Romania: Funding for Small and Medium-sized Enterprises (SMEs) II

Ex post evaluation report

OECD sector	24030 - Financial intermediaries in the formal sector	
BMZ project ID	2001 05 007 (random sample), 2001 40 533, 2003 279, 2006 359, 2006 360	
Project executing agency	Government of Romania (Ministry of Public Finance)	
Consultant	Horus Development Finance	
Year of ex post evaluation	**2009**	
	Project appraisal (planned)	**Ex post evaluation (actual)**
Start of implementation	Q1 2002	Q1 2002
Period of implementation	18 months	23 months
Investment costs	EUR 4.6 million	EUR 4.6 million
Counterpart contribution	--	--
Financing, of which FC funds	EUR 4.6 million	EUR 4.6 million
Other institutions/donors involved	--	--
Performance rating	3	
• Relevance	2	
• Effectiveness	3	
• Efficiency	3	
• Overarching developmental impact	2	
• Sustainability	3	

Brief description, overall objective and project objectives with indicators

This project comprised an FC loan of EUR 4.6 million, a supplementary grant of EUR 1.0 million, and three training programmes which amounted to EUR 0.7 million in total. The project increased the funds of EUR 4.35 million that had been provided to the German-Romanian Fund (GRF), a revolving fund for loan refinancing, under Phase I of the SME programme (BMZ no 1998 05 011, now completed). Loans were issued from the GRF on market terms via selected Romanian partner banks to small and medium-sized enterprises (SMEs). The partner banks and fund management team were supported by a supplementary programme during the project and by a number of training initiatives which included, in particular, education in suitable lending techniques. The project objective was the sustainable provision of loans and other financial services to SMEs through the partner banks. The overall objective was to strengthen the capabilities of the SMEs and of the finance sector.

The project objective indicators were:

1. The average value of the loans outstanding should not exceed EUR 25,000;
2. The SME credit portfolio of the partner banks should increase at least by the amount of refinancing funds provided (up to 31 December 2004);

3. The proportion of problem loans in the SME area should not exceed 5 % (based on portfolio at risk [PAR] analysis, arrears greater than 30 days).

Overall objectives were defined as:

1. A minimum of three banks should offer financial services tailored to SMEs in at least 15 branches;
2. At least 50 % of borrowers in each bank should apply for / receive follow-on credit.

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

In principle, the conceptual design of this second phase of the project was appropriate. By continuing the package approach used in Phase I – providing loans and implementing institutional development measures at the same time – SMEs were promoted as a profitable customer group for the banking sector. We consider the project design as fundamentally appropriate, although no project objective indicator was defined for the efficiency and sustainability of the fund structure at the level of the apex unit. We have taken this into account in our evaluation.
Project implementation proceeded as planned. The most significant provisions in the fund's design were:

- A framework refinancing contract with the partner banks, based on market terms, to a maximum of EUR 0.51 million (increased in 2003 to EUR 1.5 million, and subsequently raised to EUR 4 million). The term was initially set at five years, and subsequently raised to seven years.
- Adequate collateral against the refinancing loan (such as by transferring the loan portfolio to the Fund, with due notice given to the SME borrowers). The partner banks (PBs) bear the full credit risk.
- The PBs to finance loans granted under the programme using a maximum of 80 % from refinancing funds and at least 20 % from their own assets.
- Earnings from interest differentials to be used by the FC funds on a revolving basis, and therefore remain within the GRF.
- The funds are designated exclusively for the supply of credit on market terms to small businesses and microbusinesses. Individual loans in Phase II had a limit of EUR 60,000, which was subsequently raised to EUR 150,000 (EUR 100,000 in the case of credit for operating expenditure or for financing trading companies). Since the maximum number of staff in any SME receiving a loan was cut to 50 (small businesses), effectively creating a barrier, the increase in the borrowing limit principally benefited larger SMEs. Moreover, during the life of the project the maximum credit term was extended from two to five years, and the minimum interest on PBs' credit lines was reduced from Euribor + 2.75 % to Euribor + 1.5 %. In 2008, in view of further improvements in conditions in the refinancing market, terms for PBs were dropped to Euribor + 0.65 %.
- The PBs are free to define their own lending terms, but must agree them with the consultant. They must adhere to the environmental exclusion list.

