ICR Review
Operations Evaluation Department

Report Number : ICRR11512

1. Project Data:		Date Posted :	06/30/2003	
PROJ ID :	P040139		Appraisal	Actual
Project Name :	Investment Recovery	Project Costs (US$M)	26.6	21.6
Country:	Croatia	Loan/Credit (US$M)	26.6	21.6
Sector(s):	Board: FSP - General industry and trade sector (100%)	Cofinancing (US$M)		
L/C Number:	L4246; L4247; L4248; L4249			
		Board Approval (FY)		98
Partners involved :		Closing Date	12/31/2001	12/31/2002

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2. Project Objectives and Components

a. Objectives

(1) provide stimulus to private sector development through the financing of new investments in private or newly privatized enterprises in need of fresh capital for expansion or restructuring; (2) support the Government's objective of promoting competition in the financial system by helping strengthen the institutional capacity of participating commercial banks (PCBs); and (3) foster the development of a market of medium and long-term financing of investment projects. Progress in achieving these development objectives was to be evaluated on the basis of : (a) improvement in performance (i.e. sales, employment, profitability) of final beneficiaries, as well as the number of beneficiaries having continued access to credit after the first generation of loans is due; (b) qualitative assessment of improvements in the operational efficiency of PCBs' management; and (c) increase in the share of long-term loans and lengthening of the average maturity of PCBs' portfolios .

b. Components

The project comprised a single currency loan to each of the four PCBs for on-lending to the private sector. Only private sector banks or banks with an acceptable privatization program were qualified to benefit from the loan . The Bank selected four PCBs, three which were private (Varazdinska Banka, Dalmatinska Banka, and Alpe Jadran Banka) and one which was being privatized (Slavonska Banka).

c. Comments on Project Cost, Financing and Dates

The project cost DEM 52 million which was converted to Euros 26.6 million, of which 4.3 million were cancelled, leaving a net project cost of Euros 22.3 million, financed in full by the IBRD loan. The project was appraised in October, 1996, approved by the Board on November 18, 1997, made effective on March 17, 1998, and closed on December 31, 2002, on year behind schedule.

3. Achievement of Relevant Objectives:

(1) 250 sub-loans were made to enterprises providing stimulus to private sector development . However, the ICR provides no information regarding improvement of performance of these enterprises (i.e. sales, employment, profitability) as was proposed in the PAD. (2) The institutional capacity of 2 of the 4 PCBs (namely, Slavonska Banka and Dalmatinska Banka) was clearly strengthened, although it is unclear how much of this improvement came from the project, and how much from the PCBs' sale to foreign investors (during project implementation) with their own extensive risk and fiduciary controls. The institutional capacity of Varazdinska Banka may have also been strengthened. (3) The project may have fostered the development of a market of medium and long-term financing of investment projects, but the ICR provides no information on the indicator proposed for this objective in the PAD, namely, increase in the share of long-term loans and lengthening of the average maturity of the PCBs' portfolios . Significant alternative sources of long-term funding on favorable terms emerged over the course of this project, which may have dampened demand for sub-loans. One indirect indicator of this was the decision to raise the percentage of sub-loans which could be allocated to working capital which generally not viewed as long-term finance, from 20 percent as specified in the PAD to 50 percent during implementation in order to promote utilization of funds which suggests that this objective was not fully met. However, the Borrowers' comments (especially Dalmatinska Banka and Slavonska Banka) provide some evidence that this objective was at least partially met .

4. Significant Outcomes/Impacts:

At least two of the participating banks (Slavonsak Banka and Dalmatinska Banka) appear to have benefitted substantially from the institutional development plans prepared in conjunction with the project . Varazdinka Banka also claims to have so benefitted, but does not reconcile this claim with the fact that it only utilized 54 percent of the original allocation of 7.1 million Euros.

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

1. One of the four PCBs went bankrupt while a second played a much smaller role than foreseen and was dropped from the project during implementation. .

2. Bank disbursement procedures were cumbersome and unclear to at least two of the three PCBs which offered comments for the ICR. Disbursements were delayed and sub-loan amounts had to be repeatedly recalculated to take account of financial charges. Bank staff guidance during implementation appears to have been inconsistent to at least one of the PCBs. Two of the PCBs offered very specific criticisms in the Borrowers' Comments, one dealing with coordination between World Bank departments, and the other regarding a range of issues related to disbursement delays. All of this must have subtracted substantially from the value of the project in terms of the PCBs' capacity to service their clients.

