KfW

Romania: Promotion of Small and Medium-Sized Enterprises

Ex-post evaluation

OECD area of promotion	24030 - Financial intermediaries of the formal sector	
BMZ project number	1998 05 011 (Investment in fixed assets) 2000 70 037 (Complementary measure) 2000 40,501 (Complementary measure)	
Project-executing agency	Auditing firm KPMG Romania	
Consultant	IPC GmbH, Frankfurt	
Year of evaluation	**2003**	
	Project appraisal (planned)	**Ex-post evaluation (actual)**
Start of implementation	Q I 1999	Q III 1999
Period of implementation	1999-2001	1999-2001
Counterpart contribution (partner banks)	20% (of the volume of sub-loans)	50% (of the volume of sub-loans)
Financing, of which Financial Cooperation (FC) funds	FC loan: EUR 4.35 million Complementary measure: EUR 1.5 million SEEAF[1]: EUR 4.6 million	FC loan: EUR 4.35 million Complementary measure: EUR 1.5 million SEEAF: EUR 4.6 million
Other institutions/donors involved	none	Commerzbank, DEG, EBRD, IFC, IMI AG (as shareholder of Miro Bank)
Performance rating	**2**	
• Significance/relevance	2	
• Effectiveness	2	
• Efficiency	2	

Brief Description, Overall Objective and Project Purposes with Indicators

The project encompasses the provision of funds which were onlent or channelled through a local refinancing unit (Apex Unit) to selected Romanian commercial banks. The funds were granted for the refinancing of loans extended to small and medium-sized private enterprises (SMEs). With the personnel support measures, consulting services for the Apex Unit and for partner banks as well as payments in kind (i.e. software) were financed. The project purpose is to sustainably improve the access to loans and other financial services for viable private small and medium-sized enterprises (up to 100 employees, including micro enterprises and craftsmen) of all sectors. With the reduction of the existing deficits in the financial services offered by the Romanian banking sector to this group of clients, their income situation is to be improved and additional jobs are to be safeguarded and/or obtained (overall objective).

Indicators to measure the achievement of the project purpose are:

a) The APEX Unit, the German-Romanian Fund, accomplishes its tasks of properly assessing and selecting the commercial banks as well as on-lending the FC funds,
b) all the funds are utilized during a period of no more than two years,
c) the staff of the commercial banks reviews the sub-loans according to banking standards and in accordance with the needs of the target group,
d) the commercial banks taking part in the programme raised number and value of the outstanding loan portfolio for the SME sector overproportionally and
e) default rates for this sub-portfolio average no more than 5% per year ("portfolio-at-risk" perspective).

No target indicators were determined specifically for this overall objective.

Project Conception / Major Deviations from the original Project Appraisal and their main Causes

Unlike the original planning, the project was not carried out as a purely downscaling project. Due to the initial reluctance of the commercial banks to engage in the programme, the establishment of Miro Bank, which had emerged from a non-banking credit institute, was also supported.

Contrary to the indications made in the appraisal report, the Apex Unit is not part of the Romanian Central Bank. The Central Bank argued that, contrary to its original promise given during the project appraisal, the Apex Unit´s tasks are not compatible with the bank´s functions. Therefore, the organization of Apex was put to tender among the Romanian representations of international auditing firms and the contract was awarded to KPMG. Unlike the original planning, KMPG´s spectrum of activities was reduced to bookkeeping and fund liquidity management and to occasional spot checks of the loan portfolio of the partner banks.