The Phase II funds, amounting to EUR 4.6 million, were paid to the GRF by the end of 2001. Together with the revolving funds from Phase I and the funds from the follow-on project, SME III (BMZ no 2002 65 298), which were mostly disbursed in 2003, the GRF had a total of EUR 17.6 million at its disposal. Funds from all three phases were managed jointly, hence it is no longer possible to allocate refinancing across the different FC projects with any precision.

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Key results of the impact analysis and performance rating

With its focus on small loans and microloans, the FC project contributed to widening the finance sector. The take-up rate, i.e. the proportion of total available GRF funds outstanding at the banks (which increased in the initial years of the programme from 52 % at the time of the project appraisal in December 2001 to 88 % in June 2005), demonstrated the high demand at the PBs for refinancing for their MSME business. It is safe to assume that the project, and especially the supplementary measures, promoted the interest and abilities of the PBs in serving the small business sector. Due to the FC project, all the PBs undertook credit business with smaller SMEs for the first time. In this respect the project has, in terms of institutional development, widened and deepened the partner banks' services.
Access to loans at the SME level has clearly improved during the course of the project. It is reasonable to assume that this has contributed to improving income levels and employment in Romania.
Although these SME loans have not necessarily benefited the poorer population directly, the project has contributed indirectly to creating and securing jobs and incomes. Those who are newly employed often come from the pool of jobless, who belong to the poorest section of Romanian society.
The project was not directed toward environmental protection. SMEs whose business activities had a specific, damaging impact on the environment were excluded from the FC programme. An exclusion list was appended to the PBs' loans handbook. This which was reviewed and agreed upon with each new refinancing contract between the GRF and the PBs. Loan advisors were made aware of environmental protection considerations as part of their training.
The loans programme does not specifically target the advancement of women. At the same time, basic principles of equality are observed. Eligibility criteria for borrowers are directed towards financial probity and entrepreneurial skills, and are therefore gender-neutral. The majority of posts in the PBs are filled by women (often in leadership positions). According to the PBs, female entrepreneurs also represent the majority of credit customers.
Relevance: According to official figures, SMEs make up almost 99 % of the private sector, which accounts for 71.2 % of the Romanian economy. However, official studies show that still only 47 % of companies can obtain financing from the banking sector. At the time of the project appraisal the proportion was markedly lower. Against this background, the approach taken within this project - to support several partner banks in the establishment of appropriate SME loan techniques and in the issuing of loans - is reasonable, and conforms to BMZ guidelines for this sector and to the sector approach of German development cooperation in Romania. SME development is in fact an explicit goal of the Romanian Government, but individual institutions within government were, and remain, critical of market-oriented lending. Hence it was particularly important to emphasise the significance of market-oriented, sustainable lending to the donor community as a whole. In the case of this project, that was achieved. The relevance of the programme has therefore been assessed as good (sub-rating: 2).
Effectiveness: As in Phase I, the initial issue of programme funds was well received by the partner banks. Project objective indicator 1 (orientation towards microbusinesses) was attained, with an average outstanding loan balance of around EUR 6,800 across all the participating partner banks. At one former partner bank, ProCredit, the average value of loans outstanding under the programme was as low as EUR 2,700. Similarly, project objective indicator 2 (increasing the SME loan portfolio above the refinancing volume) was either attained or markedly surpassed. In March 2007, lending to SMEs by five partner banks stood at 3.8 times the value of funds disbursed under the programme, i.e. 9,672 SME loans with a total volume of EUR 66.1 million. Up to the end of 2008, the PAR (arrears > 30 days) at all PBs was consistently below 5 %; since then it has climbed above 15 % at all partner banks, in the wake of the financial and economic crisis. However, since this derives from a specific development which is

attributable to external factors and not to inappropriate lending policies on the part of the banks, project objective indicator 3 may be considered as achieved in principle. The high proportion of the SME portfolio financed from partner bank equity is a welcome development. The assumption of the currency risk by individual borrowers is considered problematic; following the depreciation of the Leu by almost a third between mid-2007 and mid-2009, it may be responsible for the significant rise in the proportion of problem loans.

