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South East Europe: European Fund for Southeast Europe

Ex post evaluation

OECD sectors	24030/Formal sector financial intermediaries 24040/Informal/semi-formal financial intermediaries 32130/Small and medium-sized enterprises (SME) development 33120 Trade facilitation	
BMZ project ID	See overview on additional sheet	
Project executing agency	Various refinance funds administered by KfW	
Main consultants	• Bankakademie International Micro Banking Competence Centre (later: Frankfurt School of Finance and Management) • GFA Management GmbH • IPC Internationale Projekt Consult GmbH • LFS Finance Systems GmbH • MACs Management & Consulting Services GmbH	
Year of ex-post evaluation report	**2008**	
	Project appraisal (planned)	**Ex-post evaluation (actual)**
Start of implementation	See overview	See overview
Period of implementation	Revolving funds	Revolving funds
Investment costs	EUR 39.3 million	EUR 39.3 million
Counterpart contribution	-	-
Financing, of which Financial Cooperation (FC) funds	EUR 39.3 million	EUR 39.3 million
Other institutions/donors involved		<>
Performance rating	See overview	
• Relevance	See overview	
• Effectiveness	See overview	
• Efficiency	See overview	
• Overarching developmental impacts	See overview	
• Sustainability	See overview	

Joint Ex-post Evaluation of the European Fund for Southeast Europe

No.	Country	Sample	BMZ ID	Project	Project category	Volume (€)	Start of Implement. (planned)	Start of Implement. (actual)	Relevance	Effectiveness	Efficiency	Impact	Sustainability	Performance Rating
(1)	Southeast Europe	yes	200040477	German Contribution to EBRD Trade Promotion Programme	Financial sector project	2.246.684	IV / 2000	IV / 2000	1	2	2	2	1	**2**
(2)	Southeast Europe		200040618	Apex Fund for the Promotion of Small and Medium-Sized Enterprises	Financial sector project	3.717.092	IV / 2000	IV / 2000	1	2	2	2	1	**2**
(3)	Southeast Europe	yes	200265751	Poverty Reduction: Lending to MSEs in Kosovo and Montenegro	Financial sector project	2.800.000	III / 2002	III / 2002	1	1	2	2	1	**1**
						8.763.776								
(4)	Southeast Europe/Kosovo		200140756	Promotion of MEB Housing Programme (Inv.) Microbank/Kosovo	Financial sector project	1.278.229	IV / 2001	IV / 2001	1	1	2	2	1	**1**
(5)	Southeast Europe/Kosovo		200140764	Promotion of MEB Housing Programme/CM	Complementary measure	255.646	I / 2002	I / 2002	1	1	2	2	1	**1**
(6)	Southeast Europe/Kosovo	yes	200266106	SME Promotion and Housing Investments	Financial sector project	2.500.000	I / 2003	I / 2003	1	1	2	2	1	**1**
(7)	Southeast Europe/Kosovo		200270405	SME Promotion and Housing Investments (CM)	Complementary measure	500.000	I / 2004	I / 2004	1	1	2	2	1	**1**
(8)	Southeast Europe/Kosovo		200365767	European Fund for Financial Sector Promotion/Kosovo	Financial sector project	3.000.000	I / 2004	I / 2004	1	1	2	2	1	**1**
(9)	Southeast Europe/Kosovo		200465872	Housing and SME Loan Programme (anticipated appraisal) (Inv.)/Kosovo	Financial sector project	4.900.000	IV / 2004	IV / 2004	1	2	2	2	1	**2**
						12.433.875								
(10)	Montenegro		200140582	Promotion of SMEs via the Financial Sector (Inv.)	Financial sector project	2.198.555	III / 2001	III / 2001	1	1	2	2	1	**1**
(11)	Montenegro		200140590	Promotion of SMEs via the Financial Sector (CM)	Complementary measure	869.196	III / 2001	III / 2001	1	1	2	2	1	**1**
(12)	Montenegro	yes	200265355	Promotion of SMEs via the Financial Sector II (Inv.)	Financial sector project	3.500.000	I / 2003	I / 2003	1	1	2	2	1	**1**
(13)	Montenegro		200270470	Promotion of SMEs via the Financial Sector II (CM)	Complementary measure	500.000	I / 2004	I / 2004	1	1	2	2	1	**1**
(14)	Montenegro		200365569	SME Promotion (Montenegro) III (Inv.)	Financial sector project	3.600.000	IV / 2003	IV / 2003	1	1	2	2	1	**1**
						10.667.751								
(15)	Serbia		200140483	Loan Guarantee Fund for SME Start-ups	Financial sector project	4.090.355	III / 2002	III / 2002	--	--	--	--	--	**--**
(16)	Serbia		200370528	SME Promotion (Serbia) II (CM)	Complementary measure	1.000.000	I / 2004	I / 2004	--	--	--	--	--	**--**
						5.090.355								
(17)	Bosnia-Herzegovina		193002359	Loan Fund for SME Promotion	Training measure	812.954	I / 2001	I / 2001	1	1	2	2	1	**1**
(18)	Bosnia-Herzegovina		200265744	Lending Programme for Crisis Regions	Financial sector project	4.500.000	III / 2002	III / 2002	1	1	2	2	1	**1**
(19)	Bosnia-Herzegovina	yes	200365734	Microlending Programme for Srebrenica Region	Financial sector project	1.000.000	IV / 2003	IV / 2003	1	1	2	2	1	**1**
						6.312.954								
	Total					**43.268.711**								
	of which Personnel Support/PS (CM, TM)					3.937.796								
	of which investment					39.330.915								

