# ICR Review
Operations Evaluation Department

Report Number : ICRR11894

| 1. Project Data: | | Date Posted : 07/20/2004 | | |
|---|---|---|---|---|
| PROJ ID : | P069629 | | Appraisal | Actual |
| Project Name : | SME Credit (kosovo Tf) | Project Costs (US$M) | 15.7 | 9.5 |
| Country : | Kosovo | Loan/Credit (US$M) | 4.4 | 4.0 |
| Sector(s): | Board: FSP - Other industry (100%) | Cofinancing (US$M) | 11.3 | 5.5 |
| L/C Number: | | | | |
| | | Board Approval (FY) | | 1 |
| Partners involved : | European Agency for Reconstruction (EAR) | Closing Date | 12/31/2003 | 12/31/2003 |

| Prepared by : | Reviewed by : | Group Manager : | Group: | |
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## 2. Project Objectives and Components

### a. Objectives

The primary objective of the line of credit for small and medium enterprises (SMEs) was to serve as a pilot project to provide financing to SMEs on market-based terms to jump-start production and private sector economic activity. Loans to eligible SMEs were expected to revive some industrial production and finance an increased proportion of high value-added services.

A secondary objective was to reinforce reforms in the financial sector incentive structure and institutional framework introduced by The United Nations Interim Mission in Kosovo (UNMIK) to help re-establish basic credit management capacity and loan administration skills of newly emerging banks, and to assist SMEs by increasing financial discipline and planning capacity through the credit process.

### b. Components

**1. Credit Line for SMEs; 2. ICU Operations and Training for Local Banks**

### c. Comments on Project Cost, Financing and Dates

This was a joint project of the European Agency for Reconstruction (EAR) and IDA acting as administrator of the Trust Fund for Kosovo. On December 1, 2003, around 90% of the IDA grant had been disbursed, and the undisbursed balance of US$581,000 was canceled.

## 3. Achievement of Relevant Objectives:

The PAD identified 4 performance indicators of project progress toward achievement of the primary objective:

1. **Loan Volume**: An initial target of 60 "first-cycle" loans and an additional 43 loans "recycled" in years 2-3 of the implementation period. (Targets were subject to flexibility depending on the ability of the SME sector to present viable proposals, and the average size of the loan requests and disbursements made).
Unsatisfactory: 64 sub-loans were approved during the project, however, poor repayment rates --among other factors--did not permit significant lending of reflows.
2. **Cumulative Lending**: Total cumulative lending was expected to be 92 and 171 percent of total loan funding commitments by the end of Years 2 and 3 of the implementation period 3, respectively.
Unsatisfactory: Total lending under the project amounted to 90.5% of the grant amount, less than was envisioned.
3. **Cost Recovery**: Income derived from interest on loans and service fees for loan commitments and origination was expected to exceed the local cost of operations (personnel, office rental, supplies, etc.) as long as provisioning requirements for non-performing loans did not exceed modest levels.
Unsatisfactory: Due to the high provisioning requirements, income derived from loans did not exceed the local cost of operations.
4. **Job Creation**: Loans under the pilot SME line of credit were expected to directly generate some 600 new jobs, and help to create about 1,500 jobs in total (including contracting work).
Satisfactory: 1073 new jobs were created.

**Capacity Building**: Satisfactory: In addition, the project aimed to bolster capacity for SME lending. This objective was achieved, with the ICU conducting 5-week programs on loan appraisal, classification, and recovery. In late

2002, the ICU decided that further training efforts were not needed, as local banks had developed in -house training programs, and other donors had also become active in this area .

**4. Significant Outcomes/Impacts:**

- The ICR states that the project resulted in the creation of more than 1073 new jobs.
- The ICU was set up as a direct lender, with strong staffing provided under contract by an international bank experienced in operating in difficult environments . At project end, the "exit strategy" for the IDA portion of the ICU loan portfolio was to sell it, and a private commercial bank purchased the portfolio for 30.8% of its nominal value. Total proceeds returned to the budget, including repayment of principal, interest, and fees, as well as the sale of the portfolio, amounted to 78.6% of the funds disbursed under the grant .

**5. Significant Shortcomings (including non-compliance with safeguard policies):**

- As of June, 2003 (6 months before project close), of 58 outstanding loans, 35 were at least 30 days late and 22 "were classified as losses." Also as of that date, provisions against loan losses comprised 59% of the outstanding loan portfolio. The difficulties in the post-conflict environment that contributed to the poor repayment rate included: a culture of non-payment; poor enforcement of creditor rights and contracts; lack of transparency in the enterprise sector; and lack of financial institutions that could mitigate losses .
- The project did not reach its specified goals relating to loan volume or cumulative lending .

| 6. Ratings: | ICR | OED Review | Reason for Disagreement /Comments |
|---|---|---|---|
| Outcome: | Unsatisfactory | Unsatisfactory | |
| Institutional Dev .: | Modest | Modest | |
| Sustainability : | Likely | Likely | |
| Bank Performance : | Satisfactory | Satisfactory | The Bank took a calculated risk in initiating this project, but the obstacles posed by the environment did not permit success. Overall, the decision to proceed was warranted. When the repayment rate turned out to be much worse than expected, the Bank and its partners tightened lending requirements, which improved the quality of new loans, however, the quality of the overall portfolio was little changed. |
| Borrower Perf .: | Satisfactory | Satisfactory | |
| Quality of ICR : | | Satisfactory | |

**NOTE**: ICR rating values flagged with ' * ' don't comply with OP/BP 13.55, but are listed for completeness.

**7. Lessons of Broad Applicability:**

- The goal of satisfying financing requirements of a cash -starved private sector, and the imperative to make prudent lending decisions in a less-than-ideal environment, are sometimes in conflict
- Implementation of a credit line in a post-conflict situation requires intensive supervision and the willingness to adjust project sub-lending arrangements to developments in the sector
- In a post-conflict situation characterized by the absence of a financial intermediary willing or able to lend to SMEs, establishment of an ad-hoc non-bank financial institution and the outsourcing of its management can serve as an effective measure to address the need for timely provision of financing to SMEs .

**8. Assessment Recommended?** ○ Yes ● No

**9. Comments on Quality of ICR:**

The ICR was satisfactory; the ratings were accurate, and ample data are presented in support of most arguments . However, it did have the following weaknesses:

- The ICR states several times that the project monitoring indicators (sec.3) were "inadequate measures of the project development objective." It further states that the "disconnect" between the measures and the objective "caused problems during supervision because it prevented proper monitoring and evaluation of the project development objective." OED disagrees, and believes that <u>the project monitoring indicators were appropriate</u>. For example, a credit line project with 60% non-performing loans will almost certainly be unsatisfactory in achieving its development objective.
- The IDA loan portfolio was sold, and the ICR states that total proceeds, including repayment of principal, interest, and fees, as well as the purchase price of the portfolio, amounted to 78.6% of the funds disbursed under the grant. It would have been useful to disaggregate these data to understand how much of this total was comprised by the purchase price of the portfolio (this information was obtained separately from the region).