Serbia and Montenegro: European Fund for Serbia/ProCredit Bank

Ex-post evaluation

OECD sector	24030 – Formal sector financial intermediaries	
BMZ project ID	2001 40 467 2002 65 348 2003 65 296	
Project-executing agency	European Fund for Serbia (EFS)/ProCredit Bank (PCB)	
Consultant	LFS Financial Systems, IPC	
Year of ex-post evaluation	**2005**	
	Project appraisal (planned)	**Ex-post evaluation (actual)**
Start of implementation	4/2001	4/2001
Period of implementation	41 months	41 months
Investment costs	No information available	No information available
Counterpart contribution	No information available	No information available
Financing, of which Financial Cooperation (FC) funds	EUR 16.7 million	EUR 16.7 million
Other institutions/donors involved	EFS: none PCB: IFC, EBRD, FMO; Commerzbank; ProCredit Holding	EFS: European Agency for Reconstruction, SDC (Switzerland) PCB: IFC, EBRD, FMO; Commerzbank; ProCredit Holding
Performance rating	1	
• Significance/Relevance	1	
• Effectiveness	1	
• Efficiency	1	

Brief Description, Overall Objectives and Project Objectives with Indicators

The three FC projects aimed at securing the long-term provision of loans and other financial services by private financial institutions to small and medium-sized enterprises (SMEs). They were intended as a contribution to building efficient capacities in the Serbian financial sector (overall objective).

The objectives were to be achieved through the following package of measures: setting up a revolving credit fund (European Fund for Serbia - EFS) amounting to about EUR 14.6 million to extend credit lines to selected local commercial banks (partner banks) for refinancing final loans to small and medium-sized enterprises (downscaling approach) and equity capital for the ProCredit Bank (PCB) founded in April 2001 totalling about EUR 2.1 million (greenfield approach). The European Agency for Reconstruction (EAR) and the Swiss government (SDC) also provided the EFS with refinance funds. The choice of the Serbian partner banks was supported under the personnel support measures (EUR 2.1 million) and training measures were carried out to enable the partner banks to operate an efficient, localized and cash-flow-based lending system. In the two training measures (EUR 1.0 million), the focus was on supporting the expansion of PCB's branch network and training and upgrading the loan officers in the new branch offices.

At the refinance fund level (European Fund for Serbia), the following target indicators were defined:

- The average amount for SME loans by the partner banks refinanced from project funds does not exceed EUR 25,000.
- The partner bank loans refinanced with project funds in interest and/or repayments arrears of more than 30 days (portfolio at risk) as a ratio of the total loan portfolio amounts to 5% at most.

The following target indicators were defined at ProCredit Bank level:

- Net loan portfolio > EUR 45 million
- Return on equity > 18%
- Portfolio at risk = 5%
- Deposits = EUR 65 million

At overall objective level, the projects were intended to make a contribution to building efficient capacities in the Serbian financial sector. The indicator set for overall objective achievement was that at least three private banks provide appropriate financial services to SMEs five years after project start.

Programme Design/Major Deviations from Original Programme Planning and Main Causes

The projects were carried out without diverging from the original plans. EUR 2.1 million in equity capital was provided to the ProCredit Bank. The equity capital is held in trust by KfW, which presently chairs PCB's Board of Directors. The intention in the medium term is to convert KfW's interest in PCB into an arrangement where it no longer holds a direct share. EUR 14.6 million was provided to the European Fund for Serbia. The FC funds were held on a special assets account by KfW as fiduciary. The FC funds were provided under credit framework agreements to 4 Serbian partner banks and PCB for refinancing their SME portfolios. They were assigned on market terms (EURIBOR plus risk margin). The different interest margins resulting from conduiting funds to the partner banks and the interim deposits have increased the fund's assets by almost EUR 1.4 million.

In the 2 backstopping measures, support was given in selecting the partner banks (due diligence studies), upgrading their loan officers and those of the ProCredit Bank in cash-flow-based lending technology and in monitoring implementation. Two training measures were conducted for PCB personnel engaged to develop the branch network. The backstopping and training measures were carried out in keeping with needs. They made a major contribution to the successful implementation of the project measures and objectives achievement. In our assessment, their overall implementation was good.

From FC funds, the EFS has EUR 14.6 million in refinance at its disposal for the projects under review here. The bulk of the funds (EUR 9.6 million) was provided in an initial disbursement to PCB. Moreover, four other Serbian banks have received refinance from EFS in initial payments so far: Zepter Banka (EUR 0.8 million), Kulska Banka (EUR 1.5 million), Komercijalna Banka (EUR 1 million) and Eksim Banka (EUR 1.7 million). A credit framework agreement was concluded with another bank (LHB Banka) in November 2005 (from recirculating funds).

