Phare *Ex post* Evaluation. Phase 1, Multi-Beneficiary Programmes: Small and Medium-Sized Enterprise Finance Facility

MWH Consortium

Small and Medium-Sized Enterprise Finance Facility

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EUROPEAN COMMISSION
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GLOSSARY OF ACRONYMS

Acronym	**Description**
CA	Contribution Agreement
CCs	Candidate Countries
CEB	Council of Europe Development Bank
CEB/KfW	CEB in cooperation with KfW (see below)
CEEC	Countries of Central and Eastern European
DIS	Decentralised Implementation System
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ERC*	Exchange Risk Cover
EIB	European Investment Bank
EU	European Union
€	Euro
EW*	Equity Window
FC	Framework Contractor
FDI	Foreign Direct Investment
FI	Financial Intermediary
FM	Financing Memorandum
FP	Financing Proposal
FSL	Fee for Smaller Loan
IE	Interim Evaluation
IF	Investment Fund
IFI	International Financial Institution
IPA	Instrument for Pre-accession Assistance
IRC*	Interest Rate Cap
JOP	Joint Venture Phare Programme
K€	Thousands of euro
KfW	*Kreditanstalt für Wiederaufbau*
LA	Leasing Agreement
LG*	Loan Guarantee
LGLW	Loan Guarantee and Leasing Window
LTTE	Long Term Technical Expert
M€	Millions of Euro
MBP	Multi-Beneficiary Programme
MCF	Management Cost Funding
MEDA	Mediterranean Economic and Development Assistance
PFee*	Performance Fee
PFI	Participating Financial Institution
RSW*	Rural Sub-Window
SME	Small and Medium-sized Enterprise
SMEFF	Small and Medium-sized Enterprise Finance Facility
TA*	Technical Assistance
TF*	Transaction Fee
ToR	Terms of Reference

Note: Terms marked with an asterisk (*) are explained in more detailed in the following Glossary of Terms Used

GLOSSARY OF TERMS USED

Term	Description
Exchange Risk Cover	The objective of the ‘exchange risk cover’ instrument is to enhance long-term lending in domestic currency to clients/enterprises with little/no foreign currency income and who prefer to loans in local currencies. The ERC is used to: a) cover the price of foreign exchange forward transactions that the PFI arranges to hedge the foreign exchange risks related to payments the PFI makes to the sponsor international financial institution (IFI); b) indemnify the PFI for foreign exchange losses (devaluation of local currency against the € in comparison with the exchange rates that are used for the conversion of the disbursed loan amounts into local currency) incurred with respect to the payments by the PFI to the sponsor IFI.
Equity Window	The objective of the Equity Window is to provide support for self-sustainable small and medium-sized enterprise (SME) Investment Funds. Support through the Equity Window is not invested directly into SMEs but into Investment Funds operating in the participating countries that are specifically designed to take equity investments in SMEs. The Funds supported by the Facility are managed by independent fund managers. These Funds may be either new Funds set up for the purpose of SME investment or existing Funds, which open a dedicated operation for SMEs. The Funds may cover a region within one country, a whole country or several countries and each Fund is structured individually to match market conditions in the applicant country concerned as well as best international business practice for investment funds. Two components are offered through the Equity Window: 1) Equity Co-Investment funding. Phare takes equity participations alongside EBRD and other investors on the following basis: i) with regard to rewards, Phare funds will participate in profits when other investors have received a minimum return (hurdle rate) which shall be negotiated on a case by case basis; ii) with regard to losses, the basic principle is equal sharing. However, in exceptional circumstances to be justified, Phare may accept a higher proportion of losses on its contribution as compared with other investors; 2) Management Cost funding. Phare funds are used to cover costs of the Investment Fund on a grant basis and are specified within the project agreement signed between the sponsor IFI (EBRD) and the Investment Fund.
Fee for Smaller Loan	The objective of the Fee for Smaller Loan (FSL) is to stimulate the PFI to expand its lending of smaller loan amounts. The FSL covers part of the lending cost, thus increasing the attractiveness and profitability of this business. The size of loan/lease which can attract a FSL is agreed between the sponsor IFI (CEB-KfW) and the PFI and can be up to €50,000. In the case of leases, the FSL can be used to reduce the down payment payable by the SME.
Interest Rate Cap	The interest rate cap applies to floating interest rates and sets an upper limit for interest rate increases. It primarily reduces the interest rate risk of the participating financial institution.
Leasing Window	The Leasing Window was introduced in 2001 to further support the access of SMEs to small and micro credit. Leasing is seen as an effective mechanism for financing SMEs which may not qualify for bank lending, but which may qualify for a financial lease, due to the different status of the security. In the case of financial leases, transfer of ownership of the asset to the lessee (the SME) at the end of the lease corresponds to a form of long-term finance to the SME. Through the Leasing Window, the Commission aimed to promote the development of leasing mechanisms through grant support to eligible leasing companies.
Loan Guarantee	Where appropriate, a partial first-loss guarantee may be provided on the SME sub-loan portfolio managed by the PFI. It is envisaged to limit this guarantee to a maximum of 40% of the first loss risks of the PFI involved in its first year SME loan portfolio. Where such a loss occurs, the IFI verifies that the criteria for triggering the guarantee, as set down in the original project proposal, have been met. Any funds used to meet an acceptable claim would be earmarked for servicing of the SME related loan/credit line agreement with the IFI and deducted from the principal amount owed by the PFI to the IFI. The guarantee can take the form of a lump sum or specific insurance premium for a fixed period bought on the open market. In principle, PFIs are discouraged from taking on SME lending based upon any other financial incentive than a higher than usual margin (between the cost of funds and interest earned). However in exceptional cases a first loss guarantee as defined above may be made available.

Micro loan	Micro loans are defined within the Facility as loans of up to K€30 (in the case of EBRD) and K€ 50 in the case of EIB and CEB/KfW.
Performance-Based Incentives	Performance-based incentives are paid to the PFI based on compliance with certain performance criteria as set out in the project proposals. These vary between performance criteria related to the quality of the lending - in the case of EBRD loans (i.e. less than 5% arrears rate over 60-days, calculated as portfolio at risk on the volume of outstanding loans to SME borrowers funded by the Facility). In the case of CEB/KfW, the criteria for draw-down of the performance fee relate to the achievement of certain policy objectives. For example, in the case of the Rural Sub-Window, the eligible loans must be to SMEs in rural zones or farmers with less than 100 full-time employees (or the equivalent number of part-time employees).
Performance Fee	The Performance Fee is a fee paid to the PFI to compensate for the special risks and administrative burden involved in lending to SMEs. The payment period starts with the signing of the credit line with the IFI and is conditional on the PFI meeting certain performance criteria, as set out in the project proposal, for example loan size and/or quality of the lending (i.e. less than 5% arrears rate over 60-days, calculated as portfolio at risk on the volume of outstanding loans to SME borrowers funded by the Facility).
Project	This is a financial package with a PFI comprising the IFI credit line and one or more incentives according to the specific arrangement: transaction fee, technical co-operation, guarantee etc.
Risk-Based Incentives	Risk-based incentives aim to assist the PFI to manage the increased risks associated with lending to SMEs, and include Loan Guarantees, Exchange Risk Cover and the Interest Rate Cap.
Rural Sub-Window	The Rural Sub-Window (RSW) was introduced in 2003 as part of the Loan, Guarantee and Leasing Window. The RSW aims at strengthening the financial sector's capacity to increase access to finance for farmers and rural businesses and had the following aims: to help financial intermediaries to provide appropriately structured, including long-term financing to rural businesses; to help financial intermediaries develop a clear strategy to support the rural economy; to help financial intermediaries adapt products and risk assessment procedures to circumstances of the rural economy and thereby make available credit financing to rural businesses at more affordable rates and to improve services of financial intermediaries towards rural sector borrowers. Beneficiaries of the RSW beneficiaries are: 1) Farmers (i.e. "registered agricultural producers" and; 2) Rural Businesses (i.e. businesses located in rural zones). The indicators used to define an eligible rural zone are based on criteria such as population density or location and in line with definitions under the national legislation.
Small loan	Small loans are defined within the Facility as loans of up to K€250 (with a voluntary cap at K€ 125 in the case of EBRD).
Sub-Project	Sub-loans or leases to, or investments in, individual SMEs made by the PFI according to rules and conditions set down in the project agreement signed with the sponsor IFI.
Technical Assistance	Technical Assistance (TA) is defined as help provided specifically for institutional development, strengthening and capacity building, usually in terms of advice, guidance, studies, training, information, know how, and similar actions. TA 'packages' are designed in line with the needs of the beneficiary and are delivered by private sector consultancy companies.
Transaction Fee	The Transaction Fee instrument is used to encourage SME lending by PFIs. For each sub-project (i.e. loans/leases to individual SMEs) a grant from the Phare Facility funds is paid in the form of a flat Transaction Fee in line with the agreement between the Commission Services and the sponsor IFI and according to the agreement with the PFI. The Transaction Fee is used extensively by the EIB whereby a grant of €5,000 is paid for every loan made in accordance with the eligibility criteria specified in the project proposal.

PREFACE

This *ex post* evaluation report has been prepared by the MWH Consortium[1] during the period January-March 2006, and reflects the situation at 31 May 2006. It examines the performance of the programmes in addressing the objectives stated in the formal programming documents, provides a general assessment of the programmes and draws conclusions and lessons learnt from them.

The evaluation is based on analysis of documents provided by the Commission Services and the participating international financial institutions, as well as interviews with, and questionnaires to, participating banks, financial intermediaries and leasing companies in the new EU member states, Bulgaria and Romania.

[1] The Report was prepared by Lead Evaluator, Elizabeth Cunningham and Short-term International Expert, Harvey Susser. It was reviewed at MWH by Martin White and Andrew Fountain and Short-term International Expert, Anders Grettve.

EXECUTIVE SUMMARY

Small and Medium-Sized Enterprise Finance Facility

Scope and Objectives

The overall objective of this *ex post* evaluation is to provide accountability with respect to the use of European Commission funds, and lessons learned for decision making on improvements to the Small and Medium-Sized Enterprise Finance Facility (the Facility) for remaining and future candidate countries. The purpose of the evaluation is to review 1999-2001 Facility programmes as well as the design and performance of the Phare allocations in the 2002-2005 period.[2]

Key Evaluation Findings

The Facility has been implemented effectively by the participating International Financial Institutions. In the period under review, €M 323 of Phare grant support was matched by €2.2 billion in credit lines from the participating institutions; the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB) and the Council of Europe Development Bank (CEB) in partnership with *Kreditanstalt für Wiederaufbau* (KfW). Over 74,000 loans and leases to small businesses were delivered through more than 150 credit lines in 10 new member states, over 4,400 staff were trained and more than 70 technical assistance packages were implemented.

The grant support to the Facility was highly relevant for the first years of its operation, but its relevance declined over time. When designed in 1997/1998 all the available evidence pointed to a need for a supply-based instrument to induce financial intermediaries to address market failures in providing finance for small and medium-sized enterprises. This fitted well with the institutional mandates of the international financial institutions. However, by 2000-2001, privatisation in the banking sector was largely complete and accompanied by substantial foreign bank investments. Additionally, advances were made in the regulatory environment and with accession firmly in sight, investments in all sectors and transfer of knowhow, including banking, increased substantially. From 2001 onwards, competitive pressures caused banks to re-define their small and medium-sized enterprise business models, deepen and widen target market segments and refine their products (maturities, margins, and terms). In practice, market changes have driven changes at participating financial institution level, rather than the Facility itself. Relevance of the grant support declined, since at programme level, the Facility did not adjust sufficiently to changing conditions. It was essentially a 'one size fits all' approach, i.e. not differentiated based on real market needs.

Catalytic effects of the grant support to the Facility diminished over time. Whilst in general the average loan size of the participating financial institutions has decreased, and the maturity of loans and percentage of loans to regionally based small and medium-sized enterprises have increased, there is no evidence that this is significantly attributable to the catalytic effect of the grant support to the Facility rather than to the evolution of the competitive environment. At best there were initial catalytic effects from technical assistance supporting new credit methodologies. Thus the recommendation from the previous interim evaluation to carry out a needs' analysis study examining general market coverage and regional market differences should have been implemented to ensure that the catalytic principle was respected.

[2] Allocations from the 2005 Phare envelope were not at implementation stage, therefore the analysis focuses on design.

Additionality in line with the Phare definition has also declined over time. The consistently high levels of commitment of credit lines by the sponsor international financial institutions indicate that they rate the Facility highly according to their own internal criteria for delivering additionality, demonstrating that they can satisfy their internal tests for additionality even in near-developed markets (i.e. where the supply of funds to small and medium-sized enterprises in the candidate countries and new member states, is at tenors and conditions approaching those of the EU-15 member states). However, while there may be remaining gaps to be filled, for example niches that the market is unwilling to address (particular geographic regions or types of enterprise), this may not be an appropriate use of Phare funds. The Phare test for additionality is that "*Phare support should not displace other financiers, especially from the private sector or from the international financial institutions*". In early stage markets, displacement was unlikely. However, with the influx of foreign capital, expertise and technical assistance into the banking sector, the scope for additionality from the grant support to the Facility has substantially diminished.

The intervention logic of providing grant support to the Facility was weak and has resulted in inadequate strategic direction for the Facility. Management of the Facility has focused on disbursement of credit lines and monitoring of implementation. The design of the Facility was not underpinned by a robust intervention logic and lacked agreed and appropriate indicators for anticipated impacts at participating financial institution level. This reflects insufficient leadership of the Facility on the part of the Commission Services.

Outputs were delivered effectively by the international financial institutions, and benefits from grant support were obtained in early stages, but these diminished over time. The large number of outputs was obtained at a perceived low cost to the Commission of a 1.25% flat management fee. However, assessment of the cost-effectiveness of the Facility (from the Commission Services' point of view) must include the extent to which the catalytic principle has been respected, as well as the additional costs due to a) the 'Performance Fee' provided by the Phare grant being used thereafter in the take-up of the international financial institution credit lines, and b) the extent to which the programme has built sustainable capacity within the participating financial institutions. Given that the catalytic effect of the substantial grant support was highest in the early stages and this diminished with time, cost-effectiveness of this support to the Facility is now considered to be low.