Brief description, overall objective and project objectives with indicators

The following is a joint ex-post evaluation and encompasses the projects listed in the overview (including 5 complementary measures and 1 training measure). Common to all the listed measures is that they all basically belong to the parent population eligible for ex-post evaluation in 2007 and have now been merged into the European Fund for Southeast Europe (EFSE). Five of the projects listed and appropriately designated in the overview (supplemented by appropriate complementary or training measures) formed part of the sample from the parent population of projects for 2007. Due to their substantive relevance and geographical proximity to the sample projects, the others were also reviewed and evaluated for their developmental performance wherever enough information was available. This joint evaluation included a local inspection of the main sample projects carried out at the end of October/beginning of November 2007 in Kosovo and in Montenegro.

Altogether included are 13 financial sector programmes plus 6 complementary or training measures totalling EUR 43.3 million (EUR 3.9 million of which was PS). The grants were administered by KfW on a trustee basis in specific country funds for Bosnia Herzegovina, Kosovo, Montenegro and Serbia. As a rule, the funding was allocated for refinancing low-interest loans issued by selected partner financial institutions that in turn extended these to MSMEs and/or for residential building. The funds were disbursed in specific countries on a revolving basis. The complementary personnel support was to enable the partner banks to build and expand the respective business segment and run sustainable operations. Besides the BMZ funding (in part from the Stability Pact), EAR and individual European bilateral donors also paid financial contributions into the international funds administered by KfW.

All financial sector projects in the present ex-post evaluation were amalgamated into the new European Fund for Southeast Europe (EFSE) at the end of 2005, with the exception of the loan guarantee fund project for Serbia (BMZ ID 2001 40 483) that does not belong to the sample and which is being successively merged into EFSE. The foundation of EFSE and the transfer of funds from South Eastern European financial sector projects was aimed at ensuring the efficient and sustainable use of revolving finance for the future as well. Additional projects in the region were transferred later to EFSE or are being progressively merged into it.

The objective of the FC projects was the sustainable supply of credit and other financial services for micro, small and medium-sized enterprises (MSMEs) as well as the provision of housing finance by private financial institutions. The projects were supposed to make a contribution to poverty reduction and/or improving the conditions of life of the population and to developing efficient capacity in the financial sector (overall objective). In Bosnia-Herzegovina, they were also intended to contribute to conflict prevention and the economic stabilisation of the Srebrenica region, which was severely damaged in the war, by creating jobs and improving conditions of life (overall objective).

The target group consisted of private small and medium-sized enterprises, including micro enterprises, individual traders and business start-ups in all sectors, as well as private households with residential property.

The project objective indicators set for the refinancing funds were defined as follows:

- All funds have been called in under 3 years.
- Real fund capital has been maintained 5 years after initial payment (excluding expenditure for personnel support).

In the **MSME sector**, the following project objective indicators were also to be met by the partner banks 5 years after receipt of initial payment:

- The average amount for SME loans of the partner banks refinanced from project funds does not exceed EUR 25,000 (SME).