Altogether, the four Serbian banks have allocated 278 SME loans worth a total of about EUR 6.6 million as part of the downscaling approach (including the use of recirculating funds for new loans). The average loan amount came to EUR 23,700. The portfolio at risk ratio (arrears > 30 days) is satisfactory at 2.2%. Seventy-five per cent of the volume of credit was allocated to finance fixed assets and 25% for circulating assets. The production sector accounted for 47% of credit, trade, 27%, and services 26%. The loans secured or created about 320 jobs. The SME target group outreach was good.

PCB (greenfield approach) provided about 2,800 loans from the revolving FC funds totalling some EUR 16.2 million. The average loan amounted to EUR 5,800. Sectoral distribution, maturities and portfolio quality in the SME portfolio refinanced from FC funds are in keeping with the very high standard of PCB's total loan portfolio.

The accounts of the ProCredit bank are audited by the international auditors KPMG. None of KPMG's reports raised objections. In January 2005, the international auditing company PWC conducted an application of funds audit for the three projects on final evaluation (including the backstopping and training measures) and raised no objections. The balance-sheet application of funds audit conducted as part of the final evaluation did not give rise to any objections, either.

Key Results of the Impact Analysis and Performance Rating

The aim of the three FC projects was to secure the long-term provision of loans and other financial services by private financial institutions to small and medium-sized enterprises (SMEs).

At the refinance fund level (European Fund for Serbia), the following target indicators were defined:

- The average amount for SME loans by the partner banks refinanced from project funds does not exceed EUR 25,000. Met: The average loan amount of the SME loans issued by four Serbian banks under the auspices of the European Fund amounts to about EUR 23,700.
- The partner bank loans refinanced with project funds in interest and/or repayments arrears of more than 30 days (portfolio at risk) as a ratio of the total loan portfolio amounts to 5% at most. Met: The loans at risk (arrears > 30 days) make up about 2% of the outstanding loan portfolio.

The project far surpassed the target indicators for the European Fund for Serbia.

The following project target indicators were defined at ProCredit Bank level:

- Net loan portfolio > EUR 45 million. Met: The net loan portfolio amounts to EUR 147 million.
- Return on equity > 18%. Met: return on equity amounts to 27%.
- Portfolio at risk: = 5%. Met: The portfolio at risk amounts to 0.5% bank-wide.
- Deposits = EUR 65 million. Met: PCB holds deposits amounting to EUR 133 million.

Almost five years after starting business, the ProCredit Bank has well exceeded the goals set in the business plan on its foundation. It has now established itself firmly as a universal bank in the Serbian banking sector with a core business of granting SME loans using a cash flow-based lending technology.

At overall objective level, the projects were intended to make a contribution to building efficient capacities in the Serbian financial sector. The indicator set for overall objective achievement was that at least three private banks provide appropriate financial services to SMEs five years after project start. The projects exceeded this indicator at final evaluation. All five financial institutions promoted in the FC projects render appropriate financial services to SMEs.

In hindsight, we still judge the set of objectives defined and the indicators chosen for objectives achievement at project appraisal as appropriate for assessing the developmental efficacy of the three FC projects. In our assessment, the indicators are relatively complete, sound and commensurate with the project measures.

The target group comprised private enterprises from all sectors, particularly efficient micro, small and medium-sized enterprises (SMEs) whose demand for credit was not being met adequately or at all by the banking system. The SME target group outreach was very good: The Pro-Credit Bank (greenfield approach) primarily targeted micro and small SMEs that do not effectively count as prospective clients for the other Serbian banks. Ninety per cent of the PCB loan portfolio is allotted to SMEs. Ninety-one per cent of the loan amounts are under EUR 10,000. The average size of all SME loans issued by the PCB since foundation amounts to EUR 5,600. The four Serbian banks refinanced under the European Fund (downscaling approach) grant loans to small and medium-sized SMEs averaging EUR 23,700. Altogether, the SME target group outreach via the two complementary approaches was very good with the greenfield approach focusing primarily on small and micro SMEs and the downscaling approach on small and medium-sized SMEs.

The establishment of the ProCredit Bank as a new financial intermediary (greenfield approach) has had very beneficial capacity-building impacts on the Serbian financial sector and credit supply to SMEs over the last 5 years. New products have been introduced and established on the market (widening the financial sector) and new clientele have been solicited (deepening the financial sector). Owing to the market entry of PCB, the access of SMEs to credit from the formal financial sector has been improved considerably and very noticeably. Particularly the SMEs that take out loans of less than EUR 10,000 with PCB, i.e. 91% of PCB borrowers, would have had no other opportunity of obtaining a loan in the Serbian banking sector. Most of the SMEs served by PCB were able to raise a bank loan for the first time and establish relations with the formal financial sector. PCB has performed genuine pioneering work in this client segment.