The apex organisation has not proved sufficiently effective. Over the project duration, the Fund had difficulty in promptly disbursing the GRF monies to the partner banks. At the end of 2003 the Fund's value amounted to EUR 16.1 million, but only EUR 11.6 million had been disbursed to the partner banks. At the end of 2005, when partner bank refinancing peaked at 88% of monies in the Fund, only EUR 15.5 million out of EUR 17.6 million had been distributed to the PBs. Partner bank refinancing has continuously declined ever since, reaching its lowest level of EUR 4.6 million (26 % of Fund monies available) in June 2008, only increasing during the course of the economic crisis to EUR 7.7 million at the end of 2008 (EUR 6.5 million in June 2009). In this respect, the administrative organisation of the project - management by an accountancy firm with advice from a consultant - may not have been appropriate for building long-term, goal-oriented relationships with the partner banks. However it should also be noted that, with the support of this project, SME financing has become established at the banks as a business sector, and that the banks are now able to refinance on the capital market at more favourable terms, especially since Romania's membership of the EU. Against this background the declining level of interest in the programme's refinancing funds is understandable, since participation in the programme has involved (and still involves) increased organisational and administrative expenditure for the banks. Overall, we rate the effectiveness of the programme as satisfactory (sub-rating: 3).

Efficiency: At the level of partner bank lending to individual borrowers, production efficiency is considered good. This is demonstrated by the fact that, throughout the full duration of the programme, the partner banks advanced significantly more credit to SMEs than they received in refinancing from the programme. The banks operated profitably; they used the knowledge imparted in the supplementary programmes to manage the SME loan portfolio efficiently and they demonstrated, at least until the outbreak of the financial and economic crisis, an NPL level significantly below 5 %. The allocative efficiency of lending to individual borrowers was also appropriate. Loans were disbursed on market terms, and were well serviced by borrowers. The recent deterioration in portfolio quality can be attributed to external factors - the financial and economic crisis, and the depreciation of the Leu.

However, because of the low level of lending per bank combined with the high level of administrative expenditure (the reporting system, three actors – KPMG, the consultant, and the Ministry), the programme's efficiency at the refinancing level (the apex unit – the partner banks) has fallen during the course of the programme. The 'take-up quota' of the GRF funds (Phases I to III) can be called upon as a measure of programme efficiency at the refinancing level. The allocation of funds, after an initial climb to 88 % in 2005, has diminished continuously ever since. In June 2009 the take-up quota amounted to 37 %, i.e. 63 % of the funds available in the GRF were not being used at that point. In retrospect, one could ask whether the level of refinancing then made available to the PBs could have been achieved with lower FC funding.

Compared with the total of funds for refinancing across Phases I to III (EUR 18.6 million), the level of FC funding used for supplementary activities (around EUR 3 million) seems high; on the other hand, it appears to have been used efficiently, at least at the level of the partner banks, as demonstrated by their adoption of MSME-oriented business policies. We rate the programme's efficiency as satisfactory (rating 3).

Overarching developmental impact: The overall objective indicator that was based on the project's structural contribution to development in the financial sector (a minimum of

three banks offering financial services suitable for SMEs at a minimum of fifteen branches) was clearly surpassed (five banks and 73 branches). Attainment of the second overall objective indicator (50 % of borrowers in each bank to apply for /receive follow-on loans) could only be demonstrated by Banca Carpatica (66 %). However, from a developmental standpoint this should not be considered a limitation, since borrowers are increasingly able to make use of the range of products that is now established in the market.

