Report Number : ICRR0020643

1. Project Data

Project ID P111780	**Project Name** SME ACCESS TO FINANCE	
Country Bosnia and Herzegovina	**Practice Area(Lead)** Finance & Markets	**Additional Financing** P129914
L/C/TF Number(s) IBRD-78390,IBRD-81670	**Closing Date (Original)** 31-Jul-2014	**Total Project Cost (USD)** 70,000,000.00
Bank Approval Date 15-Dec-2009	**Closing Date (Actual)** 31-Jul-2016	

	IBRD/IDA (USD)	Grants (USD)
Original Commitment	70,000,000.00	0.00
Revised Commitment	190,000,000.00	0.00
Actual	157,711,902.74	0.00

Prepared by	Reviewed by	ICR Review Coordinator	Group
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2. Project Objectives and Components

a. Objectives

According to the Financing Agreement (FA) on page 7, the project development objective is "to enhance access to finance for small and medium enterprises in Bosnia and Herzegovina in the context of the global financial crisis". Additional financing (AF) was approved in 2012 to scale up the project scope, but there was no change to the project objective.

b. Were the project objectives/key associated outcome targets revised during implementation?

No

c. Will a split evaluation be undertaken?

No

d. Components

At appraisal, the project had two components, with a small unallocated amount as detailed below:

(i) The Credit Line component: (US$70.0 million equivalent at appraisal, plus additional financing of US$120 million equivalent at restructuring, totaling US$190,0 million equivalent, with actual cost of US$156.585 million): The component aimed to use the credit line resources to fund investments and/or incremental working capital in industry, agro-processing and related service sectors. The loan funds were to be on-lent by the Ministries of Finance for the Federation of Bosnia and Herzegovina (FBiH) and the Republica of Srpska (RS) through their respective project implementation units (PIUs) to participating financial institutions (PFIs). The sub-loans to PFIs were to be extended to final borrowers and under terms and conditions similar to those under which the resources were obtained. The PFIs were to bear the full credit risk. In September 2012, additional financing of US$120 million equivalent was approved to scale up the scope of the funded activities under similar conditions.

(ii) The Project Management and Monitoring Component (US$0.75 million equivalent at appraisal, with actual costs of US$1.125 million): At appraisal, this component was to finance the costs of the project management and monitoring, including financial management, audits, procurement, environmental compliance supervision, and other activities related to project management and coordination. No additional financing was allocated to this component.

(iii) Unallocated funds (EUR 0.3 million equivalent at appraisal): These resources were intended for unplanned expenses. They were allocated to the Project Management and Monitoring Component after the additional finance was approved.

e. Comments on Project Cost, Financing, Borrower Contribution, and Dates

Cost: Actual cost of the projects amounted to US$157.71 million, or 83 percent of the approved amount. Disbursement of AF resources slowed in 2015-16, due to overall deterioration of the business environment, and ineligibility of domestically-owned banks in the Republic of Srpska.

Financing: The project was funded by an IBRD loan in the amount of US$70.0 million equivalent at approval, with additional financing of US$120 million equivalent at restructuring, totaling US$190,0 million equivalent. An undisbursed amount of US$20.41 million was cancelled at project closure.

Borrower: There was no contribution from the Borrower.

Dates: The closing date of the original loan was extended by two years until July 31, 2016 (when the project closed) to match the closing dates of the AF and to enable utilization of the remaining balance of the original project funds allocated to project management and monitoring.

3. Relevance of Objectives & Design

a. Relevance of Objectives

When the global economic crisis hit in 2008, European Union banks dominating the banking sector in BiH started to decrease their market exposure, and to reduce their credit lines, making credit more difficult to obtain, maturities became shorter and operating costs started to increase. The deterioration in access to finance was impacting SMEs more than other borrowers, as they offer the least collateral to secure a loan. Companies started to experience liquidity problems due to higher interest, payment terms deterioration, and drop in their liquid assets. This is the context that prompted the Bank to address the shortage of term funding sources and stagnation in capital flows by making available additional medium and long-term funding to ensure sustained development. This was consistent with the Country Partnership Strategy (CPS) for the period FY08-FY11, which focused on improving the environment for private-sector-led growth and convergence with Europe as one of its two key pillars. The project was addressing one of the key targets under the first pillar of the CPS - expand business activity and increase economic opportunities - through stimulating SME development and access to finance in the context of the global financial crisis. When the project closed, one of the three focus areas of the FBiH's CPF FY16-FY20 aimed to create conditions for accelerated private sector growth, including building a more stable and accessible financial sector, particularly for underserved segments in the market and the SMEs.