Key Results of the Impact Analysis and Performance Rating

In the scope of the project, altogether 8,085 loans with an overall volume of about EUR 51 million were granted since 08/1999 on a revolving basis. As of 02/2003, 5,575 loans (EUR 24.1 million) are still outstanding. The loans have an average maturity of 19 months and bear interest at the prevailing market rates. Apart from loans, many SME clients have been granted access to other financial services (savings/transfers). Among the participating partner banks are three commercial banks specialized in the financing of small and medium-sized enterprises. Through their participation in the programme these three banks have also financed micro-loans for the first time. The other participating partner bank is the newly established Miro Bank (institutional refinement of the non-banking financing institute MCR, founded in 1999). Around 32% of the outstanding loan portfolio is currently held by Miro Bank. This hiqh quota is historically rooted because initially, the partner banks were not very interested in financing SMEs. In the course of the macroeconomic stabilization of the country and in light of the positive results achieved by Miro Bank, the banks´ interest in SMEs has increased and Miro Bank´s share in the programme is declining (78% in 1999 / EUR 399,000). The second and third largest shares are those of Banca Comerciala Carpatica (BCC) and Banca Romanesca (BR) with a share of EUR 3.2 million and EUR 2.9 million, respectively, followed by the People´s Bank of Romania (VBR) with EUR 0.25 million, which joined the programme recently, in mid-2002. The cooperation with the state-owned Romanian savings bank CEC was cancelled. The sectoral distribution of the FC portfolio does not reflect the structure of the Romanian economy. With a share of 34%, commerce is underrepresented and with a share of 35%, services are overrepresented. The share of production amounts to 12%, other sectors to 19%. Regionally, only 20% of the loans are concentrated in greater Bucharest (according to volume: 35%), the rest is distributed equally among the other seven economic regions of the country.

The indicators for achieving the project´s purpose were reached with only one exception (a).

a) The tasks attributed to the Apex Unit were carried out satisfactorily by KPMG with the participaton of the consultant. Due to a lack of institutional foundation, a sustainable administration and organization of the fund is not yet assured.

b) As was scheduled, the funds were used within the first two years, although the loans could only be granted as of August 1999 and not, as was planned, as of the beginning of 1999 due to delays in the identification of the Apex Unit and of the partner banks.

c) The personnel of the partner banks review the sub-loans according to banking standards and in accordance with the needs of the target group. The credit technology developed by the consultant especially for micro loans and small loans was implemented successfully in the partner banks and partially also used to improve other financing activities.

d) The partner banks involved in the programme have increased number and volume of the outstanding loans granted to SMEs overproportionally. At the beginning of the project, no inventory of the portfolio of loans granted to SMEs by the partner banks was made so that it is not possible to assess the development. The relatively high proportion of SME loans in the entire portfolio of the partner banks (Miro Bank: 100%, BCC: 22%, BR: 10% and VBR: 3%) indicate how important this market segment is for the partner banks. 50% of the loans granted to SMEs are financed from the partner banks` own funds.

e) The quality of the portfolio is very good. The portfolio-at-risk (default rate > 30 days) accounts for a very low 0.4% of the entire portfolio.

Given the high number of borrowers reached by the programme and given the use of adequate loan technology, it is plausible to think that a positive contribution to the achievement of the overall objective has been made. An impact analysis carried out before the final evaluation including surveys of borrowers has shown that small enterprises financed by the programme have created approximately 3,000 additional jobs. On average, the extension of loans has had a positive effect on the incomes of the financed enterprises and therefore also on the living conditions of the households involved. Furthermore, the study showed that the beneficiaries of the project were more innovative than other enterprises. Another constraint that should be mentioned, however, is that the creation of jobs and income depends firstly on the macroeconomic environment and the expected growth potential of the enterprise. Moreover, the FC programme benefited from the beginning economic recovery and at the same time contributed to it.

The German-Romanian Fund is the largest supplier of small loans in Romania and therefore contributes significantly to a quantitative deepening of the financial sector. New loan technology, tailored to the situation of the micro enterprises, was introduced for Romania. With an average loan volume of EUR 5,500, loans were granted nearly exclusively to small and micro enterprises. In the course of the programme, apart from the savings bank CEC and Miro Bank, three other banks joined, leading to multiplier effects. Given the great demand potential, the participation of one or two other banks would be desirable. The interest of the commercial banks, however, is limited, as other groups (i.e. larger SMEs) seem to be more lucrative clients.

Most FC funds are granted in EUR or US dollars (currently, about two thirds of all Romanian loans). This transfers the credit risk to the sub-borrowers. Even if the risk of a possible devaluation of the Romanian LEI is relatively low, a drop of the exchange rate of the LEI would make it harder for small and micro enterprises to redeem their loans, and the credit risk of the partner banks would increase considerably.