Support including technical assistance delivered immediate impacts, but the intermediate and wider impacts of Facility projects were limited. The model of credit line + incentives + technical assistance (as used by the EBRD) provided the bridge between the use of the credit line plus incentives and the development of a sustainable business model. The impacts of the technical assistance built on the delivered outputs, which provided support for organisational development. This model was most effective in participating financial institutions in the early stages of transition as it provided good opportunities for 'learning by doing'. Projects without technical assistance may have delivered immediate impacts, but these are difficult to attribute to the Facility. Where the technical assistance interventions had good immediate impacts, these had only been taken up into wider bank strategies towards small and medium-sized enterprises in less than half of the cases reviewed. The comparatively small size of the Facility's intervention (cumulatively barely the size of a small bank) limited the extent of its impact on the wider business environment. The Facility was only one of a number of funding options used by the participating financial institutions to tailor their products to the needs of small and medium-sized enterprises.

Risk-based incentives and the Equity Window were small components with limited impacts. Risk-based incentives (e.g. interest rate or currency conversion risk protection) were effective only where the instrument used was new to the participating financial institution, and this was the case in only a limited number of instances. Early negative experiences with the Equity Window, including the collapse of boom markets and the loss of appetite by investors for what were perceived as high-risk or low-return funds meant that it was not continued under subsequent programmes. The Phare grant was re-allocated to incentives under the Loan Guarantee and Leasing Window.

Long-term sustainability of effects of the Facility assessed as marginal. The majority of participating financial institutions were already targeting small and medium-sized enterprises and had business models/strategies in place prior to their participation. Some aspects of the Facility have been carried into the medium-term (e.g. credit management skills, credit-scoring methodologies etc.). However, in most cases the fast changing business environment has required further evolution of the small and medium-sized enterprise lending business model. Where sustainability is judged through development of human resource skills, these too have diminished in the medium-term (24-36 months) if not refreshed in line with market requirements. Some 'soft' impacts have been sustained, for example attitudinal changes towards small and medium-sized enterprises and an improved image of the participating financial institution in the market place, through association with an EU-supported product that is perceived by clients as being of a 'European standard'.

Conclusions

Market developments were not matched by timely changes in the Facility, and the intervention logic of grant support became less valid over time.

Over time, the intervention logic underlying the Facility became less about addressing market failures in the broader sense, and more about gap filling in a developing market. This represented a significant shift in positioning and ethos of the Facility that was not matched by appropriate changes in objectives or methodologies. The case was not made for the continued high levels of blanket support of the Facility, as a pre-accession instrument, in these new market conditions.

Catalytic impacts of grant support and Phare additionality diminished over time.

Despite considerable changes in the competitive environment, there is little evidence that the Facility was reoriented to focus on clearly identified market failures in relation to particular countries, regions or segments. Instead, changes in the availability of funds to participating financial institutions and generally to small and medium-sized enterprises have been driven principally by the market, so the catalytic effect envisaged for the grant support to the Facility has not emerged as a significant factor. These changes in the business environment also created new challenges for the Facility to maintain additionality. Whilst the international financial institutions could satisfy their own internal definitions of additionality in near-developed markets through their participation in the Facility, the increased availability of alternative funding as accession approached, and the growing ability to buy in or transfer skills and methodologies from the parent bank or other sources, eroded the additionality of the Phare funds.

Despite substantial outputs, cost-effectiveness of the grant support to the Facility has declined over time.

Whilst comparatively limited Phare resources were deployed, and good use was made of international financial institution resources to deliver substantial outputs in terms of numbers of loans and leases made, staff trained and technical assistance contracts completed, the high level of Performance Fees paid coupled with the difficulties of ensuring that sustainable capacity directly attributable to the Facility was built, particularly for later programmes, mean that the cost-effectiveness of the Facility declined over time. The most effective model was where incentives were combined with technical assistance, and whilst this had undoubted initial beneficial effects, it could not be sustained over time as the competitive business environment evolved, more foreign banks were involved, and alternative funding and support mechanisms were attracted into the small and medium-sized enterprise sector. For projects comprising incentives only, it is difficult to identify and attribute changes in bank behaviour to the Facility, rather than to responses to market changes.

Wider impacts were limited by the size and approach of the Facility.

As the Facility was never intended to be a significant presence in the markets, the potential for wider impact lies principally in its ability to deliver demonstration effects. However, there was little evidence of widespread take-up of Facility models or tools developed through the Facility. The exception to this were the successful technical-assistance-based projects, where processes and practices were taken up in wider business models and adapted over time. Given the dynamic environment, only limited sustainability could be identified, particularly for projects that comprised only incentives + credit line.

Recommendations

There are two key areas in which the recommendations are made for action: redesign of the Facility and need for proactive strategic management.

Action 1: Redesigning the Facility

Recommendation 1: Before launching a new facility, thorough re-assessment and redesign of grant support is required.

There is a need for a full review of the future role and operations of a new Small and Medium-Sized Enterprise Finance Facility, and its introduction under the Instrument for Pre-accession Assistance should be preceded by a thorough re-assessment and consequent redesign. The future facility must have a clear intervention logic, establishing the case for any grant support for the new instrument.

Recommendation 2: The thorough re-assessment and redesign of Facility should be based on detailed analysis of differences in the maturity of economies and markets.

The redesigned instrument would need to be examined critically and reconstructed at every level, starting with an examination of the areas of market failure or a differentiation in the level of market maturity or market underdevelopment that can reasonably be addressed. Any methods and tools proposed should take account of the differing regional and country conditions and market segments. Specific objectives relating to micro-credit institutions or development/promotional banks should be clearly identified.

Recommendation 3: Redesign should respect the principles of catalytic impact and additionality.

The principles of catalytic impact and additionality should be set up as positive criteria by the Commission Services, which must be met by individual arrangements with the international financial institutions, and should be clearly reflected in individual project proposals with participating financial institutions.

Action 2: Need for proactive strategic management

Recommendation 4: The Commission Services should be proactively at the heart of strategic decision making on the development and implementation of the Facility.

As the entire Facility is largely driven by absorption of the Phare grant, the Commission Services (DG Enlargement, DG ECFIN, DG Enterprise and other Commission stakeholders) should be at the heart of strategic decision-making on the development and implementation of the Facility. This would involve clarity about the policy objectives at regional, national or segment level that the Commission is pursuing and the role of the Facility in achieving these objectives. This should be set out in a series of working papers outlining the Commission's expectations of the Facility, guidelines for ensuring additionality and catalytic effect and a set of core monitoring indicators linked to specific policy objectives.

Recommendation 5: The management of strategic operations of the Facility should have appropriate tools and resources to tailor the Facility's response to changing conditions.

It should be the responsibility of the Facility's strategic management to equip itself with the tools and methodologies to identify in which countries and market segments the intervention is warranted, in accordance with the intervention logic. Decisions about programmes should be placed firmly within the context of the competitive environment at that time. Fulfilment of the Commission Services' requirements for catalytic impact and additionality should also be ensured. Changes should trigger a process of review and refinement, for example to accelerate or stop implementation mid-programme if necessary. This would be particularly applicable where the original intervention logic is no longer relevant or where a Commission Services definition of additionality can no longer be met. Achievement of the policy objectives should be made central to strategic management by linking instrument design, management structures, performance measures and reporting tools to the underlying intervention logic.

MAIN REPORT

1. INTRODUCTION

1.1 Objectives

1. The evaluation of the Small and Medium-Sized Finance Facility (the Facility) Multi-Beneficiary Programme (MBP) is one of a series of MBP evaluations carried out as part of the *ex post* evaluation of the Phare programmes 1999-2001. In view of the significance of this programme and planned contribution for the Western Balkans this is an in-depth evaluation that will be published as a stand-alone report. In addition, it feeds into a consolidated report on the Phare MBPs in the 1999-2001 period and also contributes to the thematic evaluation of Phare support for the SME sector in the period. Both of these will in turn form part of a consolidated *ex post* evaluation of the Phare programmes in the period 1999-2001.

2. This evaluation report complements the *ex post* aspect (dealing with programmes from 1999-2001) with an interim evaluation aspect, whereby it addresses design and performance of the Phare allocations in the 2002-2005 period.[3]

3. The purpose of this evaluation is to assess the extent to which the Facility has met its objectives. These differ between the *ex post* or earlier period (1999-2001) and interim or later period (2002 –2005). In the *ex post* period, the objective is stated in the Financing Proposals (FPs) as "*... to induce financial intermediaries to expand and maintain, in the long term, their financing operations with Small and Medium-Sized Enterprises*." In the later period (2002-2005) successive programmes have widened the overall objectives: "*… to assist the candidate countries in meeting the Copenhagen criteria and to contribute to the reform and strengthening of the financial sector*". This is dealt with in more detail in Section 2.1 below and in Annex 8.

1.2 Background and Context

4. In the period 1999-2005, Phare allocated total grants amounting to M€ 323 to the Facility (see Table 1). This has in turn been matched by M€ 2,214 of funding from the participating international finance institutions (IFIs) – the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB),[4] and the Council of Europe Development Bank (CEB) in partnership with *Kreditanstalt für Wiederaufbau* (KfW).

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[3] Allocations from the 2005 Phare envelope were not at implementation stage, therefore the analysis focuses on design.

[4] Up to 2005, EIB had signed three Contributory Agreements under the 2001, 2002 and 2003 budget lines, but implementation has been slow to date for a number of reasons, including: a) the EIB was the last IFI to join the Facility and, b) the implementation scheme adopted by the EIB involves approval of each sub-loan (rather than 'project' with the PFI) individually, which slows down the rate of implementation. Despite the slow start and slowness of the implementation scheme, the number of sub-projects approved has grown annually.

Table 1.- Overview of Phare contributions to the SME Finance Facility

Prog. No.	Prog. Title	Allocated (M€)[5]	Contracted (M€)[6]	Disbursed (%)[7]
ZZ-9901 ZZ-0013 ZZ-0106	1999 SME Finance Facility 2000 SME Finance Facility Phase 2 – EBRD 2001 SME Finance Facility Phase 2 – EBRD	110	106.40	70.67
ZZ-0007 ZZ-0108	2000 SME Finance Facility Phase 2 – CEB 2001 SME Finance Facility Phase 2 – CEB	51	47.40	59.65
ZZ-0126	2001 SME Finance Facility – EIB	30	26.1	25.9
2002-000-621	2002 SME Finance Facility - EBRD	20	19.77	33.33
2002-000-622	2002 SME Finance Facility - CEB-KfW	15	15.05	33.06
2002-000-629	2002 SME Finance Facility - EIB	15	13	16.88
2003-005-745	2003 SME Finance Facility - EBRD	25	22.01	11.00
2003-005-765	2003 SME Finance Facility - EIB	10	0	0
2003-005-766	2003 SME Finance Facility - CEB-KfW	15	7.5	0
2005-017-220	2005 SME Finance Facility - EIB[8]	5	0	
2005-017-221	2005 SME Finance Facility - EBRD[9]	18	8.50	12.00
2005-017-222	2005 SME Finance Facility - CEB/KfW[10]	9	0	
	Total	**323**	**265.74**	

5. An Interim Evaluation (IE) of the Facility was carried out in 2003.[11] The IE Report concluded that while the Facility was a good concept, with a high potential for success, it required fine-tuning across a range of areas to respect Phare guidelines related to the catalytic effect, additionality and sustainability. Key issues identified in the IE Report included the need to ensure additionality and the need to focus on promoting sustainability by focussing on capacity building at the participating banks, leasing companies and other financial intermediaries - hereafter collectively referred to as participating financial institutions (PFIs).

6. The IE also noted weaknesses in the technical assistance (TA) delivered under the EBRD credit line + incentives + technical assistance model, due to lack of commitment of the senior management of PFIs, need for a better 'fit' between the consultants and the needs of the PFIs; and the need for pro-active management of the TA components by the EBRD. At the time of the IE, the Equity Window (EW)[12] was performing poorly and the potential impact (in terms of demonstration effect) was at risk. Operational issues identified by the IE included: a) the need to ensure a uniform quality of reporting from the participating IFIs to the Commission Services, and b) more transparent management of the IFI pipelines, including the availability of information on terms and conditions offered by all participating IFIs to PFI affiliates.

5 As per the Financing Proposal.

6 In this context, 'Contracted' refers to funding committed on the basis of Project Proposals submitted by the IFIs and signed off by the Commission Services. Source of information; DG ECFIN as per 10 July 2006.

7 Of signed projects.

8 Covers Bulgaria, Romania, Croatia and Turkey.

9 Covers Bulgaria, Romania and Croatia.

10 Covers Bulgaria, Romania, Croatia and Turkey.

11 R/ZZ/SME/02.146 issued on 18 February 2003, EMS Consortium.

12 The Equity Window is only sponsored through the EBRD. It involves the establishment of special funds using Phare/Facility capital matched by EBRD funds. Its aim is to facilitate access to equity investment by SMEs in the ten CCs. Independent fund managers are appointed as partner FIs to manage the funds on a fee plus profit sharing basis.

7. The IE report concluded with thirteen recommendations which focused *inter alia* on the need to fine-tune the Facility to be more responsive to regional and sectoral variations; to re-examine how the Facility projects deliver additionality and catalytic impact, and to improve the quality of reporting by the IFIs. Annex 3 sets out the recommendations and the related action agreed by the Facility Steering Committee. A number of changes were introduced over time, e.g. more attention to tracking indicators, greater attention to justifying the need for second credit lines in the individual project proposals, greater standardisation of reports from the IFIs to the Commission Services) and a new format for the project proposal that included more attention to issues of sustainability and additionality. However the underlying rationale and intervention logic, despite the fast pace of change in the competitive environment in the CCs, remained largely unchanged. Where changes were made, for example to increase the focus on micro-loans, or to target new clients (particularly in the case of the later EBRD projects), this was at the initiative of the IFIs, rather than as a central part of a strategic reorientation of the programme. Importantly, the recommendation for an updated analysis of the situation in the countries in which the Facility operated was only partially acted on. The Steering Committee[13] for the Facility downgraded this recommendation to focus only on Bulgaria and Romania, despite plans for second credit lines in the soon to be member states. Even this downgraded recommendation was only partially implemented. The recommendation relating to the Equity Window (EW) was implemented, with the result that this was discontinued.

8. To date the three IFIs (EBRD, EIB and CEB-KfW) occupy an exclusive position within the Facility that the Financing Proposals justified as follows: "*The technical nature and the multi-country approach of the SME Finance Facility required the involvement of highly-specialised financial institutions, with a long track record in international finance and SME development. Also the preference was for financial institutions with the status of international public-law bodies, who shared the values of the EU, in particular, in relation to enlargement and had similar public policy objectives, rather than private-sector financial institutions looking for commercial investment terms … In terms of the Financial Regulation applicable to the general budget (Art.110), and its Implementing Rules (Art.168), the characteristics of these financial institutions as public-law bodies, pursuing European public policy objectives not just for profit, as well as their track record and specialisation in financing international development, therefore put them in a monopoly situation leaving no other choice as partner for the Commission in these actions.*" It is worth noting that the original conception of the Facility (with EBRD) emphasised the delivery of technical assistance (TA) as a core capacity-building instrument. The later inclusion of other IFIs without the capacity or mandate to deliver TA marked an important change in the *modus operandi* of the Facility.