The objectives were also relevant to Government strategy. One of the main policy goals of the Medium-Term Development Strategy (MTDS) for 2004-2007 was to promote a sustainable and balanced economic development. Strengthening the competitiveness of the economy and increasing the employment rate were two of the six strategic objectives of the medium term Country Development Strategy of 2009. The Reform Agenda for the period 2015-2028 targets several areas of reform, including boosting competitiveness through a more stable and accessible financial sector.

Rating

High

b. Relevance of Design

The statement of project objective was clear, as the whole credit line was principally devoted to enhancing the access to finance by SMEs. Eligibility criteria of PFIs, SMEs and projects were well laid out in the PAD, thereby facilitating implementation and disbursement. The results chain was straightforward, as the quasi-totality of the credit line was intended to be used to fund one activity: the extension of medium and long term loans to eligible SMEs and qualifying projects. The results framework and M&E arrangements in Annex 3 of the PAD provided a clear result chain linking the main activity to expected outputs, outcomes and objective. However, the results framework could have included more detail to demonstrate how the sustainability of outcomes and their attribution to the project could be achieved. There was no adjustment of the levels of result indicators to reflect the surge expected from the additional funding.

Rating

Substantial

4. Achievement of Objectives (Efficacy)

Objective 1

Objective

To enhance access to finance for small and medium enterprises in Bosnia and Herzegovina in the context of the global financial crisis.

Rationale

Outputs:

(i) The number of loans disbursed to SMEs reached 390 at closure, exceeding the original target of 150, (ii) the outstanding SME finance loan portfolio amounted to US$2,156 million in 2016, against a baseline of US$515 million, and (iii) 98 percent of the total value of all the loans had a maturity over 12 months. 378 loans had a maturity of over 12 months, for a total of US$125.2 million, and the average maturity of all loans was 5 years.

In FBiH, beneficiary SMEs were involved in in the key industrial sectors of manufacture of food products (26% of total volume of loans), basic metals and metals products (12% of total), traffic, warehousing and communications (12% of total), and catering (11% of total). Loans were predominantly long-term (88% of total), and to a lesser extent medium term (12% of total). The size of 16 % of the loans count was superior or equal to US$1 million, while 84 percent were lower than US$1.0 million.

In the Republic of Srpska, beneficiary SMEs were operating in the manufacture of food and beverage products (31% of total), construction (17% of total), sawmill, and planning of wood (9% of total), and the manufacture of metal, steel products, and floors (16% of total). 94% of the loans value were long-tem, against 6% for short-term loans. 19 percent of the loans count were superior to one million US$, while 81 percent were inferior to US$1.0 million. The average loan size was US$328,000, indicating that the targeted sample of SMEs was at the lower end of the SME sector.

Outcomes:

Outreach and portfolio quality: (i) the number of firms financed under the project was exceeded, reaching 338 against a target of 140; (ii) the total amount of loans (original loan and additional finance combined) disbursed by the PFIs reached US$157.7 million, falling below the target of US$189.00 million; (iii) the project supported an estimated creation of 1,937 jobs, and contributed to investments totaling US$27.2 million (21.3 percent of disbursed funds), enabling SMEs to expand capacity, purchase equipment, and employ workers; (iv) the project also financed US$19.8 million (15.5 percent of disbursed funds) in working capital, enabling SMEs to manage their liquidity and operations, while another major portion of the loan (63 percent) was used to refinance existing loans at more favorable rates, boosting SMEs' efficiency and profitability, and finally (v) the total NPLs for this credit line volume was, on average, 1.7 percent, considerably below the 7 percent threshold set at appraisal. However, the portfolio at risk (>90 days) worsened, as it increased up to 15.18 percent at end-2015, against a baseline of 5.9 percent.

Sustainability: Two other ratios reflecting the financial health of the supported PFIs performed well: (i) the return on assets improved, reaching 1.04 percent, against a baseline of 0.09 percent, and (ii) the return on equity improved significantly, reaching 7.38 percent against a baseline of 0.8 percent.

