it was certainly reasonable in the context of its time. The GMF complements other MSME credit lines (EBRD) as well as EFSE. Overall, we assess the project's relevance as good (sub-rating 2).

Effectiveness: The indicators for measuring the achievement of the project objective were substantially achieved. All GMF funds were promptly issued to the partner banks and subsequently passed on to the MSMEs. Delays occurred only in the third phase, as NLB Tutunska Banka, IK Banka and Invest Banka could no longer access new GMF funds because their PAR ratios were above 5 %. The funds were then provided to ProCredit Bank. Due to the current economic crisis, however, GMF lending has declined slightly since the start of 2009.

GMF lending to end customers (EUR):

	Number of loans outstanding 30/12/2008	Value of loans outstanding 30/12/2008	Number of loans outstanding 30/06/2009	Value of loans outstanding 30/06/2009
IK Banka	1,687	5,496,524	1,452	3,673,585
Invest Banka	507	1,305,528	564	1,295,942
NLB Tutunska Banka	1,158	4,536,486	1,224	3,988,991
ProCredit Bank	4,823	6,417,868	4,579	6,416,336
Savings House Moznosti	500	1,533,011	469	1,331,524
Total	*8,675*	*19,289,418*	*8,288*	*16,706,308*

All GMF funds were invested in accordance with project objectives, and were further supplemented to a large extent with the partner institutions' own funds. Recent developments in the arrears rate are less satisfactory, however. As a result of the current crisis, the PAR has climbed markedly since the last quarter of 2008. At mid-2009, none of the partner institutions achieved a PAR > 30 days below 5 %, which is also the threshold for qualifying for new credit from the GMF. Given that portfolio quality has deteriorated primarily as a result of the financial crisis, we consider the project objective indicators to still be achieved. Overall we assess the project's effectiveness as good (sub-rating 2).

<u>Efficiency:</u> The project's production efficiency shows variations at the level of the partner institution. Net interest margins fluctuate between 8.5 % and 3.4 %, and net interest income from the credit portfolio varies between 17.4 % and 4.6 %. Due to substantial differences between the individual partner institutions in terms of processing and business focus, the figures are only comparable to a very limited degree. Allocative efficiency was reasonable. Loans were granted to borrowers on market terms. From today's perspective, it has to be criticised that, at the level of the project executing agency (MBDP), no 'leveraging' of the GMF funds is taking place – for example, by incorporating market funds – and that the funds are disbursed to the partner institutions at rates which are too low in today's business environment. Overall, we assess the project's efficiency as satisfactory (sub-rating 3).

<u>Overarching developmental impact:</u> The developmental objective was achieved. Whereas at the start of this project only Savings House Moznosti (which does not have bank status) offered financial services to MSMEs, now almost all Macedonian banks are active in this field. Furthermore, modern, cashflow-based credit-checking techniques, alternative approaches to loan securitization and all the other elements of a modern MSME credit technology were completely unknown when the project began. Thanks to the highly successful supplementary programmes (and also to the example set by ProCredit Bank), these credit technologies are now used for credit checking in other sectors in Macedonia as well, even at banks that did not take part in the project. Apart from loans, all Macedonian banks offer their MSME customers a range of additional products, including savings schemes, current accounts, and electronic payment services. The project's developmental objective was thus fulfilled, especially in terms of its structural impact on the financial sector. Whereas at the start of the project there existed no credit products for the MSME sector on the market, by mid-2009 an estimated 80 % of MSMEs had access to credit. Today, almost all Macedonian banks offer such products. Modern, cashflow-based credit-checking

techniques and alternative approaches to loan securitization have become commonplace in the Macedonian banking sector. It is reasonable to assume that the project made a considerable contribution to this development. At the level of the individual borrower, an impact analysis carried out in 2006 demonstrated positive effects on income and employment. For the ten companies visited as part of this ex post-evaluation, significant, credit-financed business expansion was evident in each case. However, it should be borne in mind that the relationship between creating or safeguarding jobs and the provision of credit is too complex to allow for clear attribution (especially given the lack of a control group). Overall, we assess the overarching developmental impact of the project as good (sub-rating 2).

Sustainability: With the help of the GMF, MSME lending has been successfully established within the partner institutions. The GMF acted as a catalyst, in the sense that the partner institutions invested substantial sums beyond the GMF funds into the MSME sector; and other business banks, which had no access to GMF funds, adopted MSME lending on their own initiative. Macedonian business banks have identified the MSME segment as an important market for the future. The current crisis-related deterioration in portfolio quality presents a risk, however. As of June 2009, none of the partner institutions is entitled to draw on new GMF funds since all five institutions have a PAR > 30 days above 5 %. Yet, it is reasonable to assume that the situation will stabilise again once the crisis abates. Overall we assess the project's sustainability as satisfactory (sub-rating 3).

Overall rating: Overall, we assess the project as good (rating 2).

General conclusions and recommendations

The project involved three partner banks which introduced the MSME business as part of a 'downscaling' strategy (IK Banka, NLB Tutunska Banka, Invest Banka), the newly established ProCredit Bank ('greenfielding' approach) and one microfinance institution (MFI), which was supported in its 'upgrading' approach (Savings House Moznosti). When comparing these three strategies, the most successful approach was clearly the ProCredit model; here the ProCredit Bank of Macedonia benefited enormously from the experiences of other ProCredit banks in the region.
The project's supplementary programmes were critical to project success and facilitated the introduction of new credit technologies in Macedonia. They were flexibly managed and adapted to the needs of the partner institutions. Furthermore, it became apparent that consultants need to work together with staff having decision-making authority on the side of the partner.
A design such as the GMF, in which financial resources cannot be supplemented by additional financial means, is inferior to structured funds such as EFSE. Given the low cost of GMF funds compared with other refinancing facilities available in Macedonia (EFSE, EBRD), the incorporation of market funds should be considered. An alternative to this would be to integrate the GMF into EFSE.

Abbreviations used

SP	Supplementary Programme
CAR	Capital Adequacy Ratio
EBRD	European Bank for Reconstruction and Development
EFSE	European Fund for Southeast Europe
EU	European Union
Euribor	Euro Interbank Offered Rate
GMF	German-Macedonian Fund
MSME	Micro, Small, and Medium-sized Enterprises

MSE	Micro and Small Enterprises
MBDP	Macedonian Bank for Development Promotion
MFI	Microfinance Institution
MKD	Macedonian Dinar
NPL	Non-Performing Loans
RoE	Return on Equity

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

Projects are evaluated on a six-point scale, the criteria being relevance, effectiveness (outcome), "overarching developmental impact" and efficiency. 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 rating that clearly exceeds expectations
2	Good rating fully in line with expectations and without any significant shortcomings
3	Satisfactory rating – project falls short of expectations but the positive results dominate
4	Unsatisfactory rating – significantly below expectations, with negative results dominating despite discernible positive results
5	Clearly inadequate rating – despite some positive partial results the negative results clearly dominate
6	The project has no positive results or the situation has actually deteriorated

A rating of 1 to 3 is a positive assessment and indicates a successful project while a rating of 4 to 6 is a negative assessment and indicates a project which has no sufficiently positive results.

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 an improvement is very unlikely. 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. A rating of 1 to 3 indicates a "successful" project while a rating of 4 to 6 indicates an "unsuccessful" project. In using (with a project-specific weighting) the five key factors to form an overall rating, it should be noted that a project can generally only be considered developmentally "successful" if the achievement of the project objective ("effectiveness"), the impact on the overall objective ("overarching developmental impact") and the sustainability are considered at least "satisfactory" (rating 3).