1.3 Evaluation Methodology

9. Evaluation questions were set out in the Terms of Reference (ToR) for this evaluation (see Annex 1), and were divided into performance evaluation questions and thematic/cross-cutting questions. Following consultation with the IFIs, DG ECFIN and DG Enlargement (Implementation, Contracts and Nuclear Task Force Unit[14] and Evaluation Unit) an Evaluation Plan including the primary sources of evidence was finalised (see Annex 2).

10. By December 2005, a total of 142 PFIs were participating in the Facility. Of these, 32 were signed up in 2005 and were therefore at a very early stage of implementation. The final

[13] 4 July 2003.
[14] In mid 2006 this became D3, Regional Programmes Unit.

sample, agreed with the Commission Services and IFIs, focussed on PFIs where the Facility was at an advanced stage of implementation.

11. The final sample was selected using the following criteria:

- Distribution by country;
- Distribution by IFI;
- Stage of implementation;
- Distribution by type e.g. banks/leasing companies;
- Follow-up of PFIs interviewed earlier under the interim evaluation;
- Inclusion of the Rural Sub-Window (RSW).

12. A total of 37 PFIs were selected and interviewed for this exercise,[15] of which 18 were follow-up interviews from the last IE exercise. The list of PFIs interviewed is contained in Annex 4 and the complete list of persons interviewed is given in Annex 11. The sample comprises 26 % of total PFIs, but approximately 38 % of total credit lines committed/disbursed in the 1999-2005 period (very little funding has been delivered to date under the 2003/2005 budget lines).

Table 2.- Breakdown of sample by IFI

IFI	Total No of PFIs	No of PFIs in Sample	%
EBRD	65	19	28
CEB-KfW	48	11	23
EIB	29	7	24
Totals	**142**	**37**	**26%**

Table 3.- Breakdown of sample by country

Country	No of PFIs	%
Bulgaria	5	13.5
Czech Republic	5	13.5
Hungary	4	10.8
Latvia	2	5.4
Poland	7	19
Romania	8	21.6
Slovak Republic	2	5.4
Slovenia	4	10.8
Total	**37**	**100**

13. A questionnaire was developed and distributed to the interviewed banks. The questionnaire is given in Annex 5 and the findings are integrated into the relevant sections of this report. Interviews with PFIs were undertaken using a structured interview methodology designed to:

- Establish the linkage between the strategic priorities of the respondent and the objectives of the Facility;

[15] In addition two 'on-lending' banks were interviewed in Slovenia (i.e. banks that borrow from the Facility PFIs for on-lending to SMEs).

- Differentiate between wider influences of the competitive environment and the capacity of the Facility to induce behavioural changes;
- Identify the method of the Facility implementation and its impact on the SME business model used by the PFI.

14. Each interview was conducted around four core modules, commencing with the wider SME competitive environment, how the PFI addressed commercial opportunities and competitive pressures at the strategic and operational levels and finally implementation of the Facility itself and its impact (immediate and intermediate) at the strategic and operational levels. The interview structure was highly complementary to the questionnaire in that it provided a good vehicle to explore strategic and commercial imperatives governing the SME business within the institution. More detail on the interviewing methodology is given in Annex 6.

15. Evaluation of the Facility is constrained by a number of factors. Firstly, the extensive penetration of the banking sector by the Facility through the IFIs means that the majority of the major banks are participants, thus making it difficult to identify a control group. Even if a control group had been identified, detailed information on their SME loan portfolios would have been virtually impossible to obtain. Secondly, much of the impact at the PFI level is intangible, making it problematic to establish firm evidence of outcomes directly attributable to the Facility; outcomes that would have happened in the same or similar way regardless of the Facility; and those outcomes that would have happened regardless of the Facility but have happened more rapidly due to the Facility intervention. Where it is not possible to establish tangible evidence of linkages, the evaluators have relied upon the assessment made by management at the PFIs themselves.

16. In its design, the Facility logframes setting out the intervention logic and the appropriate indicators for each level are weak.[16] In order to achieve clarity on the use of terminology, and to assist in identifying impacts at the appropriate level, the Evaluation Team reconstructed the intervention logic, which is shown in Annex 7.

[16] Only logframes for the following programmes were openly available: ZZ0013, ZZ0106, ZZ0108, ZZ0126.

2. PERFORMANCE OF THE FACILITY

2.1 Grant support to the Facility was highly relevant for the first years, but its relevance declined over time

17. ***The needs' analysis underpinning the Facility was firmly grounded***. Before the introduction of the Facility, Phare was already deeply involved in financial instruments in support of SME creation and development, including through financial intermediaries. As of 1999, € 212 million of programmes had been supported in providing debt and equity finance. In addition, various Phare sector programmes in energy, environment and regional development included SME finance components.[17] The Agenda 2000 impact study specifically identified lack of access to finance as a key bottleneck in SME development. With the adoption of the Phare New Orientations in 1997, the Commission Services were mandated to establish a horizontal SME facility for the region as a whole. The needs' analysis underpinning the Facility was firmly grounded in the Agenda 2000 impact study, the EBRD/World Bank "*Business Environment and Enterprise Performance Study*" (BEEPS) in 1999, and in the Commission Services' own feasibility study and market demand analysis[18] supporting the design and launch of the Facility. Based on this body of research, the 1999 Financing Proposal stated that SME financing problems were becoming increasingly serious. Demand for finance was found to be rising rapidly, but banks and investment funds continued to lack experience and were reluctant to provide finance to the sector. The FP went on to conclude that SMEs were effectively excluded from debt and equity finance in virtually all SME size categories and countries. All the evidence at the time pointed to the occurrence of market failure.

18. ***The original concept and design of the Facility was strongly driven by the market environment of the mid to late 1990's***. At that time, it was not clear that financial sector market liberalisation would continue; or what the private (financial) sector response would be in terms of competition, Foreign Direct Investment (FDI), mergers and acquisitions. The Asian market crisis of 1997 had undermined confidence in emerging market economies, which was subsequently reinforced by the 1998 Russian financial crisis. In this period accession was uncertain. Much of the banking sector in the region was still dealing with historic loan portfolios of state-owned enterprises facing financial difficulties. There was relatively little financial sector interest in lending to SMEs, and market failure was easily identified.

19. The Facility as it was designed could therefore be characterised as intervening in two areas that inhibited banks from addressing SME needs:
- Banks lacked the liquidity or access to term funding to support medium-term or foreign currency SME loan products, or
- Banks lacked management capacity and willingness to provide appropriate products in a controlled risk environment under a sustainable business model.

20. These opportunities for intervention sat well with the IFI partners' institutional mandates. For the EBRD, supporting SMEs through financial intermediation is the core component (Pillar 1) of the Bank's SME strategy. For the EIB, the Facility is an opportunity to fulfil their role as an implementation arm of Commission policy and the Facility has been adapted and

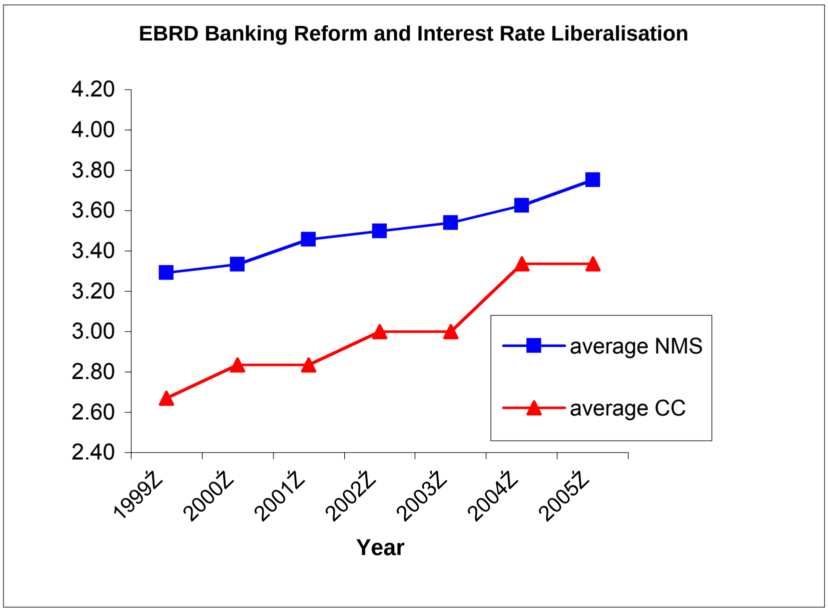
[17] Small and Medium-Sized Enterprise Finance Facility Financing Proposal 1999.

[18] Based on Agenda 2000 and the Phare New Orientations, a Working Group comprising the Commission, the EBRD and the EIB was set up to collaborate on the design of the Facility. The EBRD and EIB conducted their own market testing among financial intermediaries in the EU and the then Central and Eastern European Countries (CEECs). The Commission carried out a feasibility study and market demand analysis with target financial intermediaries in the EU and the then applicant countries.

implemented as an extension of their SME Global Loan product. Likewise for CEB/KfW, the Facility has provided the chance to extend fulfilment of their respective mandates.

21. ***By 2000 a series of major events were in process that were to fundamentally change the competitive landscape*** for the delivery of commercial banking services in candidate countries. Firstly, future membership of the EU was firmly accepted as a policy goal by candidate countries. With it came adoption of the Copenhagen Criteria and a move to reform and modernise banking sector regulation. The evolution of banking sector regulatory reform can be tracked through the EBRD Banking Reform and Interest Rate Liberalisation Index. Above a value of 4, countries are considered to approximate to EU member standards. Many of the candidate countries can be seen to accelerate the reform process from the late 1990s onwards (and in the case of Bulgaria and Romania progress in 2004 and 2005 is noticeable - see Figure 1).

Figure 1.- Evolution of EBRD Transition Indicators for 5 countries



22. Secondly, and consistent with reform of the banking sector regulation, the bank privatisation process continued. This coincided with the opening up of markets to foreign bank ownership. By 2001, major banks in the region were already controlled by foreign banks. The following figures present a few examples of the percentage of bank assets owned by foreign banks in 2001.[19]

Table 4.- Percentage of bank assets owned by foreign banks in 2001

Country	%
Poland	51%
Hungary	61%
Czech Republic	78%
Slovakia	75%

[19] Comparison of Banks C&EE 2001 Bank Austria Creditanstalt.

23. By this time (2001), European commercial banks had clearly identified that beneficiary countries provided the potential for asset and profit growth rates far above west European levels. Annual growth rates of 10-15% over the medium term were predicted by analysts at the time, albeit from a lower base than in mature European markets. Banks were also aware of the need to establish their position in these fast liberalising markets or risk being excluded by high competitive barriers to entry. Further, for many European banks, candidate country markets were regarded as being extensions of the home market or existing lines of business and therefore far more accessible than other emerging markets that might be on a similar reform or growth path but very distant geographically, commercially and culturally.

24. ***With accession firmly in sight, investments in all sectors, including banking, increased.*** The path to accession was firmly established on 13 December 2002, with the decision of the Copenhagen European Council that ten candidate countries (Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia) could join the EU on 1 May 2004. Subsequently on 16 April 2003, the EU signed accession treaties with these countries. Thus the guarantees of political and economic stability and particularly rights of private sector bank ownership were established. This led not only to sharp increases in foreign direct investment, but also to intensified investments in the banking sector.

25. ***Banks that had entered the market through acquisition were left with a major task of bank restructuring***. Retail banks often exhibited cost-income ratios approximating European levels but this was on account of high loan margins, which disguised an average ratio of costs (operating costs excluding loan provisions and extraordinary items) to volumes (customer loans and deposits) at approximately double west European levels.[20] Interviews with foreign owned privatised banks in the sample group identified, without exception, that the period of the mid-late 1990s and early 2000s were dominated by restructuring issues.[21] All banks interviewed also observed intensifying competition over this period in traditional larger corporate lending markets, evidenced by declining loan margins and easing loan conditions.

26. ***Banks identified the SME market as a core business sector with potential for growth***. With restructuring well underway, commercial challenges being faced in their traditional loan markets and the prospect of accession firmly on the horizon, banks turned to the SME market as one of the business sectors in which future growth opportunities existed. Banks were also aware that in the face of intensifying competition, it was essential to build up a defensible market position in a short period of time.

27. This shift in strategic emphasis by most of the major banks in the region is the third factor in the step change that has occurred in the competitive environment in which the Facility operates. All banks interviewed in new member states identified their strategic priorities as addressing new SME market segments with appropriate products and business processes on a wider geographical basis than had previously been the case. Thus from late 2002-onwards, competitive pressures caused banks to define their SME businesses models, deepen and widen target market segments and refine their products (maturities, margins, terms).

28. For most PFIs, the timing of the Facility was fortuitous and coincident with the above-described circumstances that had caused banks to reconsider their opportunities and approach to the SME market. The same is also broadly true of leasing companies that reported similar

[20] McKinsey Quarterly, '*Eastern European Banking Matures*', No. 2, 2003. Di Maggio, Romanowski, and Walter.

[21] Banks in markets that went through an earlier process of privatisation and regulatory reform addressed SME business strategies ahead of this general timeframe.

competitive pressures to explore new clients, asset classes, flexibility in lease size and geographical coverage.

29. The earliest Facility FP of 1999 recognised that the potential demand for SME finance far exceeded the capacity of an instrument such as the Facility to satisfy. Rather, its value lay in establishing a critical mass of debt proposals that would demonstrate the profitability of the sector and provide a clear demonstration effect to entice other banks to start up similar operations themselves. The later FPs also included objectives aimed at inducing or building the confidence of Participating Financial Institutions (PFIs) to expand and maintain their financing operations with SMEs. However, whilst the increasing competitive pressures in the market forced banks to respond quickly, the Facility itself moved too slowly in the key period from 2002-2004 to maintain its effectiveness. In that period, average (non-Facility) loan sizes by PFIs were decreasing, tenor was increasing, and the PFIs were actively seeking new and smaller segments of the SME market. In this context, the Facility as a whole could have responded by identifying particular niches in the SME market e.g. support for start-ups or an intensified focus on micro-enterprises and micro-credits (areas into which the PFIs were still reluctant to expand), particularly for second credit lines. With particular regard to micro-finance, the Facility did not set any overall targets or objectives, but individual IFIs, in particular the EBRD, have taken action to encourage lending at the smaller end of the spectrum.