Additionality and Attribution:
The project was approved in order to provide a financial cushion to banks operating in the FBiH and the RS, because the global financial crisis, high country risk premium and sluggish economic activity affected their ability to deliver medium and long-term lending, especially to SMEs. Without the credit line, both local and foreign-owned banks had little possibility of expanding long-term loans to SMEs given the business environment. While the ICR did not discuss the without-project hypothesis, the complete disbursement of the initial credit line two years ahead of the project closing date, and the ensuing AF strongly indicate that there was an unmet credit demand from SMEs in the country, and that lending to SMEs supported by the credit line was additional. Similar support provided in parallel by other donors (IFC) to SMEs and microfinance reinforce the same point, but the ICR did not discuss their respective contributions to the project outcome.

Rating
Substantial

5. Efficiency

There was no economic or financial analysis conducted either at project appraisal or closure. However, the PAD indicated that sub-loans were to be subject to the calculation of financial and economic rate of return, and financial soundness was to be assessed for each final beneficiary and each PFI (PAD, p.30). Performance of final beneficiaries was to be monitored throughout the project life in order to distill lessons for future crisis responses for SMEs (PAD, p.20).
Economic and financial efficiency: The credit line was extended to private enterprises judged to be creditworthy, and eligibility requirements included well-defined policies and procedures for analyzing credit risk. The project attempted to ensure a robust financial soundness analysis through three tiers: a) the PFIs, which performed the analysis for the sub-loans, b) the PIUs, which reviewed the sub-loan applications, and c) the World Bank, which appraised PFIs. As a result, lending rates were market-determined and PFIs bore the full credit risk of the sub-loans. There was competition among several eligible PFIs, especially for the highest credit quality SMEs, thereby making it likely that SMEs obtained loans from the PFI which offered most favorable terms. Rates offered by PFIs had also to cover the cost of funds, operating costs, and a reasonable margin. A sample of the most active banks under the original loan was chosen to analyze the interest rates charged to the final beneficiaries for all sub-loans they disbursed against their cost of capital and non-interest expenses, as reported in the table below.
Table 1: Cost/benefit analysis of intermediation of the credit line

Selected PFIs		Total number of loans	Average interest rate charged to beneficiary	Cost of capital (2)	Non-interest expense / Total Assets (3)	Net profit to bank from credit line (1)-(2)-(3)
FBiH	PFI A	23	5.36%	1.80%	2.0%	1.53%

RS	PFI B	19	5.70%	1.80%	3.3%	0.57%
	PFI C	19	7.00%	2.40%	3.5%	1.10%
	PFI D	5	6.20%	2.40%	3.6%	0.17%

Source: Information provided by the Bank team

The analysis indicates that the average interest rate charged to sub-borrowers was sufficiently high to cover the cost of capital as well as non-interest expenses and ensure a reasonable profit. At the same time, the eligible PFIs were, on average, more efficient than the banking sector in general - the average non-interest expense as a percentage of assets for all banks in BiH was about 5.0% in comparison to 2.0% - 3.6% for the PFIs shown. The positive rate of return for the sub-loans is also evidenced by the low percentage of non-performing loans (NPLs) funded through this credit line. NPLs as a percentage of gross loan amount was 1.7%, well below the average for the banking sector (12.1% in 2Q 2016). Hence, the overwhelming majority of SMEs financed through this credit line produced enough cash flow to fully repay the loans. For this reason, PFIs continued to participate during the life of the project, funding additional SME clients.

Administrative and operational efficiency: The initial credit line was carefully designed and swiftly delivered to the final beneficiaries despite a complex institutional setting. The implementing agencies had adequate capacity to manage the project. The Bank team processed the AF and project restructurings in a timely manner and promptly took supervision decisions to support disbursement in both entities. However, there were delays and uncertainty in the implementation of the AF in FBiH due to issues in the PIU management. These delays caused financial costs to certain PFIs and SMEs, since they prompted some PFIs to extend preemptively expensive loans and bridge-financing to SMEs. Moreover, a weaker risk assessment downplayed political and institutional weaknesses that in the end affected the level of disbursement of the AF.