- The share of the partner bank loans refinanced from project funds with interest and/or repayment arrears of more than 30 days (non-performing loan portfolio) does not exceed 5% (portfolio-at-risk assessment).

- The outstanding portfolio at the partner institutions for loans to micro and small enterprises has increased by at least 30% (MSE).

Project objective indicators set for partner banks in the **housing construction sector** were as follows:

- At least 3 commercial banks issue appropriate housing loans 5 years after initial payment.

- The average loan amount (project loans) does not exceed EUR 30,000 5 years after initial payment (housing loans by the Microenterprise Bank Kosovo, today ProCredit, DM 20,000).

- The share of NPLs (30 days) at the partner institutions does not exceed 5% 5 years after initial payment.

The Housing Loan Programme through the Micro Enterprise Bank of Kosovo (MEB) also included the indicator: At the end of 2003, housing loans amount to DM 5 million, equivalent to EUR 2.5 million.

Project design/major deviations from original planning and main causes

The European country funds administered by KfW, which only occasionally included more than one country, were all launched in the course of the reconstruction phase after the war in the period since 1998 to provide urgently needed refinancing facilities in the banking sector for housing reconstruction and for financing MSMEs (including rural areas) as well as in many cases to initiate the requisite business segments in the banking sector. Both the banking sector, which was still partly dominated at that time by government, and the business sector were in the privatisation phase and in urgent need of sources of long-term finance to support this process.

In the **financial sector** in the countries reviewed, which plays a key role for promoting economic development, intermediation was very meagre after the wars in the region. In Bosnia-Herzegovina, for example, the EBRD transition index for the banking sector was only 1 after the end of the Bosnian war, i.e. the transition process had hardly begun and banking had only been separated into a two-tier system. No banking services at all were initially available in Kosovo after the end of the war in 1999. The first far-reaching reform steps were in preparation at project appraisal and/or were already underway.

In the transition countries, particularly those lacking in large mineral resources, such as the South East European nations, the **MSME sector** plays a key role in the economic transition process. This sector drives the process of privatisation and the mobilisation of private-sector initiatives by broad classes of society, while the privatisation of large state-owned enterprises usually lags behind, but MSMEs also create the most new jobs. In view the drastic drop in the standard of living and the rapid rise in unemployment in the course of transition and also the wars in the South East European region, this was another reason why foremost importance was attached to promoting the development of the MSME sector in supporting economic development and reducing poverty.

One of the main obstacles to the development of MSMEs was their lack of access to finance. The very many micro entrepreneurs who started up business in the informal sector in the South

East European countries and bore and still bear responsibility for the livelihood of many families frequently had no access at all to the formal financial system, but also formal SMEs seldom gained access to the loan amounts and financing terms they needed to carry out their plans, particularly larger, long-term investments.

The projects were designed to promote SME business with a special, cash-flow-based lending method developed in microfinance and geared to the needs of SMEs. This required a considerable adjustment of operations by the commercial banks (more frequent local contacts with borrowers, closer monitoring, adjustment of EDP) and specific training of personnel. Beyond just refinancing lending business, the complementary measures assisted the banks in making these adjustments.

Besides the MSME sector, residential building was the second priority targeted by the South East European programmes, with the focus on renovation, repair and extension instead of new housing construction. This included repairing war damage. In all the countries concerned, many people own houses with tenancies playing a minor role only, even in urban centres. Most houses are built and maintained with the help of friends and relatives. Providing access for broad classes of society to finance for housing improvements is of central importance for raising the standard of living in the South East European region. The reasons for this include:

- A large number houses were destroyed or damaged in the course of war or housing quality had declined greatly due to insufficient maintenance. This exacerbated the housing shortage that already existed prior to hostilities.
- Due to legal uncertainties in collateral, either housing loans were not offered at all or were confined to higher income brackets.
- At the same time, poorer households frequently lacked sufficient current income to finance larger-scale renovation phases.
- There is frequently a discrepancy between the size of household and the size of housing. This is particularly evident in rural Kosovo, where very large households live in confined space.

After the end of the war, the approach of some donors in housing construction consisted in providing subsidies for renovations or building materials. This posed a risk of setting negative incentives. To avoid this and enhance the self-help capabilities of the poorer households more efficiently, the FC project aimed at providing loans to meet needs, while gradually raising conditions to market level. Instead of arranging the loans from the outset to finance all renovation costs, the innovative aspect of this approach was to allocate them intermittently for carrying out feasible small renovation phases. The intention here was to place the monthly burden for the households in manageable relation to income. As with SME business, this housing credit had to be initially built up gradually as a banking business in most countries. Most of this was undertaken by microfinance institutions, which played an increasingly important role in the banking landscape during the national transition processes due to the significance of MSMEs for economic development.

