ICR Review

Operations Evaluation Department

Report Number : ICRR10921

1. Project Data:		Date Posted :	06/15/2001	
PROJ ID:	P008536		Appraisal	Actual
Project Name :	Ent & Fin Sect	Project Costs (US$M)	50.3	42.3
Country:	Lithuania	Loan/Credit (US$M)	25	25
Sector(s):	Board: FSP - General industry and trade sector (100%)	Cofinancing (US$M)	18	10
L/C Number:	L3866			
		Board Approval (FY)		95
Partners involved :	Danish, Swedish, Dutch gov'ts; EU-Phare; USAID	Closing Date	06/30/2001	06/30/2001

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

a. Objectives

The project's objectives were to support and accelerate the government's reform efforts in the enterprise and financial sectors, in particular by strengthening the banking system; by providing term financing for private and privatized enterprises; and by providing technical assistance to improve the capacity of the banking system to deliver the resources and of the enterprises to prepare plans to secure them . An important ancillary objective was to accelerate the reorganization and/or liquidation of large nonviable state owned enterprises . Direct involvement in pre-and post-privatization restructuring, particularly of state -owned banks, was dropped because of the government's reluctance to address these issues using best international practice and to borrow for this purpose .

b. Components

The project had two components: (i) a credit line to provide financing through participating financial institutions (PFIs) for medium-term loans (later amended to allow short-term working capital loans) to private enterprises; and (ii) a technical assistance (TA) component to strengthen (a) the supervisory and regulatory capability of the Bank of Lithuania (BOL), (b) commercial banks' institutional capacity and appraisal skills, (c) the government's capacity to reorganize/liquidate nonviable state-owned enterprises, and (c) enterprise strategic planning capacity. The credit line was supplemented by a capital facility from the government of Sweden to expand the capital base of participating banks.

c. Comments on Project Cost, Financing and Dates

The bank capitalization component, financed by Sweden, was reduced from US$ 10 million equivalent to US$5 million because other foreign strategic and financial investors became interested in investing in the banks . The TA component was reduced from US$13.8 million to US$9.8 million because of lower than projected costs and the elimination of the sub-component to reorganize/liquidate nonviable state enterprises. US$1 million of the unused TA component was shifted to the credit line. The project will close on time.

3. Achievement of Relevant Objectives:

The key objectives were achieved. Policy actions, including enactment of new banking legislation and meaningful amendments to the bankruptcy law, were completed as conditions for processing the loan . Changes to collateral legislation were carried out; BOL prudential regulations were brought more in line with international and EU rules; BOL supervisory systems and skills were improved; and an apex unit was established in the BOL to manage the line of credit. PFIs underwent institutional development programs to qualify for the credit line; and equity infusions from the Swedish capital facility strengthened the capital base of qualifying banks directly and indirectly, by attracting other investors. The credit line helped finance capital investments and /or working capital of 40 private companies.

4. Significant Outcomes/Impacts:

The credit line was fully committed well ahead of the deadline (except for the US$1 million additional funds). Three PFIs used the credit line to benefit 40 enterprises; most of these are doing well, and there have been no defaults on sub-loans. A recent survey found that all but one of the enterprises have achieved the targets of their sub -projects (although calculation of financial and economic rates of return were not required). Sub-borrowers introduced modern equipment and started to produce new, high quality products . Sales increased by an average of 26 percent, and the

sub-borrowers all weathered the 1998 Russian financial crisis well. Only 200 jobs were created, but this was not an objective, since in most cases the projects were part of labor shedding restructurings necessary for survival of the firms.
A TA program improved procedures and practices of the Bank Supervision Department of BOL. The number of bank examiners and other supervisory staff was increased and their skills enhanced. Funds were made available for assistance by audit firms, an early warning system for off-site surveillance was introduced, and procedures and standards for examinations were developed. Licenses were withdrawn from a large number of banks. Twinning programs were arranged for the two initial PFIs, and a development program for a third; credit analysis and internal audit were emphasized. The twinning programs were assessed as very successful by the banks, the twinning partners and the World Bank, and the two banks became the market leaders. Three other banks also underwent twinning programs, but did not achieve PFI status. Consulta (Enterprise Restructuring and Consulting Agency) performed over 60 diagnostic studies of enterprises to identify problem areas and requirements for further assistance, and arranged for domestic and international consultants to carry out pre-feasibility and feasibility studies for about 40 companies (11 of which were state owned). Some of these companies were later privatized, some obtained finance from the credit line, and many received financing from other sources. A survey of Consulta's clients found that they were satisfied with the services. The government closed Consulta in 1998, on the grounds that its subsidized activities were no longer needed because private companies capable of performing the same services had emerged.

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

None.

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Highly Satisfactory	Satisfactory	Efficacy was substantial, not high, for the majority of objectives (Annex 5 of ICR).
Institutional Dev.:	High	High	
Sustainability:	Highly Likely	Highly Likely	The only question is whether the bullet repayment increases risk.
Bank Performance:	Highly Satisfactory	Highly Satisfactory	
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:

(i) Flexibility and careful supervision enabled the project to weather a banking crisis, but automatic procedures for aligning interest spreads to market rates would have speeded up implementation. (ii) Careful institutional design, accompanied by substantial technical assistance, implemented through close cooperation among donors and the government helped ensure the success of the project. (iii) Inclusion in the design of a gradual phase-out of subsidies to Consulta might have led to its privatization rather than its closure.

8. Assessment Recommended? ○ Yes ● No

9. Comments on Quality of ICR:

The ICR is of satisfactory quality. However, it could have brought out more clearly the fact that the project's flexibility came during supervision and that it would have been appropriate to design the project more flexibly from the beginning. (For example, the ICR points out that the strict link between access to the line of credit and investments by the Swedish capital fund was not needed and therefore not enforced, and that sub-loans for working capital were initially not permitted, but later allowed.) In addition, the ICR should have analyzed more fully the potential riskiness from the bullet repayment from a vantage point of six years after approval. Finally, the ICR seems to contradict itself when it says in two successive paragraphs (p. 11) that the projects improved profitability for most recipients and that profits on average did not increase.
Inputs to the ICR from the borrower, two cofinanciers, and two PFIs reflect the close cooperation among all partners.