Efficiency Rating

Substantial

a. If available, enter the Economic Rate of Return (ERR) and/or Financial Rate of Return (FRR) at appraisal and the re-estimated value at evaluation:

	Rate Available?	Point value (%)	*Coverage/Scope (%)
Appraisal	✓	0	0 ☑Not Applicable
ICR Estimate	✓	0	0 ☑Not Applicable

* Refers to percent of total project cost for which ERR/FRR was calculated.

6. Outcome

The relevance of objectives was high, and that of design substantial. Efficacy of the single objective was substantial, due to good performance with regard to outreach and sustainability of the achieved outcome, although the portfolio quality worsened during project implementation. Efficiency is rated as substantial, mostly reflecting the competitive intermediation of the credit lines. Overall outcome is rated Satisfactory.

a. Outcome Rating

Satisfactory

7. Rationale for Risk to Development Outcome Rating

Both PIUs face serious issues. One (OdRaz) has had to be dismantled due to internal political strife, and the reputation of the other (RS Development Bank) has declined following its involvement in fraudulent transations. These developments, together with the economic slow-down in the country and the difficult situation in the banking sector following project closure, are the key factors determining a high rating of the risk to development outcome. The two PIUs implemented the project, and had the potential to contribute to institutional building capacity in the project's beneficiaries in the future. Their unavailability to provide further support and advice to key project stakeholders may affect the establishment and implementation of the revolving fund from repayments of the sub-loans.

The economic environment of the SME sector in BiH is highly exposed to macroeconomic developments in the European Union. Economic growth since the crisis has been slow, and credit demand by SMEs has been lower than expected. In this context, the ability and willingness of banks to continue to extend long-term finance to SMEs are not assured, particularly for foreign-owned banks operating in the BiH, which target the larger and corporate business segment to avoid higher costs linked to business with SMEs.

a. Risk to Development Outcome Rating

High

8. Assessment of Bank Performance

a. Quality-at-Entry

The project design was informed by previous Bank's credit lines implemented in other countries, but it incorporated specifically a higher degree of flexibility in order to match the complex institutional structure and governance of the country. Implementation arrangements were agreed upon between the Bank and all stakeholders in the FBiH Government entities. However, the inclusion of the SMEs based in the Brcko District, and the flexibility in re-allocating proceeds were aspects that were overlooked at appraisal, and these omissions had to be addressed during implementation.

The project’s risk assessment framework correctly identified several risks which could eventually affect the achievement of outcomes, and mitigation measures were, overall, appropriate. The risk assessment was nonetheless weak regarding the political and institutional risk, which in the end affected both effectiveness and disbursement. M&E arrangements lacked clarity at approval, and could not allow consistent monitoring until their adjustment at a late stage of implementation. In view of the extensive presence of other external partners, the Bank teams coordinated and engaged with other international financial institutions (IFIs) and donors, including the IFC, to ensure a continuous exchange of ideas in the area of financial sector engagement.

Quality-at-Entry Rating
Satisfactory

b. Quality of supervision

There was close supervision by the country office, complemented by 10 supervision missions from headquarters, which focused on resolution of operational and strategic issues. Supervision strongly emphasized technical assistance and capacity-building in both intermediary and beneficiary institutions. Aide-memoires reported adequately on implementation progress, next steps to be undertaken by each party, and on safeguards and fiduciary compliance. Five task team leaders (TTLs) were involved in preparing and supervising the project, and the team assessed each PFI against eligibility criteria, and organized workshops for PFIs to enhance their understanding of procurement, financial management, and environmental safeguard guidelines. Bank specialists regularly addressed issues related to fiduciary and safeguards compliance.
Flexibility enabled a process of "adjust-as-you-go", and SME eligibility criteria, conditions for refinancing, loan maturity requirements, and lending ceiling for each PFI were revised during the life of the project through routine supervision discussions with entity authorities and PIUs. As a result, the Operational Manual (OM) was frequently adjusted to field realities. Total disbursement of the original loan to both entities was completed within two years of effectiveness, almost two years ahead of the original closing date. An AF project paper in late 2014/early 2015 served in lieu of a midterm review. It assessed implementation progress and planned future project activities. Following the discontinuation of OdRaz, reflecting internal political strife, and the declining reputation of the second PIU (RS Development Bank), the WB team escalated technical assistance at the request of the authorities of both entities.