In our estimation, the projects were generally designed in keeping with the problem. In response to the similar problems in the different countries, the evaluated FC projects adopted a comparable approach in all of them and already included a cross-border aspect in line with the findings from microfinance. Under initial KfW administration, the funds were able to provide prompt finance geared to target-group needs and conditions, despite the institutional political and economic upheavals in these countries.

Key results of impact analysis and performance rating

Altogether, we consider the set of objectives defined at project appraisal and the indicators for objectives achievement as appropriate for assessing the developmental performance of the FC projects, also in hindsight. In our assessment, the indicators are relatively complete, valid and adequately tied in with the project measures. For the MSE FC project, indicators for the overall objective would have been useful, for example, to be able to measure the objective of developing an efficient financial infrastructure for MSEs with indicators on the development of the microfinance sector or the entry of new banks into this segment. A caveat here, however, is that for lack of reliable definitions for MSEs these indicators could have resulted in mis-statements. An indicator might, however, have been useful on the maturity of loans and the trade off between low-interest loans and real capital maintenance could have been addressed.

The projects in the **MSME sector** include Nos. (1) to (3), (10) to (14) and (17) to (19), in part also the projects (6) to (9) in the overview.

Almost all project objective indicators for these projects were met in full. Disbursements were made very speedily so that the funds were repeatedly replenished. At ex-post evaluation, the PAR for the partner banks/institutions under review amounted to < 1% and the average outstanding loan amount came to EUR 3,200 and EUR 2,000 resp. Instead of 5 years after payment, the ex-post evaluation took the end of 2005 as a point of reference for the real capital maintenance indicator due to the transfer of the funds to EFSE.

The fund financed from three SME credit lines for Montenegro had increased in nominal terms from the original amount of EUR 0.41 million to EUR 9,949 million, including a pilot project not under evaluation here. Based on the low rates of inflation in the euro zone, the requirement of real capital maintenance was therefore met. In the MSE project in Kosovo and Montenegro (BMZ ID 2002 65 751), the funds increased nominally to EUR 3.02 million and real capital maintenance was also achieved here. In the apex fund, which also received finance from sample project 2000 40 477, real capital was not maintained, however. The reason for this was the early disbursement of the apex fund in 2000 already and the lower interest, which was normal at that time for the promotion of financial institutions to start up the new business segments. In the KfW fund for Bosnia-Herzegovina, which included the projects BMZ ID 2002 65 744 with a related training measure and BMZ ID 2003 65 734 (sample project), the project objectives were also achieved. At EUR 1 million, real capital maintenance was not quite achieved in the relatively small microloan programme for similar reasons to those mentioned above.

At overall objective level, the projects were intended to make a contribution to building efficient capacities in the Montenegrin financial sector and/or an additional contribution to poverty reduction in the MSE sector by creating or securing jobs. For overall objective achievement, the indicator set in the MSME segment was for at least three private banks to provide appropriate financial services to MSMEs 5 years after initial disbursement. This indicator was met in full at ex-post evaluation, since all commercial banks now generally run a product segment geared to MSMEs. For the MSE FC project, no overall objective indicator was specified. For the cross-border apex fund, the additional overall objective indicator was chosen to depict financial sector development: Private lending/GDP as well as M3/GDP is at least 10% higher than 1998/99 for the respective country 5 years after project completion. Partly because Montenegro and Kosovo joined the euro zone, no data is available for the M3/GDP indicator. Looking at the ratio of private lending/GDP, which in Montenegro rose from 8.3% (2002, first available figure) to 43.3% (2006), in Bosnia from 3.2% (1999) to 23.2% (2006) and in Serbia from 13.6% (2001, first available figure) to 18.9% (2006), the indicator has therefore been met in full, at least for Montenegro and Bosnia-Herzegovina. The additional overall objective of contributing to conflict

prevention defined for the KfW fund in Bosnia-Herzegovina was not provided with indicators and cannot be evaluated.

The accompanying complementary measures for developing (M)SME business at partner institutions can also rate as successful judging by the widespread lending to (M)SMEs at the time of ex-post evaluation.