30. In the period 2000-2004, for the reasons explained above, most of the major banks in the region had established their strategies for addressing the SME market and had begun to focus progressively on smaller loans and smaller clients, and the potential for the Facility to contribute to strategy development declined. The design of the Facility failed to incorporate the management and governance mechanisms that would have facilitated a strategic review and consequent action plan regarding the Facility objectives and implementation in the light of fundamental changes in the market environment.

31. ***From 2000, the overall objectives of the Facility presented in the FPs changed somewhat*** from an initial focus on building capacity, and interventions at the level of financial intermediaries towards contributing also to broader financial sector reform. This was in response to Agenda 2000 and the New Orientations of the Phare programme. Annex 8 shows the evolution of objectives over the entire period. They have essentially remained unchanged, however, focusing continuously on improved SME access to banking services, and their sustainable supply from the banking sector. The rationale and *modus operandi* of the Facility (provision of credit lines, incentives and technical assistance) did also not undergo any major changes.

32. ***The design of the Facility was not underpinned by a robust intervention logic supported by appropriate indicators***. The available logframes were weak, particularly with regard to indicators of impact of the Facility at PFI level, or in terms of its wider objectives. While there is broad acceptance that the programme focuses on change at PFIs, there was no consistent agreement between the sponsor IFIs and the Commission Services on how this could be measured. While it is argued by the IFIs that the desired changes in bank behaviour are defined at the level of the project proposal in agreement with the PFI, these do not feed in to measurement of overall progress at programme level. Indicators for the projects considered for this evaluation focussed largely on outputs (number and size of loans, average maturities etc.), rather than changes at PFI level.

33. ***Despite a focus on monitoring and control, there was little focus on the extent to which the Facility was meeting Phare's strategic objectives***. In general, there was a preoccupation with monitoring and control at the operational level and little attention was given to which strategic goals the programme - and in particular the Phare funds - were trying to achieve. However, the extent to which the Facility meets the goals of the sponsor IFIs is a matter for internal discussion and debate within the IFIs themselves. High levels of commitment of IFI funds to the Facility, in excess of commitments made during drafting of the FPs, indicate that there is considerable added value to the IFIs in this cooperation. Therefore, under the current management structure of the Facility, it is perfectly possible for the continuing relevance to Phare grant support to be questionable, whilst at the same time satisfying internal guidelines on the part of the IFIs.

2.2 Outputs were delivered effectively by the IFIs, and benefits from grant support were obtained in early stages, but these diminished over time.

34. ***Implementation of the Facility is based on a partnership between the Commission Services and the sponsor IFIs.*** Day-to-day management of the Facility activities is delegated to the IFIs. A Steering Committee comprising representatives of the Commission Services (DG Enlargement, DG Agriculture, DG Enterprise and DG ECFIN) and the three sponsor IFIs deals with overall coordination.[22] As the Secretariat of the Facility, DG ECFIN (Unit L) efficiently coordinates the flow of information between the Commission and the sponsors for all matters related to projects signed with the IFIs, the Steering Committee meetings, any technical meetings and the administration of the Special Account.[23]

35. ***DG ECFIN closely monitors the implementation of the Facility by the IFIs***. As of November 2005, a new Programme Management System (PMS) has been put in place for all Commission mandated instruments,[24] including the Facility. The PMS is a specific relational database with an internet interface, which can re-group the information contained in several dispersed Excel files and which enables easier collection and analysis of data. However this data is confined to issues of contracting (i.e. projects signed with the IFIs) and disbursement. The annual and semi-annual reports prepared by the IFIs contain more implementation level information, but this is not structured to be informative on progress towards meeting Commission objectives, especially since objectives are ill defined.

36. ***The new monitoring policy has increased control of the Phare funds, but has proved cumbersome.*** In 2005 a new monitoring policy was implemented by the Commission Services, to ensure that internal control systems at the IFIs were sufficient to confirm that the PFIs were fulfilling their obligations under their contracts with the IFIs and to permit timely identification and correction of problems in the application of the Phare eligibility rules. Feedback from the interviewing process indicates that the practical outcome of this exercise has been to increase the reporting requirements of both IFIs and PFIs and to increase the number of site visits and on-the-spot checks and missions, by both Commission Services and IFIs, to the PFIs. At present count, PFIs undergo approximately seven kinds of monitoring: by sponsor IFI management; by sponsor IFI auditors; by sponsor IFI evaluation teams; by DG ECFIN; by DG Enlargement; by the Phare Evaluation exercises and ultimately by the Court of Auditors. Although the Commission Services (DG Enlargement and DG ECFIN) combine

[22] More detailed information on the management, coordination and activities of Facility is given in Annex 9.

[23] The Special Account is an interest bearing account held at the Sponsor IFIs for the Phare contribution.

[24] Financial instruments mandated to International Financial Institutions (IFIs): include the ETF Start-up; the SME Guarantee Facility; Seed Capital Action; SME Finance Facility; Municipal Finance Facility; Municipal Infrastructure Facility; and the Preparatory Action.

monitoring visits to minimise the burden on PFIs, the process is still onerous. Reporting from the PFIs to the IFIs is also complex and lasts for the duration of the credit line signed with the IFI (up to 12 years). While procedures to ensure transparency of the use of the Phare funds is to be welcomed, it is worth noting that the IFIs have a fiduciary responsibility to ensure that Phare funds are used with the same degree of probity as their own funds. As the systems and procedures in place at the IFIs have been tested and verified as meeting the appropriate Commission standards, then both the added value of, and need for, additional cumbersome layers of operational monitoring must be questioned.

37. ***Phare grant has supported delivery of considerable IFI loans.*** Phare funds of M€ 323 have been matched by M€ 2,214 of IFI credit lines. Over the period 1999-2003, Phare made M€ 291 available under the Facility in the ten CCs. From 2001, it was decided to extend the scope of the Facility to all CCs and M€1.5 was made available under Phare 2003 for Cyprus[25]. A further M€4 was made available for Facility projects with CEB-KfW in Turkey. No Phare funding was programmed in 2004, but in 2005, an additional M€32 were made available for Bulgaria, Romania, Croatia and (in the case of the agreements with CEB-KfW and EIB), for Turkey. In line with the FPs and Contribution Agreements, the Phare support is matched, at varying ratios by IFI credit lines, as shown in Table 5 below and in Annex 9. To date IFIs have committed to provide at least M€ 2,214 in credit lines (as shown in the FPs), of which approximately M€ 1,723 has been committed to 156 credit lines under approved project proposals (PPs).

Table 5.- Credit Lines committed by IFIs

IFI	Phare support as per Financing Proposal (1999-2005)	Total Credit Lines as per FP* (M€ , 1999-2005)	Credit Lines committed by IFIs to date**
EBRD	173	690	1,100
CEB-KfW	90	458	564
EIB	60	670	550
Totals	**323**	**1,723**	**2, 214**

Source: FPs 1999-2005. * FP states a minimum contribution by the IFIs. ** As of 10 July 2006.

38. ***Phare funding has been used to provide a range of incentives*** for PFIs,[26] which can be broadly divided into four categories (see Annex 9 for more detail):

- **Technical Assistance**, which is a feature of the EBRD use of the Phare grant, and to a lesser extent and more recently, of the CEB-KfW projects;

[25] Cyprus' participation in the Facility was limited to projects with CEB-KfW.

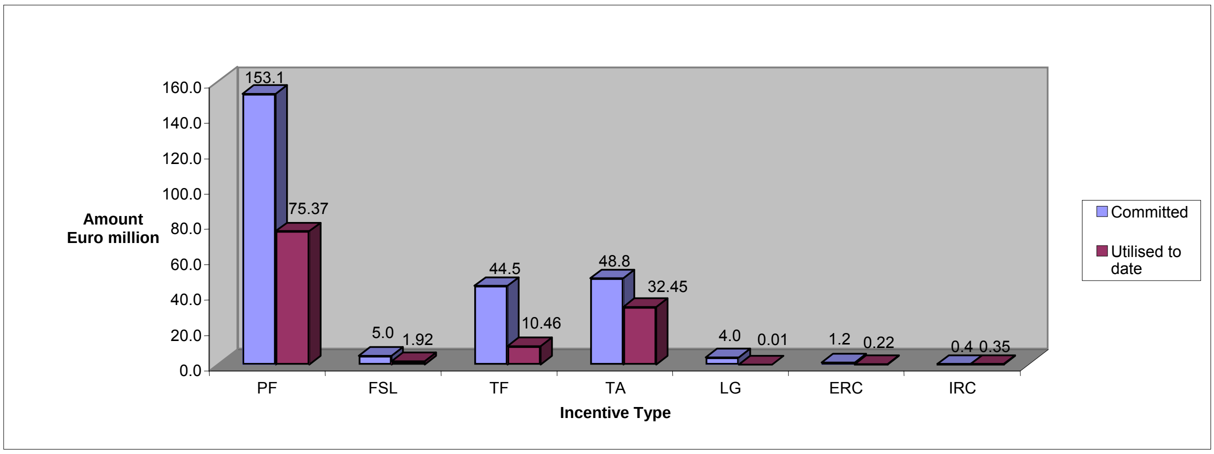
[26] The purpose of the incentive is to 'induce' the PFIs to maintain and expand operations with SMEs. While in more recent times the objective has been expanded ("… *to assist the candidate countries in meeting the Copenhagen criteria* – 2002 and "… *to contribute to the reform and strengthening of the financial sector to cope with the competitive pressure within the European Union* – 2003/2005), the Phare support continues to be used to induce changes in PFI behaviour towards SMEs.

- **Performance-based incentives**[27] such as the Performance Fee, the Fee for Smaller Loans (FSL) and Transaction Fees (TF), all contingent on successful on-lending of credit lines by PFIs;
- **Risk-based incentives** such as the Loan Guarantee (LG), the Exchange Risk Cover (ERC) and the Interest Rate Cap (IRC);
- **Equity finance** (only in cooperation with the EBRD) in which the Phare grant provides seeding or soft financing terms for the fund by investing alongside the EBRD and other investors at specified ratios.[28]

39. ***Performance-based incentives have been heavily used***. Performance-based incentives, particularly the Performance Fee, have been the most heavily utilised and account for approximately M€251. Transaction Fees (TF) and Technical Assistance (TA) amount to approximately M€44 and M€49 respectively. Risk-based incentives account for only a very small proportion of the total Phare financial incentives delivered, and are used most extensively by CEB-KfW (which utilises the widest range of incentives) (see Figure 2).

40. To date, EBRD has signed approximately 75 TA contracts, for a total value of M€ 38.725, of which 34 have been completed. Support for the EW constitutes approximately 0.3% of Phare funds and has been primarily in the form of equity investments in four funds (see Annex 9 for more details).

Figure 2. Phare grant committed and utilised.



41. ***The Facility has been implemented effectively by the participating IFIs*** (see Annex 9 for more details). In line with the reconstructed intervention logic (Annex 7), these can be divided into three main categories: a) loans/leases to SMEs; b) outputs of the TA and; c) 'soft' capacity building e.g. experience in dealing with, and reporting to IFIs, new funding options or risk management instruments utilised.

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[27] In the context of the Facility, 'performance' is judged in different ways, based on discussions between the IFI and the respective PFI. Thus there is some variation between the IFIs on how performance is measured. For EBRD projects, to draw down the performance fee, the PFI must meet specific performance and eligibility criteria related to the lending itself (e.g. size of loan) and quality of the lending (i.e. less than 5% arrears rate over 60 days, calculated as portfolio at risk on the volume of outstanding loans to SME borrowers funded by the Facility). Performance fee rates differentiate between micro and small loans, with the aim of targeting micro loans. In the case of CEB/KfW, the criteria for draw-down of the performance fee relates to the achievement of certain policy objectives, for example, in the case of the Rural Sub-Window (also relevant to EBRD), the eligible loans must be to SMEs in rural zones or farmers with less than 100 full-time employees (or the equivalent number of part-time employees).

[28] See Annex 9 for further information on the operation of the Equity Window (EW).

42. Table 6 below gives an overview of the outputs of the Loan Guarantee and Leasing Window (LGLW). By the end of 2005, approximately 74,216 loans/leases to SMEs had been made by 115 PFIs.[29] In general, and despite some start-up and IFI-specific structural problems, the Facility has been a relatively efficient instrument in terms of the large number of outputs delivered and PFIs involved.

Table 6.- Overview of Loan Guarantee and Leasing Window outputs

IFI	Loans/Leases	Credit Lines Signed	PFIs involved
EBRD	64, 854	86	65
CEB-KfW	7,354	31	30
EIB	2,008	30	20
Totals	**74,216**	**147**	**115**

43. ***The Facility made good use of IFI resources to deliver outputs***. An important strength of the partnership with the IFIs is the ability of the Facility to utilise the resources, networks and specialist knowledge of the IFIs for implementation. This means that on the Commission Services side, only comparatively limited resources need to be deployed. For their implementation services, the EBRD and CEB-KfW receive a 1.25% flat management fee[30] while EIB receives a 1.2% fee. These fees have amounted to €1,042,000; €416,000 and €120,000 respectively, for the entire period between 1999 and the end of 2005. Given that some credit lines can run for up to 12 years, with the related monitoring and reporting, this is a considerable amount of input by the IFIs for a very limited management cost to Phare.

44. ***However the total cost of delivering the outputs must include the Phare grant.*** In addition to the management fee, there is an additional cost to achieving the substantial outputs. Feedback from the interviews indicates that one of the main benefits of the Phare incentives (totalling M€265.74),[31] and in particular the Performance Fee to PFIs, has been to increase the attractiveness of the IFI credit line. Thus, part of the Phare grant (in the form of the Performance Fee) that has been used to promote take-up of the IFI credit line, should be seen as a cost to the Commission for the delivery of the outputs.

45. TA provides the bridge between the use of the credit line + incentives model and the development of a sustainable SME business model. TA is an important feature of EBRD projects. It is implemented under EBRD Framework Agreements, and supports both the implementation of the credit line and wider capacity building activities at the PFIs. Under the EBRD TA components, 75 TA contracts were implemented and approximately 4,400 bank staff received training. Unlike the EBRD model, TA delivered within the CEB-KfW projects is contracted by the PFIs themselves in line with their own requirements (6% of total incentives used by CEB-KfW was for TA).

46. Reported outputs of the TA (both EBRD and CEB-KfW) may be grouped into five categories:

[29] By the end of 2006, EBRD's cumulative commitments alone reached € 1,076.5 million to 39 banks and 37 leasing companies covering the 11 eligible countries; and over 82,500 sub-projects amounting to € 1.75 billion were disbursed to SMEs.