Complementing the PCB greenfield approach, the four Serbian partner banks refinanced from the EFS (downscaling approach) have started to issue loans to small and medium-sized enterprises. The SME lending facilities of the four Serbian partner banks supplement the PCB credit services. The clients of the four Serbian banks tend to be larger SMEs with more turnover and staff than the PCB clientele. The supply of SME loans via the EFS extends the financial service capacity of the Serbian financial sector, so it can be seen as widening and deepening the sector in this connection as well.

The majority of the borrowers of PCB and the Serbian partner banks have been able to step up their turnover and income considerably by taking out a loan and some have recruited new personnel. Even though the poor population was not an explicit target group of the project, including micro-enterprises in lending gave the project an indirect bearing on poverty. Lending by PCB and under the EFS was carried out regardless of gender. The environmental impact guidelines of the ProCredit Bank or the Serbian partner banks are applied in loan appraisal. No loans are granted to companies whose production processes or products damage or endanger the environment.

The market entry of the ProCredit Bank has brought about considerable changes in the financial sector. PCB allocates loans according to transparent, comprehensible criteria based on cash-flow lending technology. The lending decision in the ProCredit Bank cannot be influenced by personal relations, let alone bribery. In our opinion, this new transparency in the financial sector makes for an important aspect of good governance. Moreover, four Serbian banks have also started to issue SME loans applying transparent criteria and using a cash-flow-type lending technology.

In summary evaluation of developmental efficacy, we assess the projects as follows:

<u>Effectiveness</u>

The three FC projects aimed at securing the long-term provision of loans and other financial services by private financial institutions to small and medium-sized enterprises (SMEs). Measured in terms of the target indicators, project objective achievement was very successful thanks to a combination of a greenfield approach (founding the new ProCredit as a specialized institution for granting SME loans) and a downscaling project (refinancing SME business through established Serbian banks and via the ProCredit Bank). In the greenfield approach, the indicators set at project appraisal were fully met or exceeded by a substantial margin. In the downscaling approach, the indicators set were comfortably met. Crucial to the very good objectives achievement on the one side (downscaling approach) was the support given to the Serbian partner banks in building up SME business and providing comprehensive upgrading measures for loan officers in cash-flow-based lending technology and on the other (greenfield approach) the assistance in organizational development and in developing the branch network through instruction and training measures for ProCredit Bank staff. These measures were performed to complement the main measures through a consistent application of FC instruments (backstopping measure, training measures). Altogether, we assess the effectiveness as very good (Subrating 1).

<u>Significance/relevance</u>

The overall objective of the projects was to make a contribution to building efficient capacities in the Serbian financial sector. Measured against the indicators, the overall objective achievement was very good: The indicator set was that at least three private banks provide appropriate financial services to SMEs five years after project start. This indicator was very well met on final evaluation. All five financial institutions promoted in the FC projects render appropriate financial services to SMEs. Through the combined application of the greenfield and downscaling approach, the three FC projects have widened the Serbian financial sector (SME loans are firmly established as a finance instrument), and deepened it substantially through the sustainable solicitation of new clientele (SMEs with no prior access to the Serbian financial sector). The significance of the measures is substantially greater in the greenfield than in the downscaling approach. Altogether, we gauge the significance/relevance as very good (Subrating 1).

<u>Efficiency</u>

We judge the allocative efficiency of the project as good. The interest rates for SME loans by the ProCredit Bank and the four Serbian partner banks are positive in real terms and in line with the market. We assess the production efficiency of the programme banks as good for the ProCredit Bank and as satisfactory for the four Serbian partner banks. The portfolio at risk at the ProCredit Bank remains consistently very low and that of the four Serbian programme banks consistently low. A consistent record is kept of defaults and they are followed up. Altogether, we assess the efficiency as good (Subrating 1).

In a summary assessment of the above impacts and risks, we give the project overall a completely positive rating. Altogether, we judge the developmental efficacy as **very good (Rating 1)**. The project is suitable as an example of best practices.

General Conclusions and Recommendations

When setting up a new financial intermediary in future, the institution should be provided with more ample and wider-reaching startup finance, instead of 'bit by bit'. The speedy establishment of a branch network, the requisite training of new personnel, setting up an adequate IT infrastructure, a suitable risk management system and a sound management information system and conducting professional marketing campaigns are cost-intensive factors but crucial to success when establishing a new institution.

Besides lending business, major core functions of a universal bank should also be built up in a new financial institution (deposit-taking, payment transactions, credit cards, trade finance, electronic financial services, etc.). Deposit business should be actively developed in particular, which is essential for a bank to refinance itself in the long term independent of donors.

Access to medium-term and long-term investment finance is a decisive criterion for financing capital assets in SMEs, particularly in the production sector. Providing medium-term and long-term finance for SMEs to enlarge their capital assets is therefore desirable from an economic standpoint. This is why financial institutions should provide medium-term and long-term finance early on.

Key

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

Criteria for Evaluating Project Success

The evaluation of the developmental efficacy of a project and its classification during the ex-post evaluation into one of the various levels of success described in more detail below 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, organisational and/or technical support has come to an end.