The **residential building** projects include Nos. (4) to (9) in the overview.

All project objective indicators for these projects were also met in full. Five of the six banks provide housing loans in Kosovo and at present these average just under EUR 3,000 and the ratio of NPLs at the ProCredit Bank Kosovo (PCBK), for example, amounts to 0.23%. Outstanding housing loans at the project banks already amounted to EUR 27.4 million in 2003 and had risen to EUR 65.5 million by mid-2006.

All funds had been called in under 3 years. The indicator for real capital maintenance was just met in most projects. On the other hand, particularly at the beginning of the measures, the funds were onlent to the partner institutions at comparatively attractive conditions to induce the institutions to start up the new business segment, which runs counter to the indicator for real capital maintenance. As this no longer holds for the most recent project, Loan Programme for Housing and SMEs (BMZ ID 2004 65 872), the small shortfall in real capital maintenance detracts slightly from the very good rating for project objective achievement. Since, however, the development objective is foremost, objective achievement has also been good overall here as well.

At overall objective level, the projects were supposed to make a contribution to improving the conditions of life of the population and to building efficient capacity in the Kosovan financial sector. No indicators were defined. Considering the plausible results chain and the deepening of the Kosovan financial sector since project appraisal as described, we may also assume a beneficial developmental impact of the projects in promoting housing construction. The relatively small housing loans also imply that the conditions of life for less prosperous clients were improved, even though the very poor were not and cannot be reached with this product.

As lending for residential building was successfully introduced, the related complementary measures can also be assessed as successful.

The remaining project for **Serbia**, BMZ ID 2001 40 483 with the accompanying complementary measure, differs from all other projects in the joint evaluation, because it is the only loan guarantee fund also aimed at supporting SME business start-ups. The guarantee fund is in full use but unlike with the other projects the funds were not transferred as a whole to EFSE on 31 December 2005. They are successively paid into EFSE as individual guarantees expire. As an additional assessment of objective achievement by this project would have required a different methodology and thus comparatively high additional input and because it is not a project included in the sample requiring mandatory ex-post evaluation, a more detailed assessment of objective achievement has not been made and no rating given for developmental performance.

Merger of projects in EFSE

At launch, individual funds already received contributions from several, partly bilateral, donors from the EU and from of the Stability Pact. In the course of 1998 to 2005, about 45,000 loans were issued in the region worth a total of almost EUR 280 million. Through additional, personnel support measures financed by the other donors, about 30 partner institutions were strengthened in lending business.

To secure these successes in a changed market environment for the long term, there was, however, a need for conceptual realignment in 2004/2005. This was also necessary for administrative reasons (expiry of KfW management contracts), but also for reasons of efficiency (The various donor funds could only be pooled to a limited extent and international use was not possible, either.). Due to the dynamic development in the region, the requirements for the set of instruments and/or institutions to support financial system development there had also changed. Instead of favourable refinancing lines and incentives for starting up lines of business, what was now needed, besides continued provision of (long-term) sources of refinance in larger quantities as far as possible, were more innovative and flexible instruments for risk reduction and management, including personnel support, as core elements of financial sector development in Southeast Europe. The setup and capacities of the KfW country funds faced new challenges with which they could no longer have coped in the medium term.

A donor working group therefore devised a follow-on design based on the following criteria:

- Retention of the development objectives
- Leveraging additional finance
- Sustainability of the funds
- Good governance and management as well as efficiency
- Regional approach while safeguarding national interests
- Closer integration of local lobbyists

Based on these considerations, the decision was finally taken to form the European Fund for Southeast Europe (EFSE), which was designed as a regional fund with national sub-funds to enable a more flexible use of donor finance. At the same time, a complex risk mix of the fund affords extensive leverage for mobilising other sources of finance, including funds from commercial investors. The finance issued previously from the individual KfW funds for Southeast Europe flowed into EFSE at the end 2005 (including all FC projects evaluated here except for the successively transferred Serbian project) and successively also in 2006/07, affording the ‘exit vehicle’ a fresh start at the same time.

EFSE was founded in December 2005 as a variable capital investment company (SICAV) under Luxembourg law for an unlimited term. Its initial capital amounting to EUR 148 million consisted of donor funds from the governments of Germany (BMZ), Switzerland and Austria as well as the European Commission and the European Agency for Reconstruction (EAR) which had been provided in the past for predecessor projects.