[30] Based on DG ECFIN data on disbursed amounts as of 10 July 2006.

[31] As per the Financing Proposals, M€323 has been made available to the Facility; M€265.75 has been contracted and M€125.63 has been disbursed.

- Support for organisational development including development of strategies towards SMEs;
- Improved risk management processes;
- Staff training and skill enhancement;
- Improvements in procedures and documentation;
- Marketing activities connected with the credit line.

47. ***Efficiency of the EBRD TA has been adequate.*** Efficiency of the EBRD TA depended *inter alia* on a number of factors given below. Since not all these factors were always coincident there were a small minority of EBRD projects that failed to achieve their objectives as defined in the project proposal. Success factors included: well-designed TA components with good input from the PFI; a good 'fit' between the organisational needs of the PFI and the technical capacity of the contractor; commitment of senior bank management; active management of the TA contract by the EBRD Task Manager to ensure that where TA projects are not delivering they are either re-oriented or stopped. This is particularly important given the often long duration of the interventions (up to 3 years). In the cases where the TA was less than successful, this was due to a number of factors, including poor delivery by contractors and, importantly, marginalisation of the TA team within the PFI, whereby their role was seen primarily as providing sound management of the IFI credit line, rather than capacity-building in the wider institution.

48. ***Despite recent improvements in the environment for equity capital, the Equity Window concept was not revived.*** The Equity Window (EW) was introduced in 1999 and following a disappointing start, the EBRD noted that it would be difficult to commit the programmed funds within the allocated timeframe. In January 2003, the Steering Committee took the decision to re-allocate M€4.75 from the EW to the LGLW. Later, in July 2003, the Steering Committee approved the EBRD request to transfer the outstanding amount of M€4 to the LGLW and it was agreed by the Committee that no further projects would be proposed under the EW, and the EW was not continued under subsequent annual programmes. The factors influencing the poor performance of the EW in the 1999-2003 period, identified in the earlier IE report include:

- The collapse of boom markets generally in the period and the loss of appetite by investors for what are perceived as high risk or low return funds;
- The decline in interest in the technology and "new economy" sectors, which were considered a potentially fertile ground for the investment funds;
- Fund structures that were more complicated and time consuming to resolve than originally anticipated;[32]
- Unexpected delays in early stage markets in educating entrepreneurs in the benefits and modalities of involvement of private equity providers.

49. However, despite improving market conditions for equity finance (noted in the EBRD's 2005 Annual Report), as evidenced by the successful recent performance of the EW funds (see Annex 9 and Table 7), no further development or refinement of the EW concept was carried out and the performance fee instrument was preferred. To date the EW has committed around M€18 of the planned M€61 and achieved 3 full exits.

[32] For example, difficulties in reaching agreement on an appropriate domicile for one Fund.

Table 7.- Overview of Equity Window Portfolio

	Fund Size	Committed (M€)	Deals	Full Exits	Exit value (M€)	Pipeline
GIMV Fund[33]	12	2.0	3	2	2.4	0
Euroventures Danube Fund[34]	15	4.5	5	1	.8	2
Baltic SME Fund[35]	13.75	9.1	13	0	0	0
Global Bulgaria & Romania Growth Fund	20	2.3	4	0	0	6
Totals	**60.75**	**17.8**	**25**	**3**	**3.2**	**8**

2.3 TA delivered immediate impacts, but intermediate and wider impacts of the Facility were limited.

50. Immediate impacts focussed on inducing and 'incentivising' changes in business strategies and practices at PFIs with particular reference to the SME segments of their business. The model of Credit Line+Incentive+TA delivered immediate impacts for PFIs in early stages of transition, and this model provided good opportunities for 'learning by doing'. However as the accession process accelerated, changes in competitive environments were the main engines driving capacity building. By 2002/2003 the majority of PFIs surveyed were well on their way to putting in place strategies and resources to address the SME market. Projects without TA may have delivered immediate impacts, but these are difficult to attribute to the Facility. In practice, the principle impact of the Phare grant (Performance Fee) has been to enhance the attractiveness of the IFI credit lines to the PFIs. Risk-based incentives were less frequently used but under the right conditions delivered capacity-building impacts. Intermediate and wider impacts of the Facility have been limited.

51. Immediate impacts are defined as results, i.e. the extent to which assistance has had substantive, sustainable effects on direct beneficiaries of the assistance (i.e. the PFIs). The key issue is what has changed in the way that direct beneficiary institutions and systems function as a result of the assistance.[36] The following paragraphs analyse immediate impacts of the TA on the PFIs for both the *ex post* and 2002-2005 periods by: a) assessing the extent to which the immediate objectives have been achieved; b) assessing the adequacy/suitability of the immediate objective and identifying any unintended immediate impacts, if any. Further notes on achievement of immediate objectives are given in Annex 10.

52. ***Immediate objectives focused on inducing change at PFIs***. While the beneficiaries of the loans and leases are SMEs, the direct beneficiaries of the Phare support under the Facility (performance and risk based incentives and TA) are the PFIs themselves. The immediate objectives are therefore focussed in the main on 'inducing' and 'incentivising' change in business strategies and processes that would not otherwise have taken place with specific reference to the SME segments of PFI business, and thereby creating a sustainable capacity to meet the needs of SMEs in the region and supporting the accession process.

53. There are two aspects of the aim of grant supporting *greater access to finance among participating SMEs* in the region:

[33] Due to the poor performance of the GIMV Fund, the Investment Committee took the decision on 29 October 2004 to liquidate the fund, when the last investment has been sold.
[34] More recently, strong and unanticipated competition from the Hungarian State Investment Fund means that the Euroventures Fund is likely to be unable to utilise its remaining funds within the deadline.
[35] Investment period has ended and only follow-on investments are possible.
[36] DG Enlargement, draft 'Self-Evaluation Practical Guide'.

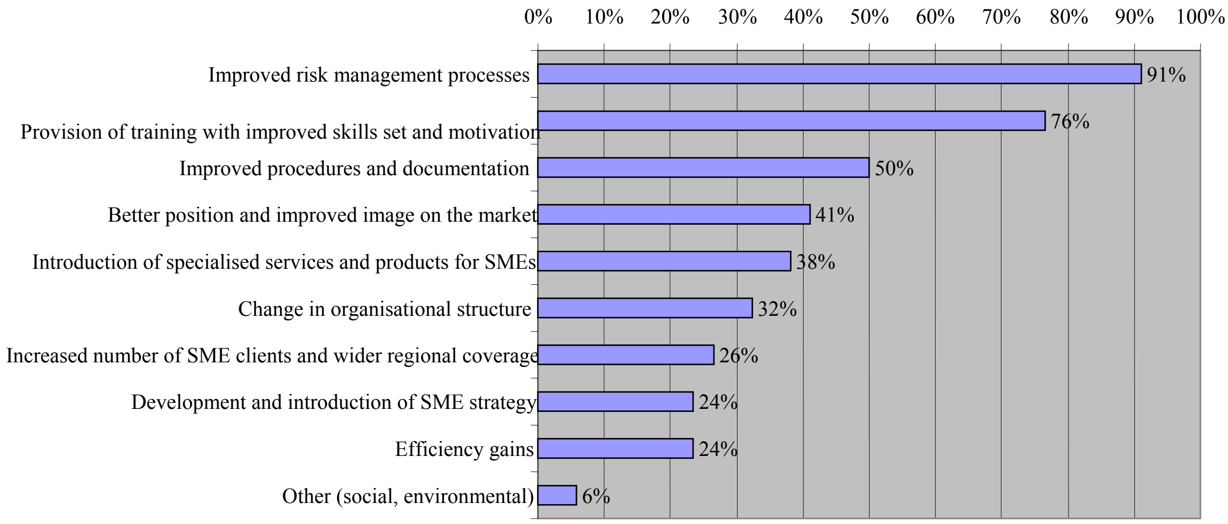
- Enhancing the ability of the Facility credit lines to address liquidity issues in both early stage Facility interventions (1999-2000) and in relation to particular types of PFIs for whom the Facility solves ongoing liquidity problems, as and where market failures occur;
- Providing capacity building through learning by doing (credit line + incentive +/- TA) thus supporting PFIs to address the SME market with appropriate products and services in the longer term that would not otherwise have been present.

54. ***The capacity of the Facility to address liquidity problems in the market is limited.*** Approximately 40% of interviewees noted that the Facility was important in addressing early stage liquidity problems. These interviewees included development/promotional banks that are majority funded by government to fulfil policy objectives, and leasing companies whose inter-group borrowings are limited by capitalisation and group exposure rules, at a time when access to capital markets by leasing companies remains generally limited. So, while the Facility is not a mechanism to pump mass funding into the SME market, it was seen an important source of low, below-market-cost financing for a considerable percentage of PFIs. However, the amounts are *de minimis* and insufficient to bring substantial extra capital into play.

55. ***The credit line + incentive + TA model delivered immediate impacts.*** This limited ability of the Facility to address liquidity issues was recognised in the design of the 1999 Facility. The 1999 PF included an immediate objective of "… *enhancing capacity of PFIs and investment funds to serve the needs of SMEs*". It is here that the essence of the Facility intervention logic is found. The credit line + incentive + TA model delivered immediate impacts that are directly attributable to the Facility, as there is generally a *causal connection* between inputs (TA, training etc.) and results (new strategies in place, streamlined processes, new approaches to credit risk management). In practice, for PFIs in the early stages of transition and indeed at key junctures in their development (e.g. during restructuring), the credit line + incentive + TA model provided good opportunities for 'learning by doing' in an environment where PFIs were hungry for new skills and where there were clear opportunities to influence changes in banking strategy and processes. The EBRD's 2005 Annual Report presents findings on impact based on questionnaires to the PFIs on conclusion of the TA,[37] and these are reproduced in Figure 3.

[37] The EBRD carried out systematic evaluation of TA programmes under the Facility only as of 2004. On completion of TA programmes, PFIs are requested to provide feedback and evaluate the assistance received under the programme. In 2005, 11 TA programmes were completed and in total 34 TA evaluation reports were received from 28 participating banks and 6 participating leasing companies by the end of 2005.

Figure 2.- TA programme – main long-term impacts



56. ***However, as the accession process accelerated, changes in the competitive environment were the main engines of change, rather than the Facility***. From the above (Figure 3), it is tempting to attribute a greater influence to the Facility in promoting sustainable change in PFIs than was the case in reality. Interviews confirmed that the EBRD model of credit line + incentive + TA[38] had the highest potential to deliver immediate impact. The immediate impact of the EBRD TA was highest in PFIs at crucial stages in their development (e.g. during the early stages of their development, or during intensive restructuring) and among PFIs that were hungry to respond to the dynamic changes in the competitive environment. However, as the accession process accelerated, changes in the competitive environment coupled with development of market maturity were the main engines of change, with the Facility serving as one of a number of 'tools' available to PFIs to support their restructuring, expansion and consolidation processes. Other tools included support from parent banks/groups, transfer of knowledge from foreign owned banks, the purchase of TA (consultancy) services from the market, the hiring of experienced SME lending bankers, and access to long-term finance on the markets.

57. ***Projects without TA may have delivered immediate impacts but these are hard to attribute to the Facility.*** Projects that deliver credit line + incentive (performance or risk-based incentives),[39] but that do not have a TA component may have delivered benefits but these are difficult to attribute directly to the Facility and it is likely that they would have been generated without Facility, but over a longer period. Examples of benefits to PFIs (leasing companies) include increases in new business through reduction in down-payment on leases and the use of the Performance Fee to support business development, marketing and training activities. Figure 2 (see also para 39) shows that the Performance Fee is the most heavily utilised form of incentive,[40] but the difficult cause-and-effect question is whether the performance fee stimulated capacity building that would otherwise have not taken place. Interviews provide information on how the Performance Fee has been used/booked by PFIs and their feedback on the main impacts of the Performance Fee on their business (see Table 8).

[38] More recently introduced on a small scale by CEB-KfW.
[39] A 'project' is a financial package with a PFI, which comprises Facility and IFI Fund resources (credit line).
[40] There has been a move to reallocate funding from unused loan guarantees and other instruments etc. to Performance Fees and a tendency for second credit lines to use only Performance Fees.

Table 8.- How has the Performance Fee been booked internally?

	Response	%
How is the Performance Fee booked internally?	Treasury	38.2
	Loan Dept. – profit centre	20.6
	Branches/loan officers	14.7
	Don't know	14.7
	Split allocation (e.g. divided between head office and branches according to a Performance Fee Policy)	8.9
	Other (e.g. special fund to reduce down payment on leases)	2.9

58. In approximately 44% of cases, the Performance Fee was booked to a part of the bank's activity that had a direct link with implementation of the credit line. This in turn focussed attention on the credit line and created a direct incentive for the relevant departments to disburse the funds. In cases where the Performance Fee was booked to treasury, staff involved in the implementation of the credit line were not directly encouraged to market and promote the Facility product/approach actively. In these cases, disbursement of the credit line, together with the introduction of new processes and procedures, was based on the ability of the relevant staff member to promote the Facility within the PFI.

59. ***Principal impact of the Performance Fee has been to increase the attractiveness of the IFI credit lines, but with limited catalytic impact on PFIs***. As the main instrument of Phare support for the Facility, it is legitimate to consider the impact the Performance Fee itself on the PFI. Interview feedback as shown in Table 9 indicates that the main perceived impact of the Performance Fee was on the cost of the IFI credit line to the PFI. In 16% of cases, the price advantage of the credit line, including the Phare grant, was applied in a way to give marginal pricing flexibility when competing for loan business that would ultimately be financed through the Facility and was thereby passed on, at least in part, to the final beneficiary. For a comparatively small segment of interviewees (8 %) the Performance Fee was an important way to focus management attention on the SME segment targeted by the Facility. Given that the majority of banks sampled had already prioritised the SME market, and were progressively targeting smaller loans and clients, this is not surprising. Thus in practice, there were limited catalytic impacts of the Phare grant finance.

Table 9.- Impact of the Performance Fee

	Response	%
What was the main impact of the Performance Fee?	Made credit line more attractive	39
	Other (increased sales/revenue, motivated distribution of credit line)	18
	Improved price of loan to client[41]	16
	Supported training, TA, marketing etc.	10
	Increased focus on micro and high risk loans	8
	Don't know	6
	No impact	3

60. Where the Performance Fee has supported activities such as training or marketing, connected to the marketing and implementation of a new product, in many cases comprising small loans developed specifically under the Facility (smaller than those typical of the mainstream SME funding portfolio and with simplified procedures), then there is a clear link between the use of the Performance Fee and the credit line. However it must be noted that there is no direct evidence that the activities would not have taken place without the Phare

[41] It must be noted that EBRD loan agreements under the Facility specifically require that sub-loans be provided at market rates.

support. It has been argued that the activities would not have taken place as quickly without the Phare support, but this is not necessarily the case due to the need for the PFIs to respond quickly to changes in the competitive environment or lose market share.