Through this programme, many SMEs gained access to the formal finance sector for the first time. Based on the results of the impact analysis carried out in 2002, it has been established – subject to all the methodological limitations discussed above - that SMEs refinanced under the programme created substantially more employment opportunities and achieved greater improvements in earnings than other SMEs in the impact analysis control group. Customer surveys, carried out by ourselves on a random sample basis, have confirmed this. The average loan value of less than EUR 10,000 indicates that the project refinanced lending primarily to small businesses and microbusinesses. Moreover, the project achieved a remarkably broad effect within the finance sector. Whereas at the start of the programme the banks that were being refinanced still played a pioneering role, since specialised lending to SMEs was not yet generally established within the business banks, this changed during the course of the programme. All the partner banks that were refinanced under Phase II established their business with SME customers on a firm footing; they significantly improved their lending, their internal processes and risk management, and they now appreciate the significance of the SME market as a field of business. In doing so, the banks cover a wide variety of areas within the SME sector. Whilst ProCredit Bank of Romania concentrates on microfinance and hence microbusinesses, MKB offers credit to the larger of the small companies and to medium-sized enterprises. In the meantime, several PBs have sought or received further SME funds from international sources of refinance (EBRD, EIB, KfW equity). It is safe to assume that this dynamic development of the Romanian banking sector, both in preparation for and following the country's integration into the EU, would no doubt have taken place without this programme, predominantly through the involvement of strong foreign banks in the Romanian market. However, the programme has established (or at least strengthened) a business model for SME financing at the partner banks, and thereby contributed to the removal of pertinent financial constraints and to the further development of the finance sector. We have therefore assessed developmental impact as good **(sub-rating: 2)**.

Sustainability: At the partner bank level, SME financing has been sustainably established as a field of business; this is further demonstrated by the fact that various partner banks have, in the meantime, received significant sums for refinancing SMEs from other institutions (from EBRD, amongst others). At the individual borrower level, based on impressions gained during site visits carried out by way of random sampling, sensible investments were financed, which enabled companies to make sustainable improvements to their earnings potential and to either create or safeguard jobs. The results of the comprehensive impact analysis carried out in 2002 were confirmed in principle by this 'mini sample'. The APEX programme structure, as such, is not organised sustainably, since contracts and outcomes are only monitored through the use of consultants. Following the withdrawal of long-term expert support in 2008, the GRF's refinancing business has regrettably come to a standstill; as a result of regular redemption payments, the take-up rate of GRF funds by the partner banks continues to drop (see 'Efficiency' above). Even though the GRF's functionality has now improved, it is questionable whether this approach, which is relatively small-scale in comparison with the regular market or with multilateral development banks (e.g. EBRD), is still efficient. The German and Romanian sides seem in agreement over the need to institutionalise the GRF in order to ensure proper utilisation of Fund assets, which, with Phase IV, have now grown to around EUR 26.6 million. However, there appears to be no consensus yet over which institutionalisation concept is correct - integration into EFSE, or appending the Fund to a Romanian state bank. Particularly in view of the

current financial and economic crisis, which puts a considerable refinancing burden on the PBs from the market side, a high demand for GRF funds could be expected. Whilst an SME-oriented business policy has been successfully and sustainably established at the PBs, the sustainability of the refinancing approach must currently be considered as under threat, at the very least. Moreover, the increase in overdue payments, in the context of the financial and economic crisis, to over 15 % (PAR analysis, > 30 days) currently represents a substantial default risk in the loan business, which significantly debases the banks' present financial situation. After weighing these individual elements, we have assessed the sustainability of the programme as just satisfactory (sub-rating: 3).
In our summary evaluation of the foregoing impacts and risks, we have arrived at a satisfactory rating for the overall developmental efficacy of the project **(rating: 3)**.

General conclusions and recommendations

From a strategic viewpoint, when establishing APEX programme structures with partner institutions (in this case, the Ministry of Public Finance) it should be borne in mind that these structures should be ready and able, once the supporting consulting operation has ended, to continue to manage the existing funds within a market-oriented refinancing business in line with the developmental objectives.

Abbreviations used

BMZ Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung (German Federal Ministry for economic cooperation and development)
CAR Capital Adequacy Ratio
GRF German-Romanian Fund
EFSE European Fund for Southeast Europe
FC Financial Cooperation
SME Small and Medium-sized Enterprises
MDG Millennium Development Goals
MFI Microfinance Institutions
NPL Non Performing Loans
PB Partner Bank
ROE Return on Equity
ROA Return on Assets
RON Romanian New Leu

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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).