This initial capital was not therefore in liquid form but consisted of the loan portfolios of the credits to partner institutions that had been built up in predecessor projects. Before inclusion in EFSE, these portfolios were subjected to a fair market value assessment by an independent accountant. The assessment methodology is adequate for the most correct valuation possible of the initial capital of a fund established in Luxembourg and is in keeping with international accountancy standards. The deductions for risk on nominal value resulting from this fair market value estimate do not merit a negative assessment in development-policy terms. On the contrary, they primarily confirm that corresponding loans would not have been granted via the commercial market due to the high country risk and therefore provide indirect evidence of the developmental purpose of the loans.

A large potential for soliciting additional funds for EFSE was afforded by arranging its initial capital as the first loss piece, i.e. the share in total fund capital that is the first to bear the risk of loss. Based on this first loss piece as an initial risk buffer, other investors could be attracted to provide additional funds for the development-policy objectives of EFSE. At the time of

foundation, the IFIs, KfW, IFC, FMO and EBRD also joined, investing in the financial tranche with secondary liability after the first loss piece, the so-called mezzanine piece. This cascading setup in risk diversification already facilitated the additional participation of private investors in EFSE in 2006. They purchased senior tranches that bore liability after the mezzanine pieces of the IFIs. At the end of 2007, subscribed fund capital already totalled EUR 524 million. This gave rise to a fund of considerable size geared to promoting MSMEs and residential building and providing substantially more finance than the funds of the predecessor projects included as a basis.

As a structured fund, EFSE has a professional management that allocates appropriate tasks to specialists and bundles donor funding in an independent arrangement. The institutional and organisational fund setup safeguards and/or balances the many different interests of donors, recipient countries/institutions and investors, enabling flexible adjustment and the entry of additional investors, depending on needs and motivation. This scope of adaptability was not available under the KfW funds. The present organisational setup is generally suitable for the sustainable performance of the main tasks and geared better to the new market requirements of the target countries than would have been possible under the KfW funds.

Finance from EFSE is still allocated by commercial banks for loans to micro, small and medium-sized enterprises and for residential building and rural lending (financing economic activities outside the capital and the provincial capitals). New sectors, such as support for energy-efficiency measures, are envisaged. The projects therefore still aim at MSMEs and private households. The target groups are defined by loan amounts to CGAP criteria with < EUR 10,000 for micro enterprises and EUR 10,000 to EUR 100,000 for small and medium-sized enterprises.

The EFSE facilities are offered close to market conditions, i.e. not at low interest as under the KfW funds. They are priced with reference to interest rates or swap rates that vary depending on country, term, loan amount and the size of the business partner. Supplying the products close to market conditions is not contrary to the objective achievement of EFSE. The specific concern is to generate supply where no or insufficient market products are available (as yet). When the market has developed enough for the provision of commercial financial services, EFSE is to shift its activities with new products to fill new gaps in the market.

The partner institutions are still largely free to arrange onlending conditions to final borrowers. The maximum loan may not, however, exceed EUR 100,000 (the actual average loan amount was EUR 4,307 in 2007). In addition, no activities may be financed that are included in the EFSE Social and Environmental Exclusion List.

The fund allocation in the form of loans, guarantees, participating interests, etc. will continue to enable a revolving system of funding. According to EFSE estimates, real capital development was positive at 3.7% in 2006 and 1% in 2007. A sustainable use of funds has thus been ensured so far even for the relatively risky BMZ investment in the C tranche (first loss piece).

The lending business of the commercial banks cofinanced via EFSE in areas where living-costs expenditure is financed, such as in the collateralisation of housing, is difficult to demarcate from consumer loans. A perusal of the webpages of the partner commercial banks showed that almost all of them also offer consumer loans. The services also indicate above all, however, that the extent of credit is restricted to an income-tied limit and numerous partner banks know that their focus is not on awarding consumer loans but on granting investment loans primarily to MSMEs. Through due diligence assessments of the partner banks and the monitoring of fund application by final borrowers, EFSE also ensures that the partner banks operate a responsible consumer lending business.