3. Repayment Rates. The ICR does not present clear information on repayment rates, only noting that they were in excess of 90 percent. However, a repayment rate as low as 90 percent would be a serious concern and could well indicate a negative financial rate of return (the ICR asserts that a financial rate of return of 12 percent was likely, but offers no evidence to support this claim). Supplementary information supplied by the project team sheds some more light on this and suggests that the repayment rate may have been about 94 percent, which would be a significant shortcoming. The calculations are as follows. Alpe Jadran Banka, which is no longer functional, seems to have incurred 0.7 million in loans not repaid or other wise not accounted for. The ICR team stated that no detailed information was available for Dalmatinska Bank but that the repayment rate was about 95-96%. Since Dalmatinska Banka had been allocated 8 million Euros, this would imply a default of about 320,000 Euros. Concerning Varazdinska Banka, a supplementary email states (though without any details) that repayments are 100 percent on time. Finally, the Borrower's submission for Slavonska Banka notes that only 3 sub-projects out of 105 "ended in the Legal Department on doubtful and bad claims", and, in the absence of any additional information, so repayments may be estimated at about 97% (out of 8.8 million Euros lent). For all four banks, total defaults could be roughly estimated at 1.3 million Euros, or 5.6% of the 22.3 million Euros in the revised loan amount (net of cancellations).

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Satisfactory	Moderately Satisfactory	It is difficult to rate this project in the absence of more solid information on financial rates of return, repayment rates, a client survey, etc. (see comments below concerning the ICR). However, some 250 SMEs were financed through subloans and two, or perhaps three, of the four PCBS were assisted by the project. Giving the benefit of the doubt to the project, a rating of moderately satisfactory appears warranted. However, it is clear that arguments could be made for "not rated" or a lower rating.
Institutional Dev .:	Substantial	Modest	AJB became bankrupt during project implementation (despite the selection of only 4 PCBs from 12 originally presented by the Ministry of Finance) while Varazdinska Banka was only a marginal player. There is no evidence presented in the ICR that credit markets were substantially affected by this project.
Sustainability :	Highly Likely	Highly Likely	For the two PCBs which fully participated in the project, it seems highly likely that project benefits will be sustained, especially with the continuing restructuring of the private sector banking and the important role now played by private foreign banks.

Bank Performance :	Satisfactory	Satisfactory	The original selection of PCBs appears to have been flawed. Nevertheless, Bank staff acted quickly to limit losses with the demise of AJB. The PCBs' complained about the lack of, and inconsistent, guidance on disbursement procedures, and there appears to have been a lack of coordination between Bank operational staff and Treasury as cited in the Borrowers' contribution, despite efforts on the part of ECA staff. The ICR does not report on intended performance indicators with the suggestion that Bank staff may not have devoted enough energy during supervision to facilitate their collection. However, the environment for commercial bank during this time was difficult, and, on balance, Bank performance is rated satisfactory.
Borrower Perf .:	Satisfactory	Satisfactory	Government appeared to have been a satisfactory partner in this project, especially as banking sector reforms took hold in the course of project implementation (though the EFSAL and other factors which much more important for the reform than was this project). In addition, two of the four PCBs are rated satisfactory. On balance, therefore, Borrower performance is rated satisfactory.
Quality of ICR :		Unsatisfactory	

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

7. Lessons of Broad Applicability:

1. Care should be taken during project implementation to follow through on performance indicators identified in the PAD. In the absence this aspect of supervision, a project's capacity to guide meaningful follow -up is substantially compromised. 2. Line of Credit projects should be used sparingly, in line with the Levy Report recommendations, restricted to situations where value added can be clearly demonstrated . They should be kept as simple as possible and disbursement mechanisms should be carefully and fully discussed with the clients, in order to avoid problems noted by some of the PCBs in this project. 3. Making clients fully responsible for implementing their institutional development reforms may provide for better commitment to following through on these .

8. Assessment Recommended? ○ Yes ● No

9. Comments on Quality of ICR:

The ICR is rated as unsatisfactory. Supplementary information from the Region and other sources played an important role in evaluating this project. Had this Evaluation Summary been based solely on the ICR, the project's outcome might well have been rated unsatisfactory. The ICR does not present information on important performance indicators highlighted in the PAD, nor even discuss this omission . There is no apparent basis for the ICR's assertions that the project had a 12 percent financial rate of return. The ICR should have focused more clearly on repayment rates, rather than asserting that repayment rates were at least 90 percent and that this was satisfactory. Based on supplementary information provided by the Region, the repayment rates appear to be about 95%, and this was critical in reaching an evaluation that the project's outcome was as high as moderately satisfactory . The ICR does not look into the impact of the project on the development of longer -term credit markets for SMEs. No data is presented on this, despite the emphasis given this objective in the PAD . The whole discussion about increasing the allowable limits for working capital suggests that the project ended up catering to a larger than foreseen extent to short term lending. The text of the ICR presents no evidence that the loan helped establish a sustained market for long and medium-term project finance in Croatia. The ICR notes that about 250 "long-term" subloans were extended to private sector SMEs, and that maturities of these sub -loans "ranged from 1 to 10 years, with a grace period of zero to two years", with no further discussion. These are serious omissions which cloud the project and make rating it, much less drawing inferences and lessons from it, most difficult. In these circumstances, the Borrowers' contributions were especially helpful in allowing the reviewer to rate the project .