Quality of Supervision Rating
Moderately Satisfactory

Overall Bank Performance Rating
Moderately Satisfactory

9. Assessment of Borrower Performance

a. Government Performance

The Authorities at all levels demonstrated ownership of the project and commitment to its objectives throughout the project life, as well as a high degree of technical capacity. There was adequate communication and coordination among the Government entities, which handled project ratification, organized timely audits, and ensured effectiveness and the resolution of issues at a political level. For the original loan, there were delays associated with fulfilling the effectiveness, due to complex governance that required a cascade of agreements (loan agreement, subsidiary loan agreement, project agreement, project implementation agreement, subsidiary financing agreement, and sub-loan agreement). For the AF, the effectiveness deadline was extended twice, due to protracted ratification procedures. Those delays affected the implementation process as funds could not be made available when there was strong demand for the funding throughout the country.

Government Performance Rating

Moderately Satisfactory

b. Implementing Agency Performance

PIUs were housed in the Sustainable Development Foundation (OdRaz) in the FBiH, and in the Investment and Development bank (IDB) in the Republic of Srpska. Both PIUs were adequately staffed throughout the project implementation, and their technical units displayed what the project team describes as a high level of professionalism and adherence to Bank fiduciary and operational procedures throughout implementation. They monitored approved loans, including the review of the documentation received by PFIs, and conducted field visits to validate the status of the sub-loans. Both PIUs strengthened compliance with Bank procedures, visited a large number of sub-borrowers to validate the purpose and progress of the sub-loans, and exchanged views and knowledge about the performance of the project. OdRaz undertook visits covering a large number of SMEs, conducted presentations and facilitated over 30 events for the chambers of commerce. The direct outreach efforts had a positive impact, although some PFIs expressed concern over the negative effect of attracting some SMEs without adequate credit worthiness, and longer-than expected processing time. The Republika Srpska Investment-Development Bank (RS IDB) provided field presentations to SMEs′ representatives in cooperation with municipalities, and sustained dialogue with PFIs through, for example, workshops for loan officers.

However, both Units were subsequently affected by political and governance issues. Due to internal political conflict, the FBiH government decided to dismantle OdRaz upon completion of the project, and transition arrangements for the continuation of project-related activities remain pending. In 2016, there was political and institutional uncertainty that affected RS IDB following the arrest of ten individuals, including the Director, over allegations of fraudulent operations related to a bank which had failed in 2014. The ICR argues that these developments did not affect the performance of the technical units in charge of project implementation, although they did affect the reputation of the banking sector (ICR, p. 34).

Implementing Agency Performance Rating

Moderately Unsatisfactory

Overall Borrower Performance Rating

Moderately Satisfactory

10. M&E Design, Implementation, & Utilization

a. M&E Design

The results framework in Annex 3 of the PAD provided a set of indicators and arrangements to monitor annual progress toward the outcome and the objective. The project outcome indicators in the original loan were, overall, consistent with the project's activities and the PDO. However, some indicators did not have targets, and there were no indicators to monitor the sustainability of the results, although they were incorporated during implementation. The Operational Manual included templates for data reporting by PFIs to the PIUs, and the two PIUs to the World Bank team, although the indications were not, according to the ICR, specific enough.

b. M&E Implementation

Aide Memoires for the original loan did not report on the results consistently, and the M&E framework in the Implementation Status and Results Reports (ISRs) was not consistent with that presented in the PAD. Sector indicators were communicated through stand-alone reports, and not through the ISRs.The M&E framework was streamlined and its implementation improved after the Additional Financing (AF). Although the PDO indicators underwent only slight revisions without changing the substance, targets were set for all of them. Intermediate outcome indicators were also revamped as three intermediate indicators were dropped, one indicator modified, and five new indicators added. The new indicators were part of the required core indicators for all World Bank credit lines that provide financing for SMEs. The revised indicators were reflected in the templates in the revised OM, and upon approval of the AF, the ISRs consistently reported results as presented in the Project Paper.

c. M&E Utilization

The ICR states that the M&E system provided accurate and timely information to decision makers for strategic and operational decisions. The team also monitored key indicators in each entity separately in order to inform decision-making, and make specific recommendations on actions to support implementation. However, the ICR is not precise about which actions were initiated based on the feedback for the M&E implementation.