61. ***Risk-based incentives and the Equity Window were small components with limited impacts***. Risk-based incentives delivered impacts where the instrument used was new to the participating financial institution, and this was the case in only a limited number of instances. Although Phare support is intended to encourage targeting of more risky segments in the asset class,[42] a considerable number of PFIs interviewed noted that they target the best performing loans, or potentially best new clients to the Facility in order to avail of the Performance Fee. Thus the risk profile of the Facility portfolio consistently outperforms the PFIs' standard portfolio with SMEs.

62. ***The apparent Facility capacity to 'leverage' funds from IFIs was high.*** The 2000-2001 programmes introduced two new immediate objectives (see Annex 10): to *leverage the largest amount of co-financing with the Community grant through co-financing with the IFIs* and *to ensure efficiency by delegating implementation to the IFIs*. With regard to the second immediate objective, implementation (identification and implementation of projects with IFIs) is taking place, but not on a delegated basis (in line with the Commission financial regulations). The division of responsibility for monitoring and ensuring financial control is complex and unclear. The programmes are being implemented as efficiently as possible, given institutional and other constraints,[43] and thus this immediate objective can be assessed as having been largely achieved. However the appropriateness of the objective must be questioned, as ensuring efficiency should be an underlying principle irrespective of the objectives set.

63. The concept of *leverage* is used extensively within the Facility literature: in the FPs which set minimum leverage ratios at programme and project level, and in the semi-annual and annual reports that report on the leverage achieved etc. Leverage ratios reported in the semi-annual reports indicate that the IFIs have contributed funding to the Facility in excess of that planned in the FPs. For example, projects with the EBRD have in some cases achieved a 'leverage' ratio of 8:1 in favour of Phare. EIB has delivered the targeted 10:1 and the CEB-KfW in excess of the planned 5:1.[44]

64. ***The extent to which the Phare grant has leveraged IFI funding varies between the IFIs***. In practice, the Phare grant has been instrumental in mobilising EBRD funds. As EBRD does not compete on price with financing from the private sector, it must deliver clearly defined additionality or 'transition impact'.[45] In the case of the Facility, this is delivered by the TA component which is funded by the Phare grant. Thus the Phare grant is an important element, which leverages the EBRD credit line. However, it is also clear that the EBRD PFIs are incentivised to target the best performing loans (see para 61) which, most likely, would have managed to find funding in any case. Where an EIB Global Loan targeting SMEs is in place, or is already in place without the Phare grant (i.e. where there is earmarking of an existing Global Loan), then there is no leverage effect of the Phare funds. In the case of the CEB-KfW funding, it is unclear whether their credit line would have been made available

42 Definition of what constitutes a risky segment varies between IFIs.

43 The ability of the EIB systems and structures to ensure speedy disbursement while exercising adequate controls over the Phare spend have resulted in less than optimum efficiency (see also Footnote 4).

44 Precise ratios are not reported in CEB-KfW 2005 Annual Report.

45 'Transition impact' refers to the influence of a project on the economy or on society, or to side effects from the project on the "wider economy" (e.g. impact on the environment)."

without the Phare grant. Given the long history of KfW involvement in the region, particularly in the area of SME promotion and support for development and promotional banks, it is likely that funding would have been made available, thus potentially reducing the leverage of the Phare funding. However it should be noted that in a number of instances at individual PFI level, new products were developed (comprising) small loans with simplified credit procedures, using the IFI credit line, the Phare grant and PFI funds.

65. ***By 2002/2003 the majority of PFIs interviewed were well on their way to putting in place strategies and resources to address the SME market***. The 2002 and 2003 programmes share common immediate objectives (see Annex 10) that cumulatively should "*…. continue to induce financial intermediaries to expand and maintain in the long term their financing operations with SMEs"*. The immediate objectives address: 1) confidence-building of financial intermediaries; 2) enhancing capacity to assess and monitor risks and manage financial exposure; 3) to deepen country coverage at a regional level by concluding more projects within each country; 4) sustain and maximise the existing projects under the LGLW by providing additional credit lines to the financial intermediaries concerned. All PFIs surveyed saw their portfolios increase significantly, privatisations were by and large complete and reorganisations had bedded in. Importantly, by 2003 accession was firmly on the horizon. The comparatively small size of the Facility in the context of overall volumes at PFIs and the growing sophistication of the market meant that the ability of the Facility to deliver confidence building was limited.

66. ***But a niche remained for the Facility in the case of 'greenfield' investments and development institutions.*** There are however two exceptions to these trends which are worth noting. Firstly in the case of greenfield investments (generally leasing companies with no parent group or only limited support from the parent group) and secondly in the case of development banks that struggled to find their niche in this complex and fast changing environment. For these two groups, the Facility was both a source of funds and expertise as well as partnering and cooperation with the IFI. In these instances the immediate objective of the Facility remained valid. However, from the interviewing process, very few leasing companies reported capacity-building results from the TA components and, of the non-TA interventions, only a small number resulted in enhanced skills and techniques. For development banks, particularly those cooperating with CEB-KfW, confidence building took place as part of their ongoing working relationship with KfW and was not specific to the Facility. Using the credit line for on-lending also helped the development banks to build working relationships with domestic banks and leasing companies and to gain experience in the development and implementation of financial instruments in support of government policy in the SME sector, including microfinance.

67. ***TA has supported new credit methodologies.*** Credit-related objectives *('capacity to assess and monitor related risks and to manage their financial exposure*') have been addressed through TA and there are some good examples of new methodologies that have been developed under the Facility and that have been taken up into the wider business model. However, the ability of non-TA incentives to have an impact on capacity building in this area has been limited.

68. ***Subsequent projects aim to build on existing systems, but this is insufficient justification for second credit lines.*** The objectives of *deepening country coverage* and *sustaining and maximising the impacts of existing projects under the LGLW* are closely related, in that both emphasise the desirability of building on the systems put in place for the first credit line. Justifications given by IFIs and PFIs for second credit lines included the need to address

'remaining gaps' or particular niches in the market, the desire of the IFI to induce the PFI to continue to 'stretch the envelope' in terms of their definition of a bankable project, and the annual Phare programming process which makes it necessary to divide support to a particular PFI into two or even three consecutive packages. Changes are noticeable in the focus of second credit lines, for example the tendency to replace ERC, IRC, loan guarantees etc. with the more straightforward Performance Fee. Given that the intervention logic of the Facility lies in its capacity building role, rather than as a pure distribution mechanism, the need for second credit lines would only appear to arise when capacity is still lacking. The need to ensure additionality of second credit lines has been raised by the Facility Steering Committee and approval of Phare grants in support of second credit lines is not automatic.

69. With regard to the *deepening regional coverage* element of this immediate objective, the aim of focussing PFI attention on businesses based outside the capital cities and more developed regional coverage is being met. However, from the interviews it is clear that this parallels the development of the PFI branch network, rather than targets particularly disadvantaged areas. The introduction of the Rural Sub-Window (RSW) in 2003, whereby funds were targeted to 'rural' areas, 'rural enterprises' and farmers (according to the relevant national classification) comprises less than 4% of the total Phare support for the Facility and is at an early stage of implementation.[46] Even at maximum utilisation, and with maximum capacity-building at the PFIs, the RSW will have a limited impact on availability of financing for rural SMEs.

70. ***Intermediate and wider impact of Facility was limited.*** The intermediate impact of the Facility (in accordance with the reconstructed intervention logic) relates to the ability of the Facility interventions to provide 'demonstration effects' at a number of levels:

a) The extent to which the interventions have influenced wider bank strategy and processes towards SMEs, and
b) Whether new business models have been developed based on the experience and skills obtained under the Facility.

The good immediate impacts of the TA interventions have been taken up into wider bank strategies towards SMEs in less than half of the cases reviewed. The comparatively small size of the Facility intervention (cumulatively barely the size of a small bank), limits the extent of its impact on the wider environment, in the absence of substantive capacity building. As the Facility funding is relatively modest, it is therefore an essential element of the Facility rationale that demonstration effects should have become evident over time, taken up into wider bank business and transferred between members of the same bank group.

71. For non-TA interventions, intermediate impacts are mostly found in banks with a development agenda, able to draw wider benefits from the relationship with the IFIs. These benefits are largely intangible, for example increased understanding of the role of development and promotional banks in economic and regional development, as well as development of and support for new financial instruments.

72. Where the wider impact of the Facility is to ensure that SMEs in the new member states have access to finance on the terms and conditions converging to those available in the EU-15, then there are indications that such convergence is taking place. Findings from the questionnaire survey indicate that loan tenors in the general SME business of banks are equal

[46] Nine projects with PFIs (7 with provision for TA) with 77 credit lines have been signed, and only 0.02% has been disbursed.

to, or indeed in excess of, tenors provided by the Facility credit lines (4 years plus). While it is tempting to attribute this to the Facility, feedback from the interviews indicates that competitive pressures and the accession dividend are the main drivers of this trend, and that the Facility itself is only one of a number of tools used by PFIs to tailor their products to the needs of SMEs.

73. The following factors should be taken into account when evaluating the wider impact of the Facility on a strengthened financial sector:

- the Facility had a direct focus on SME financing;
- the term funding and TA provided did contribute marginally to strengthening of the finances and institutional capacities of PFIs;
- the Facility was comparatively limited in size, as the funds were disbursed over a wide geographical area;
- the Facility had no direct link to other financial sector support measures in areas such as improved financial sector regulation and inspection.

Considering these factors, the contribution to financial sector strengthening, while positive, must be assessed as marginal overall.

2.4 Long-term sustainability of the Facility assistance is marginal

74. ***The majority of PFIs interviewed had an SME business model/strategy in place, but few of these are directly attributable to the Facility***. Some aspects of the Facility have been carried into the medium-term (e.g. credit management skills, credit scoring methodologies etc.). However, in most cases the fast changing business environment has required further evolution of the SME banking business model. Those banks that received funding and TA could reasonably have benefited from the early support on methods, procedures and systems in their further development of the SME business. However, a clear majority of the PFIs reported that they had evolved their SME business models using own resources (both financial and technical), and that little input was derived directly from their experience within the Facility. The responses to a number of control questions during the structured interviews confirming this effect, as elaborated below, leads to the conclusion that the sustainable contribution from Facility was marginal overall.

75. ***Sustainability of TA results difficult to ascertain.*** Of the PFIs interviewed, only 17% stated that new methodologies and processes developed under the Facility were still in use and deployed in the wider business model. A further 25% reported traces of the TA interventions still being used in the business. But a significant 53% of interviewees reported that strategies and processes developed under the Facility were no longer in use or had not been transferred to the wider business model, due to changes in the competitive environment, new processes introduced by parent bodies or introduced as part of wider banking group strategy.[47]

76. Internal and external factors reduced sustainability of the TA overall. Constraining factors within the control of the IFI included a lack of pro-active management of TA contracts, which at times resulted in poorly performing contracts running on without adequate intervention. Factors external to IFI control that impacted negatively on sustainability of TA

[47] EBRD notes that its questionnaires delivered on completion of TA contracts show that 21% of PFIs consider that the TA was the driving force behind their original SME strategy and instrument in the design of their current SME lending procedures, products and risk policies, 63% of respondents concluded that TA contributed to improvements in their existing SME strategies, produced efficiencies in their procedures and introduced new technologies, i.e. credit scoring, which have been assimilated into their wider business model for SME lending and have been used as a basis for the later development of their SME operations.

included successive large-scale restructurings at PFIs, lack of senior management commitment, or where commitment was not translated into practical support.

77. Where sustainability is judged through development of human resource skills, these too have diminished in the medium term (24-36 months), if not refreshed in line with market requirements. PFI restructuring has also had negative consequences for sustainability of impacts (particularly of training), as mergers have often been succeeded by the implementation of new or revised policies and procedures. Despite these constraints, some enduring impact could still be traced from the interviews, and may reasonably be concluded from the TA provided, as discussed below.

78. ***However, some 'soft' impacts have been sustained***. PFIs have however noted the sustainability of 'soft impacts': for example, attitudinal changes towards SMEs, particularly micro-enterprises and micro-credit; and an improved image of the PFI in the market place, through association with an EU-supported product that is marketed and perceived by potential clients as being of a 'European standard'. Most PFIs interviewed noted the growing importance of micro-enterprises and micro-credits in their portfolios.

3. THEMATIC/ CROSSCUTTING FINDINGS

3.1 Catalytic effects of the grant support to the Facility diminished over time

79. ***Conclusions of the previous IE on ensuring catalytic effect were not taken up adequately by Facility management***. The previous IE concluded that there was scope for the Facility as an instrument to be more responsive to regional (both inter and intra country) differences, differing market segments (including the less attractive market and product segments such as micro-financing and start-ups) and in adapting to meet changing needs to ensure its continued relevance. The report recommended needs' assessments of SME financing including identifying differences in market maturity at country and regional level, and in market/product segments that experience particular difficulty in accessing finance. This was interpreted by the Steering Committee as referring only to Bulgaria, Romania and Turkey,[48] and reports on access to finance by SMEs were duly commissioned from the sponsor IFIs. While reports were submitted and considered by the Steering Committee for the May 2004 meeting, there is no evidence that the Facility was reoriented to focus on market failures in any of these three countries.[49]

80. ***In the Facility context, catalytic effect is determined at PFI level***. Catalytic effect refers to the ability of the Phare support to catalyse a priority accession-driven action which would otherwise not have taken place or which would have taken place at a later date. In the Facility context, defining catalytic actions is left to individual PFIs, who are considered to be best placed to determine appropriate actions in light of market conditions and their own business models, while the IFIs provide the tools and the Phare grant provides the incentive.

81. ***However, changes in the availability of funds to SMEs on reasonable terms has been driven by the market, not the Facility***. Average loan size has decreased, and maturity of loans and percentage of loans to regionally-based SMEs have increased, but there is no evidence that this is significantly attributable to the Facility rather than to the evolution of the competitive environment. At best there were elements of Facility-related TA that have been carried forward, but in most cases the fast changing business environment has required further evolution of the SME lending business model.