In part, the risks anticipated during the project appraisal have occurred. Readiness for disbursement, for example, was established much later than originally planned due to delays in conclude the intergovernmental agreement and in ratifying the loan agreement. Additionally, the interest of the commercial banks in participating in the programme was initially lower than expected. The decision not to realize a mere downscaling project but also to support the establishment of the new Miro Bank was the right one.

In a summarized assessment of all future impacts and risks we have arrived at the following rating of the project's developmental effectiveness:

- Besides the indicator for the Apex Unit, all indicators for the project´s objectives were achieved or even surpassed. The revolving use of FC funds and the very high share of counterpart funds from the partner banks to finance the SME portfolio are very positive. This shows the high acceptance of the product in the banking sector. Nevertheless, there are certain sustainability risks concerning the institutional foundation of the Apex Unit and due to the assumption of the currency risk by the sub-borrowers. We judge the overall **effectiveness** of the project to be satisfactory (partial evaluation: **Rating 2**).

- The project is of great **relevance** for development policy. The lack of access to financial services remains a key obstacle to growth for small and micro enterprises in Romania. Thanks to the project, many SMEs had access to the formal financial sector for the first time, with the loans contributing to a positive development of income and employment. Through the cooperation with the German-Romanian Fund, partner banks and SMEs alike benefited from the establishment of a credit procedure which is economically sustainable. The enduring critical attitude of the Romanian Central Bank, however, impairs the desired signalling and model effect of the project. No sustainable institutional solution has been found up to now for the Apex Unit. We judge the overall **significance** and **relevance** of the project to be satisfactory. (partial evaluation: **Rating 2).**

- Overall, the partner banks manage the loan portfolio efficiently. The portfolio at risk is very low. The administrative costs and profitability of the banks can be described as appropriate with regard to the target group that was reached and to the banks´ development stage. The profitability of SME financing, however, cannot be evaluated finally because of the incomplete cost unit accounting of the partner banks. Nevertheless, there is enough potential to increase the productivity of the loan officers especially at BR (Banca Romanesca) and VR (probably People´s Bank of Romania). The complementary measure of about EUR 1.5 million seems to be too expensive when compared to the refinancing credit line of EUR 4.35 million, but the effect of the complementary measure should be seen in relation to the institution building that took place (for the SME and the other lending business of the partner banks) and to the total loan volume of EUR 45 million which has been disbursed up to now. We judge the overall **efficiency** of the project to be satisfactory (partial evaluation: **Rating 2**).

Taking effectiveness, efficiency and significance/relevance into consideration, we judge the project's **developmental effectiveness to be satisfactory (rating 2)**.

General Conclusions applicable to all Projects

- The negative attitude towards the SME loan technology in general and to Miro Bank in particular seems to be nourished especially by the division for banking supervision of the Central Bank. The rehabilitation of a neutral communication platform with the Central Bank is urgently needed and should be supported actively by KfW.

- Only loans of more than REI 200 million (EUR 5,700, approximately) are reported to the Central Bank´s credit register. A registration of loans below this limit would reduce the risks the banks have to face and make serving this market less expensive and more attractive.

- In case of smaller loans, registration fees for mortgages are inacceptably high (EUR 30 to 150). Through a flexibilization of collateral, additional groups of clients could be won.

- Due to the high interest rate of the REI and to the current stability of the exchange rate, borrowings under the FC programme are frequently made in foreign currencies. The currency risk is extremely high for small and micro enterprises and a steep drop of the REI would increase the credit risk of the partner banks. Therefore, granting more credits in the national currency is desirable.

- Up to now it remains unclear whether the granting of loans to SMEs contributes to the profitability of the partner banks. It is recommendable to introduce a profit calculation for the SME business on a profit centre basis including an allocation of overheads.

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 assignment during the final evaluation to 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**, a key aspect to consider for project evaluation, as a separate category of evaluation but instead as a cross-cutting element of all four fundamental questions on 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.