M&E Quality Rating

Substantial

11. Other Issues

a. Safeguards

The project was classified as Category B, triggering OP 4.01 (Environmental Assessment) and the preparation of an Environmental Safeguards Review Framework, which screened out SMEs activities and assigned one of the safeguard categories based on the associated environmental impacts and risks. The ICR reports that this procedure was followed both before and after the AF. The two implementing agencies reportedly had dedicated staff responsible for the environmental overview prepared by the PIUs and the PFIs. Regular reporting on Environmental Management Plan preparation and compliance was included in the semi-annual reports. The ICR notes that PIU staff and the WB team visited a considerable number of randomly chosen SMEs to oversee how safeguards issues were handled, and environmental safeguards compliance was rated satisfactory in the ISRs. No other safeguards policies were triggered.

b. Fiduciary Compliance

Financial management

Annual reports by the Bank specialist concluded that the financial management systems, including accounting, budgeting, and reporting, have been satisfactory, and that the project units were well staffed and well managed. The auditors issued an unqualified audit opinion on the individual and consolidated project financial statements throughout the project. Minor FM issues arose infrequently and were resolved adequately by the PIUs. However, the report for 2016 will be submitted by June 30, 2017 as defined in the legal documents. As noted earlier, an undocumented disbursed amount balance of EUR 808,682.81 is still pending.

Procurement

The procurement processes under the sub-loans were carried out by the final borrowers following established commercial practices up to certain thresholds, which were increased after project restructuring. The two PIUs were responsible for ensuring that procurement rules were followed by the PFIs and final borrowers. The procurement performed by PFIs, and supervised by the two PIUs bi-annually, was reviewed by the Bank on a sample basis. The mid-term review (December 2014) concluded that all supervised activities were in line with established private sector commercial practices agreed to in the project documents, and ISR procurement ratings were satisfactory throughout implementation. There were no reported instances of misprocurement.

c. Unintended impacts (Positive or Negative)

None reported

d. Other

None reported

12. Ratings

Ratings	ICR	IEG	Reason for Disagreements/Comment
Outcome	Satisfactory	Satisfactory	---
Risk to Development Outcome	Substantial	High	Inability of both PIUs to reinforce sustainability of results.
Bank Performance	Satisfactory	Moderately Satisfactory	Quality of Supervision is rated moderately satisfactory (see Section 8b above)
Borrower Performance	Moderately Satisfactory	Moderately Satisfactory	---
Quality of ICR		Substantial	---

Note
When insufficient information is provided by the Bank for IEG to arrive at a clear rating, IEG will downgrade the relevant ratings as warranted beginning July 1, 2006.
The "Reason for Disagreement/Comments" column could cross-reference other sections of the ICR Review, as appropriate.

13. Lessons

The first three lessons are taken from the ICR with some adaptation of language, and the fourth lesson is drawn by IEG:
(i) Flexibility helps to keep projects relevant even when the macroeconomic environment changes, but operational guidelines need to provide stronger guidance to mitigate the risks associated with flexibility, (ii) Credit lines are most relevant for predominantly locally-owned banks, because foreign-owned banks have to reconcile local demands and the priorities of the corporate headquarters, (iii) PIUs which have a financial intermediation mandate are preferable partners for credit lines, as they can add value with their local knowledge of the banking and real sector, build institutional capacity and promote sustainability of results, and (iv) assessment of the impact of credit lines is difficult, because it has to distinguish between results accruing to PIUs, the PFI, and the ultimate beneficiaries; attribution also has to be estimated, involving an assessment of the without-project scenario.

14. Assessment Recommended?

No

15. Comments on Quality of ICR

The ICR reports comprehensively on the project context, design and implementation. Evidence to support project efficacy (outputs and outcomes) was, on the whole, substantive and detailed. The findings and lessons formulated in the ICR reflect fairly the experience of the project implementation. Although there was no economic or financial analysis that could have indicated the credit's "value for money," additional information was provided by the task team upon request. This included a supplementary note highlighting the competitive intermediation of the credit lines. More attention could usefully have been paid to: (i) discussion of outcome attribution and additionality as the World Bank and other donors implemented parallel projects or activities supporting the SMEs, (ii) closer observation of OPCS guidelines in the coverage of the ICR sections (the relevance of objectives and design needed more depth), and (iii) the provision of required annexes (annexes 1 and 3 are missing).

a. Quality of ICR Rating

Substantial