Performance assessment

Accounting for their inclusion in EFSE, the objective achievement of the KfW funds can be rated as good to very good. The instruments of the European funds were applied adequately at the right time in the region to provide an additional stimulus for the incipient economic recovery and to support its sustainable development. The findings of the ex-post evaluation show that the postulated results chains were valid. The FC projects addressed a core problem. The objectives of the projects conformed with the developmental goals and guidelines of BMZ and also other international partner institutions as well as the respective governments or authorities.

Funding from the KfW funds has made a decisive contribution to the development of the financial sectors in the target countries and above all to developing products for MSMEs and residential building, a process that is ongoing and adequately adapted under EFSE. The development of competition in the financial sector was also stimulated by the KfW funds and has received repeated impetus. Furthermore, the positive approaches in donor coordination adopted by the KfW funds have been pursued further to good effect under EFSE.

The definition of the target groups and the specification of certain performance criteria (e.g. average loan amounts, ratio of loans under EUR 10,000) also continue to guarantee outreach to many members of underprivileged sections of the population.

Partner bank lending was conducted regardless of gender.

The environmental viability guidelines of IFC and/or EBRD are applied in loan appraisal. No loans are granted to companies whose production processes or products damage or endanger the environment.

The projects did not aim at participation/good governance.

As to developmental efficacy, we arrive at the following assessment of the projects. No developmental assessment will be made of the projects not contained in the sample in Serbia - BMZ ID 200140483 with CM 200370528, for the reasons given.

In terms of scale, the FC projects were suitable for achieving the anticipated impacts in the financial sector and at socio-economic level. Of positive note, the conceptual design was appropriately adapted to the changed framework on transfer of the predecessor projects to EFSE. Key constraints that still apply today and can impair the success of the projects are primarily political, above all the tense situation caused by the independence of Kosovo, which could be detrimental to the fragile stability of the region. The projects conform with the priorities of the partner countries, are in keeping with the strategies of BMZ and aim at indirect and direct poverty reduction. Both the predecessor projects and particularly EFSE play(ed) a pioneering role in donor coordination in the region. We therefore judge the relevance of the projects as very good throughout (Subrating 1).

With the exception of the slight shortfall in real capital maintenance in the apex fund (including the German contribution to trade promotion) and in one housing and SME project in Kosovo, the ex-post evaluated projects achieved their objectives very well. Altogether, minor reservations must be made for the residential building projects, since although the business segment was developed here fewer poorer sections of the population were reached. We therefore assess the effectiveness of the predecessor FC projects as follows: The effectiveness of the (M)SME projects in Montenegro (BMZ ID 2001 40 582, 2001 40 590, CM 2002 65 355 in the sample, 2002 70 470, CM 2003 65 569) is rated as very good (Subrating 1). The same applies for the Kosovo housing projects BMZ ID 2001 40 756 with CM 2001 40 764, 2002 66 106 with CMs 2002 70 405 and 2003 65 767, since these are earlier projects and nevertheless achieved or fell just short of real capital maintenance. As the relatively recent project BMZ ID 2004 65 872 fell

just short of real capital maintenance, we allot this a subrating of 2. The subrating good (2) is accorded the projects BMZ ID 2000 40 477 in the sample and 2000 40 618 for the same reason. The SME and micro projects are assessed as very good in Bosnia-Herzegovina (BMZ ID 2002 65 744, 2003 65 734 in the sample and TM 1930 02 359), since although the micro programme fell just short of real capital maintenance, the FC funds of both projects were maintained altogether in real terms, although these projects were also intended to help prevent crisis.

The partner institutions involved in the above-mentioned projects in Montenegro and Kosovo record good to very good portfolio quality in the residential building and MSME promotion sectors (Montenegro PAR < 1% and thus well under the objective indicator of max. 5%, Kosovo PAR averaging 2.5% and/or the PAR of the ProCredit Bank Kosovo (total) at 0.23% and hence also well under the objective indicator of max. 5%). The results in residential construction and MSME promotion can be taken as an indication of a good allocation of FC funds. Almost all loans are granted close to market conditions and the partner institutions inspected at the time of evaluation were operational.

The comparatively stable development of the partner institutions and the financial sector in the countries is a clear sign of good production and allocative efficiency in the FC projects. The allocation of funds, which was mainly country-specific in the projects, and the national subfunds still ongoing under EFSE (see 3.04) restrict broad flexibility in fund allocation, however - and hence allocative efficiency, since there is a general risk that residual funds from a country fund remain unused if refinancing requirements decline there. We therefore classify the efficiency of the projects as good (Subrating 2).