82. Many PFIs openly acknowledge the main impact of the Phare grant on their business is to increase the attractiveness of the IFI credit line. However, while this raises concerns about possible distortion effects of Phare grants, including displacement of funds from other sources (particularly private sector sources), minor market distortions may in some instances be justified by the development objectives pursued.

83. Some success in promoting micro-finance was achieved through the EBRD approach of paying higher performance fee rates for micro-loans with average loan sizes within the EBRD Facility portfolio comparatively lower than those for CEB/KfW.

3.2 Additionality in line with the Phare definition has also declined over time.

84. ***Definitions of additionality vary between the Commission Services and the IFIs***. Both the Commission Services and the sponsor IFIs are concerned with how additionality is ensured by the Facility. However, definitions of what constitutes additionality vary between the partners. Analysis of the extent to which the Facility is satisfying the sponsor IFIs' internal

[48] Minutes of the Steering Committee held on 4.07.2003.
[49] In addition, the report on Turkey submitted by KfW was dated 2001 and deemed to be unsuitable as a basis for strategic decision-making and an updated report requested.

tests for additionality is outside the scope of this exercise (although some remarks can be made about the additionality of TA/non-TA interventions), but the consistently high levels of commitment of IFI funds to the Facility (in excess of the minimums agreed in the FPs) indicates that the IFIs rate the facility highly according to their own criteria.

85. ***IFIs can satisfy their internal tests for additionality even in near-developed markets*** (i.e. where the supply of funds to SMEs in the candidate countries and new member states, is at tenors and conditions approaching those of the EU-15 member states) by focussing on addressing remaining gaps in the market or on particularly high-risk segments. However, a similar shift in the Facility philosophy would be in danger of moving the Facility out of the scope of Phare, because whilst there may be remaining gaps in the market to be filled, Phare may not be the most appropriate instrument. This is particularly the case for the new member states, where Structural Fund programmes supporting SMEs (through grants and revolving funds) have been in place since 2004, but focus on providing finance to SMEs through financial intermediaries, and do not have an explicit focus on capacity building in the financial sector. In addition, as banks act opportunistically to service new market niches, the role of the Phare grant in this context must be questioned.

86. ***Additionality in line with the Phare definition has been eroded over time.*** The Phare test for additionality states that "*Phare support should not displace other financiers, especially from the private sector or from the international financial institutions*". As accession became a near certainty, and with the resulting influx of foreign direct investment and expertise into the banking sector, the scope for additionality from the Facility has been substantially eroded.

87. Looking at additionality from the Phare perspective in terms of displacement of other sources of financing, the Facility is only one of a number of sources of funds available to PFIs. Of the PFIs interviewed, at least 85% report that they are able to source funds of a similar type to that provided by the Facility (see Table 10), which raises concerns regarding possible displacement of funds. However, some minor distortion of the market may be tolerable if it is in the interest of a particular policy objective, such as support for segments that are not being well served by the financial system. But this would need to be made an explicit feature of the programme design.

Table 10.- Source of Funds

	Response	%
Are you able to fund similar amounts, currency and tenor from non-Facility sources?	Parent/group	19.00
	Deposit base	5.00
	Not known	15.00
	Markets	49.00
	Reliant on government	7.00
	Other	5.00

88. ***TA is the central element that provides additionality for the EBRD credit line.*** The EBRD definition of additionality states that the EBRD should not compete with other organisations, but rather should complement or supplement existing financing possibilities. Additionality refers both to the pricing of the EBRD loans and to the 'transition impact' it confers on the recipient economy. In order to be judged 'additional' an investment must pass either of two tests:

- Demonstrate that the pricing is no less favourable to the EBRD than it would be to a private financial institution doing the same transaction with the same information; or
- Demonstrate that the financial agreement includes terms and conditions related to transition impact, by influencing the client to take actions important for their

transition impact, which would not necessarily have been agreed to if the investment was financed by a private bank.

89. Taking these tests in turn, firstly within the Facility, the EBRD credit line is not priced to be attractive to the PFIs by itself and it is argued that the TA component, together with the strict eligibility criteria for sub-loans under the credit line ensure additionality. However, once the Performance Fee is factored in, the overall price of the EBRD package becomes more attractive to the PFIs. Secondly, the financial agreement with the PFIs contains terms and conditions governing the payment of the Performance Fee (not conditionalities linked to the implementation of the TA) that require the PFIs to meet certain performance criteria (e.g. size of loan, tenor, compliance with the EU definition of an SME, overall risk of the portfolio). These criteria reflect the direction in which the Facility would like the PFIs to move in their financing of SMEs. However, in light of the step change in the competitive environment coupled with development of market maturity, most banks had already decided to move in these directions, therefore the additionality in these cases is provided by the extent to which the gap between the PFIs intention and its resources (financial and other) is filled by appropriate, well-managed and effectively implemented TA packages.

90. ***The Facility risks displacing support from other sources.*** Where PFIs can source TA from their parent, or elsewhere in their group, there is no justification for Facility TA support. An important finding regarding TA is that its additionality depends primarily on the relationship between the parent/shareholder and the PFI, rather than the form of ownership. So for example, some banking groups set overall group policy and targets, leaving individual members to implement group strategies without recourse to group financing or skills. In these instances, the TA delivered does not displace TA from the parent and was found to be the case in participating leasing companies. However, the majority of parent/subsidiary relationships examined are characterised by strong hands-on involvement of the parent/shareholder in the entire business cycle. In these latter cases, additionality of TA is difficult to ensure. It is clear however, that the majority of PFIs are capable of identifying and funding their training and developmental needs without recourse to the Phare funding, although this is welcomed as a lower-cost option.

3.3 Little linkage or complementarity with other support measures for SMEs

91. ***Dialogue on Facility projects is largely conducted outside the scope of the CC policy arenas***. The Facility is aimed primarily at PFIs and implemented by the sponsor IFIs. Complementarity with sponsor IFI programmes is ensured by the IFIs. However dialogue on Facility projects at country level takes place between the IFIs and the PFIs, and is largely conducted outside the scope of the CC SME policy arenas. While DG Enterprise participates in the Steering Committee, and is consulted on project proposals, this is insufficient to ensure that the Facility *as a whole* is located appropriately within the wider spectrum of SME support, particularly through the Phare programme. The focus of the Facility is on the PFIs and the Facility has an in-built flexibility whereby the PFIs themselves identify SME needs through the market. However, in a number of cases (including in relation to the EW), competition from state-sponsored funds has resulted in delays in getting the credit lines up and running.

92. ***Overlap of credit lines with domestic SME financing schemes.*** All of the new member states, Bulgaria, and Romania run their own financial support schemes for SMEs and the number of such programmes has increased with the implementation of Structural Funds in the post-accession environment. These schemes take the form of both direct loans to SMEs and indirect loan schemes operated via financial intermediaries. These schemes target support to

priority categories of SMEs (defined in line with government SME policy) and are not envisaged as capacity-building exercises aimed at the financial sector. There is an underlying assumption that the financial sector has the capacity to serve as a reliable partner for government in pursuit of state policies. Overlap is in evidence with possible displacement effects between the Facility and the schemes in some of the new member states, in particular Hungary where interest-free loans are offered to certain categories of SMEs.

93. ***Relationships with development banks were under-exploited in the Facility***. The CEB-KfW relationships with development banks are a potentially good way to use the Facility in concert with domestic programmes of financial support to SMEs. However this opportunity has not been exploited for a number of reasons, most importantly the perceived role of the Facility as an instrument for assisting PFIs to build capacity rather than as an instrument of SME policy.

3.4 Multi-country programme delivery has been appropriate but the absence of a tailor-made approach constrained benefits.

94. ***The horizontal delivery of the Facility has been appropriate.*** The delivery of the Facility via a horizontal, multi-partner instrument was an appropriate response to the implementation of this type of intervention. The main benefits include the linkages between the IFIs and the PFIs in the target countries, together with their extensive issue-specific expertise and well-qualified staff, and the potential for learning lessons and dissemination of good practice, not only between countries, but also between the IFIs themselves.

95. ***Economies of scale achieved in implementation of TA achieved by the EBRD.*** Economies of scale have been achieved by the EBRD through the implementation of the TA components via a series of Framework Contracts that can be mobilized individually for country-specific missions. The fact that the TA is contracted centrally by the EBRD has a number of aspects. Firstly, there is the need to ensure a good ‘fit’ between PFI needs and the consultant and to ensure that the PFI feels ownership of the process and therefore of the ensuing TA contract. Secondly the TA retained by the EBRD is perceived of as having an EBRD ‘seal of approval’ which creates confidence on the part of the PFI.

96. ***Benefits would have been greater with a more differentiated approach.*** The Facility focus on achieving ‘balanced regional coverage’, both in terms of country and regional distribution, has taken insufficient account of differences in country and market maturity. At the programme level this ‘one size fits all’ approach across a range of markets at different stages of development does not address the need to tailor the Facility to prevailing market conditions. While the Facility approach as it currently operates promotes a ‘tailor made’ approach at the ‘micro’ level, i.e. at the level of individual PFIs, this reflects corporate strategy and analysis of business opportunities rather than overall programme objectives.

4. CONCLUSIONS AND RECOMMENDATIONS

4.1 Conclusions

Conclusion 1: Market developments were not matched by timely changes in the Facility, and the intervention logic of grant support to the Facility became less valid over time

97. Over time the original intervention logic underlying the Facility became less about addressing market failures in the broader sense, and more about filling remaining gaps in developing markets, that were quickly approaching those of the 'old' member states with regard to the availability of SME financing at similar tenors and conditions. This represented a significant shift in positioning and ethos of the Facility that was not matched by appropriate changes in objectives or methodologies. Instead, changes in objectives paved the way for cooperation with additional sponsors to ensure 'balanced' regional coverage. This approach does not allow for a policy-driven approach to market segments or regions. The introduction of the Rural Sub-Window was a welcome innovation, but at such a limited scale that it cannot be said to represent a substantive shift in Facility thinking.

98. Furthermore, it is questionable whether Phare, as a pre-accession instrument, should have continued its high level of support to the Facility in these new market conditions. Funding for the Facility, while certainly popular with stakeholders as they expanded opportunistically in the new environment, also comes at a cost to the Phare programme overall in terms of opportunities lost for funding other sectors/initiatives that suffer from financial constraints, such as environmental remediation, phyto-sanitary controls at borders, civil society development, etc., all of which are high on the accession agenda. For continued Phare funding at these high levels, the case for the Facility, based on analysis of clearly identifiable and agreed objectives and impacts, should have been made. The previous IE Report offered the opportunity to do so, and this opportunity was largely lost.

Conclusion 2: Catalytic effects of grant support diminished over time

99. Catalytic effect refers to the ability of the Phare support to catalyse a priority accession-driven action which would otherwise not have taken place or which would have taken place at a later date. The previous IE concluded that there was scope for the Facility as an instrument to be more responsive to regional differences, differing market segments and in adapting to meet changing needs to ensure its continued relevance. However there is little evidence that the Facility was reoriented to focus on clearly identified market failures in relation to particular regions, countries or segments. Changes in the availability of funds to PFIs and generally to SMEs has been driven by the market, not the Facility – average loan size has decreased, and maturity of loans and percentage of loans to regionally-based SMEs have increased, but there is no evidence that this is significantly attributable to the Facility rather than to the evolution of the competitive environment. Where changes were made, for example an increased focus on micro-credits, this was largely at the initiative of the IFIs, rather than part of a strategic re-orientation of the programme.

100. Catalytic impacts of the TA-based projects were highest in the early stages, and in some cases elements of Facility -related TA have been carried forward. In most cases, however, the fast changing business environment has required further evolution of the SME lending business model. Many PFIs openly acknowledge the main impact of the Phare grant on their business is to increase the attractiveness of the IFI credit line. However, while this raises concerns about possible distortionary effects of Phare grants, including displacement of funds from other

sources (particularly private sector sources), minor market distortions may in some instances be justified by the development objectives pursued.

Conclusion 3: More attention is needed to ensuring that the Facility delivers additionality within the Phare context

101. While the IFIs can satisfy their internal definitions of additionality in developed markets (i.e. where the supply of funds to SMEs in the candidate countries and new member states, is at tenors and conditions approaching those of the EU-15 member states), the case for additionality according to the Phare definition has eroded over time. The step changes in the business environment created new challenges for the Facility to maintain relevance and additionality. However, with accession firmly in sight, increased availability of alternative funding, growing interest by other financial institutions in the SME segment, and the ability to buy in or transfer skills and methodologies either from the parent bank or from other sources, eroded the additionality of the Facility funds. This is not to say that there were no instances where the Facility could continue to deliver additionality, but how this was defined and ensured at individual project level (and particularly in the case of second credit lines with the same PFI) was not consistently and clearly addressed.

Conclusion 4: Cost-effectiveness of the Phare support declined over time.

102. On the Commission Services side, only comparatively limited resources needed to be deployed, and the participating IFIs have delivered considerable outputs in terms of numbers of loans and leases made, staff trained and technical assistance contracts completed. This came at an ostensibly modest cost to the Commission (the 1.2% to 1.25% management fee to the IFIs). However, analysis of cost-effectiveness must also include: a) the Performance Fees that support disbursement of credit lines, and b) the extent to which the Facility is fulfilling the Commission's policy objectives. In relation to the Performance Fees, these are the main part of the Commission input to the Facility and represent a significant amount. When seen in the light of the limited achievement of attributable capacity building, cost-effectiveness of the Phare support is low, and as currently structured, the Facility is weighted in favour of disbursement of sponsor IFI credit lines.

Conclusion 5: The TA model stimulated capacity building under certain conditions, particularly in the early stages.

103. The credit line + incentive + technical assistance model has the most potential to deliver (and has delivered) capacity building at PFI level. The evaluation found that in practice, where immediate impacts were high, these were attributable to the TA-driven model. The TA stimulated organisational changes and raised the levels of competence of the PFIs, both in the early stages of the transition period, and in their development, when the potential for failure was at its highest. For the TA to respect the principles of additionality and deliver impacts, certain conditions need to be met, including lack of access to technical know-how, a good fit between the needs of the PFI and the assistance delivered, commitment of PFI senior management and active management by the sponsor IFI, based on output and impact indicators. However, the TA did not have the anticipated significant sustainable impacts at the level of the PFIs, due partly to developments in the competitive market environment, including takeover by foreign banks, which resulted in changes to business models and practices. Moreover, technical assistance did not provide for value added in banks that benefited from being owned by foreign banks and additional technical know-how.

Conclusion 6: The case needs to be clearly made for non-TA based interventions

104. For non-TA based projects (i.e. comprising incentive only), it is difficult to identify and attribute changes in bank behaviour to the intervention. Supporting non-TA based interventions needs careful agreement on what capacity building will be supported, how this will be measured and how this will be sustained in the longer term.