The overall objective of contributing to building efficient capacities in the financial sector has been achieved throughout. MSME finance is now offered by almost all banks in Montenegro and Bosnia-Herzegovina and some have specialised in this. Housing finance in Kosovo has been developed with the funding and is now also provided by several financial institutions. The contribution to improving the economic and social situation of the target groups can, however, only be verified approximately, since no survey of relevant indicators was carried out. The incidence of poverty remains high in the Southeast European region, however, with Kosovo, for example, numbering among the poorest countries. Considering the capacity-building impact on the financial sector, we therefore judge the projects overall as good in terms of overarching developmental impact (Subrating 2).

Finance allocated from the KfW funds for Southeast Europe/Montenegro has made a decisive contribution to the development of the financial sectors in Kosovo and Montenegro by initiating housing finance in Kosovo, facilitating longer-term lending also in the MSME sectors in Kosovo and Montenegro and contributing to developing the requisite know-how in the partner banks. These results can also be expected to apply for Serbia and Bosnia-Herzegovina.

With the progressive development and stabilisation of the financial sectors in the region, the requirements for financial cooperation have changed, however, and the setups and capacities of the funds under KfW trust administration could not have met these needs in the medium term. The transfer of the FC funds and the resultant return flows to EFSE was a correct and necessary decision in our view. The business model of EFSE of closing gaps in market conditions (market-aligned), the revolving allocation of funds and the reduction of risks through careful selection and monitoring procedures coupled with risk-mitigating project support measures assure the sustainability of fund use from the FC projects, particularly with a view to long-term capacity building in the financial sector. With its finance acquisition and allocation procedures, EFSE affords special scope for the sustainable application of financial resources for real economic purposes - economic growth in Southeast Europe, especially through financial

sector development. Accounting for EFSE as the successor institution, we therefore assess the sustainability of all FC projects as very good (Subrating 1).

In a general assessment of the above impacts and risks, we attest the KfW fund projects overall a completely positive rating, taking special account of the developmental impact of EFSE as their successor facility. Overall, we also judge the developmental efficacy of the projects with a good effectiveness rating as good. These projects with a good rating (2) are the BMZ ID 2000 40 477 from the sample, 2000 40 618 and 2004 65 872. With the exception of the unevaluated project in Serbia, all other projects are rated as very good altogether (Performance rating: 1). The EFSE model sets an example for best practices.

General conclusions

EFSE is a consistent progression of the predecessor KfW fund projects in keeping with the further development of the regional markets. Although the KfW funds were already an effective approach to address the problems at the time, the EFSE model shows how through successful coordination among donors and their willingness to compromise instruments can achieve a high degree of flexibility and adaptability. Of particular note is the leverage afforded by the risk mix of the fund. With its design and setup, the EFSE model is generally also appropriate for other regions and can provide a major impetus for project design.

At the same time, however, it must also be borne in mind that the framework for the KfW funds was very specific in terms of the historical situation (new institutions and reform in the countries after war), economic development (new institutions, large-scale privatisation) and flexible funding arrangements (e.g. funds from the Stability Pact). The coincidence of these aspects and a suitable financing instrument, such as the KfW funds, is unlikely to recur. In this context, the KfW funds and EFSE can provide major impetus and ideas for other regions, but the EFSE approach is unlikely to be transferable on a one-to-one basis.

Altogether, the development of EFSE on the basis of the KfW funds is impressive. In the ex-post evaluation, however, there were clear indications that it is not always easy to strike a balance between (commercially warranted) yield expectations and development goals. In our opinion, as part of continued EFSE funding and in subsequent FC projects modelled on it, attention should already be paid in project design both to accounting for a comprehensive balanced development and supervising this in annual monitoring measures.

In general, special attention has to be paid to the responsible handling of consumer loans by commercial banks refinanced from FC funds. Appropriate criteria should already be defined when selecting partner banks. Also in monitoring the application of funds, there is a need to ensure that the loans are used for the purpose intended and borrower debt is kept within socially acceptable limits.

The ex-post evaluation was not intended to assess business success in closer detail, particularly the yield and cost structure of EFSE, since priority was attached to the transition of the KfW funds to EFSE. This question would still be currently premature in any case, as EFSE is only in its 3rd year of business operations. However, we recommend addressing this issue in a possible subsequent evaluation.