Conclusion 7: The limited amount of total funding restricted wider impact

105. Individual projects with participating financial institutions were not designed to have demonstration effect and there is little evidence of widespread take-up of Facility models. The volume of funding involved was insufficient to make an appreciable contribution to the volume of finance available (barely the amount of a small bank). It must also be noted that the Facility was never intended to be a significant presence in the markets, thus the potential for wider impact lies principally its ability to deliver demonstration effect (both within and between PFIs). However, whilst the increasing competitive pressures in the market forced banks to respond quickly, the Facility moved too slowly to be effective.

Conclusion 8: Sustainable change is difficult to attribute to the Facility

106. The tools used by the Facility, with the exception of TA combined with risk-based incentives, have proved to be insufficient to induce sustainable changes. Where changes have taken place in the absence of TA, it is difficult to establish a causal connection between the Phare grant plus the credit line, and the changes. Feedback from the interviews and surveys indicate that the technical assistance did improve capacity in the participating financial institutions, particularly in the early stages.

4.2 Recommendations

107. There are two key areas in which the recommendations are made for action: redesign of the Facility and need for proactive strategic management.

Action 1: Redesigning the Facility

Recommendation 1: Before launching a new facility, thorough re-assessment and redesign of grant support is required.

108. There is a need for a full review of the future role and operations of a new SME Finance Facility, and its introduction under the Instrument for Pre-accession Assistance (IPA) should be preceded by a thorough re-assessment and consequent redesign. The future facility must have a clear intervention logic, establishing the case for any grant support to the new instrument.

Recommendation 2: The thorough re-assessment and redesign of the Facility should be based on detailed analysis of differences in the maturity of economies and markets.

109. The redesigned instrument would need to be examined critically and reconstructed at every level, starting with an examination of the areas of market failure or a differentiation in the level of market maturity or market underdevelopment that can reasonably be addressed. Any methods and tools proposed should take account of the differing regional and country

conditions and market segments. Specific objectives relating to micro-credit institutions or development/promotional banks should be clearly identified.

Recommendation 3: Redesign should respect the principles of catalytic impact and additionality

110. The principles of catalytic impact and additionality should be set up as positive criteria by the Commission Services that must be met by the individual arrangements with the IFIs, and clearly reflected in individual project proposals with PFIs.

Action 2: Need for proactive strategic management

Recommendation 4: The Commission Services should be proactively at the heart of strategic decision-making on the development of the Facility

111. As the entire Facility instrument is largely driven by absorption of the Phare grant, the Commission Services (DG Enlargement, DG ECFIN, DG Enterprise and other Commission stakeholders) should be at the heart of strategic decision-making on the development and implementation of Facility. This would involve clarity about the policy objectives at regional or segment level that the Commission is pursuing and the role of the Facility in achieving these objectives. This should be set out in a series of working papers outlining the Commission's expectations of the Facility, guidelines for ensuring additionality and catalytic effect and a set of core monitoring indicators linked to specific policy objectives.

Recommendation 5: The management of strategic operations of the Facility should have the appropriate tools and resources to tailor the Facility's response to changing conditions

112. It should be the responsibility of the Facility strategic management to equip itself with the tools and methodologies to identify in which countries and market segments the Facility intervention is warranted (to be informed by and consistent with the intervention logic as described above). Decisions about programmes should be placed firmly within the context of the competitive environment at the time a programme decision is taken. Fulfilment of the Commission Services' requirements for catalytic impact and additionality should also be ensured. Changes should trigger a process of review and refinement, for example to accelerate or stop implementation mid-programme if necessary. This would be particularly applicable where the original intervention logic is no longer relevant or where a Commission Services definition of additionality can no longer be met. Achievement of the policy objectives should be made central to strategic management by linking instrument design, management structures, performance measures and reporting tools to the underlying intervention logic.

ANNEXES

Annex 1. Terms of Reference

[*These terms of reference were approved 28 November 2005, and have not been updated to take account of small changes, for example, in the time line and definitions of impacts, that have occurred in the meantime.*]

OBJECTIVES

The purpose of this evaluation is to assess the contribution of the Small and Medium-Sized Enterprise Finance Facility (the Facility) in inducing financial intermediaries to expand and maintain, in the long term, their financing operations with Small and Medium-Sized Enterprises (SMEs).

The evaluation of the Facility MBP (Multi Beneficiary Programme) is one of a series of MBP evaluations in different areas. It will become a stand alone report but will also feed into a consolidated evaluation of Phare multi-beneficiary programmes. The evaluation of the Facility will also feed into the section in the thematic evaluation of the SME sector that deals with issues of finance. Both of these will in turn form part of a consolidated *ex post* evaluation of the Phare programme.

BACKGROUND AND CONTEXT

The specific objectives of the Facility have aimed at inducing financial intermediaries to expand and maintain their long term financing operations with SMEs. These objectives have, since the start of the facility in 1999, evolved over time and in the year 2003 comprise of:

- Building further the confidence of financial intermediaries to engage in financial operations with SMEs;
- Enhancing further the capacity of financial intermediaries to assess and monitor the related risks and to manage their financial exposure;
- Deepening country coverage at a regional level by concluding more projects within each country; and,
- Sustaining and maximising the impact of existing Projects under Loan, Guarantee and Leasing Window by providing credit lines to the financial intermediaries concerned.

During the *ex post* evaluation period (1996 – 2001), the Facility assistance was provided by six MBPs,[50] with a total value of M€ 191. During the period of interim evaluation 2002 and 2004, a further M€ 100 was provided to the Facility under another six MBPs.[51] The ongoing post-2001 programmes will also be evaluated. The value of the *ex post* evaluation will be extended in this way by checking to what extent lessons learned up to 2001 have been incorporated in the subsequent programmes. Moreover, the interim evaluation will ensure that the evaluation results are more up to date as inputs for decision making.

Support to SMEs was also provided under Phare national programmes, as well as by other donors, such as World Bank, UNDP etc. The Facility is primarily designed to support financial institutions.

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[50] Projects 1999/001-979, 2000/002-046, 2000/002-052, 2001/002-077, 2001/002-079, and 2001/002-095.

[51] Projects 2002/000-621, 2002/000-622, 2002/000-629, 2003/005-745, 2003/005-765, and 2003/005-766.

The EMS Interim Evaluation (IE) Report on the Facility, finalised in February 2003[52], concluded that while the Facility was a good concept, with a high potential for success, it required fine-tuning across a range of areas to respect Phare Guidelines related to catalytic effect, additionality and sustainability. Key issues identified in the IE Report included:

- *Ensuring catalytic impact by identifying and addressing market failures*

  The IE concluded that there was scope for the Facility as an instrument to be more responsive to regional (both inter and intra country) differences, differing market segments (including the less attractive market and product segments such as micro-financing and start-ups) and in adapting to meet changing needs to ensure its continued relevance. The report recommended a needs' assessment of SME financing including identifying differences in market maturity, at country and regional level and in market/product segments that experience particular difficulty in accessing finance.

- *Ensuring additionality*

  In most cases the Participating Banks (PBs) are already present in the SME market and will remain active. Moreover, in several cases the PBs have major active foreign shareholders. Much more attention should therefore be paid to the selection of Banks and of projects to ensure that already strong and experienced PBs are not displacing other financial intermediaries such as smaller, regional locally owned banks.

- *Ensure sustainability by focussing on capacity building at Financial Institutions*

  A core anticipated impact of the Facility is the development of a successful business model for addressing the SME market, underpinned at a strategic level within the PBs. The IE report highlighted the weakness of the institution building components of the Facility and this will be an important focus for this *ex post* evaluation, particularly for remaining funds under the Facility in both the new member states and the remaining Candidate Countries (CCs).

  Capacity building at financial institutions through the delivery of technical assistance is an important part of the Facility. However, the IE report concluded that the technical assistance had not delivered the expected value for money for different reasons: the commitment of the management of the PB, the 'fit' between the consultants and the needs of the PB, and the management by the International Finance Institutions (IFIs). This has had an adverse impact on sustainability.

- *Clarify the role of, and approach to, the Equity Window*

  In the EU-15 member states, equity funds open to smaller businesses are considered a useful instrument to support SME development. In the new member states and remaining CCs however, the availability of such funding is relatively low. The IE report found that the implementation of the Equity Window (EW) component of the Facility to be proceeding at a slow pace[53]. The demonstration effect is largely dependant on the funds achieving profit in the longer term, which will in turn motivate other providers of SME equity finance to enter the market. Delays in implementation will therefore have an adverse effect on potential impact. Furthermore, even operating at its optimum, the number

52 R/ZZ/SME/02.146 issued on 18 February 2003.

53 The slow rate of take up of the equity window might be explained by the restrictive criteria used for the selection of fund managers, as well as for the selection of the investment projects by the different investment funds. The same evaluation can be made of the EW as regards the use of resources and the cost of management. In terms of results, three investment funds and five investments in SMEs for a total of M€ 4.7 invested since May 2000, does not appear to be efficient.

of SMEs that could benefit from the EW Fund, would be a maximum of around 100 investments, thus confirming its effect as a demonstration, rather than a deep impact.

- *Operational issues*

  Operational issues identified included : a) the need to ensure a uniform quality of reporting from the participating IFIs to the Commission Services and; b) more transparent management of the PB pipelines, including the availability of information on terms and conditions offered by all participating IFIs to the PBs and leasing affiliates.

EVALUATION QUESTIONS

The evaluation questions and related judgement criteria for this exercise will be derived from:
- Performance evaluation questions
- Thematic/cross-cutting questions

Performance evaluation questions

Needs assessment and design

The evaluation will start with an assessment of whether the relevance and design of the Facility was coherent with the principles of catalytic impact, additionality and sustainability. In particular, attention will be paid to whether the analysis of the demand for SME finance, took sufficiently into account known and/or potential needs, e.g. level of development of the local market, market failures, need for institution building, type of capital required (equity versus debt), presence of foreign-owned banks, and access to venture capital.

The extent to which inputs/activities have produced outputs/results

The outputs envisaged by the Facility are: i) expanded capacities of the PBs and leasing affiliates to serve the needs of SMEs and, iii) a demonstration effect to other potential financial intermediaries that operating with SMEs is viable; ii) greater access to finance among participating SMEs in the region.

The evaluation will assess the cost effectiveness of the activities. The evaluation will review whether the technical assistance provided to the PBs and leasing affiliates was appropriate.

The extent to which the results/impacts contributed to achieving wider objectives

The specific objectives have been aimed at inducing financial intermediaries to expand and maintain in the long term their financing operations with SMEs. The evaluation will assess the extent to which the specific objectives of building further the confidence of financial intermediaries to engage in financial operations with SMEs, enhancing further the capacity of financial intermediaries to assess and monitor the related risks and to manage their financial exposure, deepening country coverage at a regional level by concluding more projects within each country and sustaining and maximising the impact of existing Projects under Loan, Guarantee and Leasing Window by providing credit lines to the financial intermediaries concerned have been achieved.

Long-term viability following the withdrawal of Phare support

Long-term sustainability will be investigated at a number of levels. Linked to the overall objective, the focus will be on whether a successful business model has been developed in the PBs/leasing affiliates, directly or indirectly attributable to their participation in the Facility. This will include for example, whether PBs/leasing affiliates have adopted new strategies, policies, procedures and attitudes to undertaking, marketing actions, managing and pricing SME credit risk.

Thematic/cross-cutting questions

The extent to which Phare support improved the performance of CC beneficiaries

The purpose of this question is to assess whether Phare support through the Facility in practice addressed the *ex post* needs of the beneficiaries. Thus the evaluation would seek to assess whether the original objectives (*ex ante* needs) of the programme have evolved appropriately. This assessment would augment the analysis based on the five performance evaluation criteria.

Complementarity of the Facility to other SME financial support measures

The purpose of this question is to locate the role of the Facility within the context of other financial support measures to stimulate development of the SME sector such as SME support under economic and social cohesion.

Effectiveness and efficiency of the MBPs as a delivery mechanism

There are inherent strengths and weaknesses with centralised MBPs. Positive factors include economies of scale in design and implementation, scope for more effective cross-fertilisation, and the ability to utilise the expertise of the specialist bodies to which management is delegated. Negative factors include difficulties in effective monitoring by the Commission and the risks associated with a "one size fits all" approach. With particular reference to the Facility, the *ex post* evaluation will consider the extent to which the multi-beneficiary approach has delivered the required results.

METHODOLOGY

To reflect the high level of interest and strategic value of the Facility MBP, this evaluation will be in-depth, and will include not only a strong basis of retrospective assessment (the *ex post* evaluation of the 1996 – 2001 programmes) but also an interim evaluation of post-2001 allocations.

Following an initial collection of available documents, the evaluation will start with a desk review. This will be followed by further data gathering using the most appropriate tools (interviews or focus groups in Brussels and/or the CCs, and/or questionnaires)[54]. The evaluation will use a sample of participating banks/SMEs selected based on:

- The distribution of funds between the sponsoring organisations (EBRD, EIB, CEB/KfW);
- The distribution of funds between participating banks;
- The geographical focus – including representative samples of countries focussing on four new member states [Poland, Hungary, Slovakia and Estonia], plus Bulgaria and Romania.

[54] Interviews and questionnaires may be carried out by telephone, if appropriate.

To support the evaluation questions a set of judgement criteria and evaluation indicators will be developed. These may be both quantitative and/or qualitative. A preliminary set of indicators will be discussed during the kick-off process with the aim of ensuring that requests for information relating to the indicators are understood in context. The preparation of a set of indicators will take into account the indicators of achievement related to the Institution Building component that has recently been introduced by the sponsors.

Representatives of stakeholders and target audiences will be invited to participate during the kick-off process which may involve a meeting and/or electronic consultation meeting. This process is crucial for ensuring a common understanding of the evaluation questions and related indicators, and for allowing maximum participation. Stakeholders will also be invited to join a virtual steering group.

REPORTING AND TARGET AUDIENCES

The main users of the evaluation will be DG ELARG Directorate responsible for the Facility, DG ECFIN, and DG Enterprise, EC Delegations/Representations, and the National Aid Co-ordinators of beneficiary countries. In addition, country teams for the Western Balkans and Turkey will be important users of the evaluation results.

ACTIVITIES, RESOURCES AND TIMETABLE

The Facility MBP evaluation will be conducted in a number of stages as follows:

Step	Activity	2005				2006	
		Sept	Oct	Nov	Dec	Jan	Feb
1	Preparation						
2	Info gathering and processing						
3	Drafting of report for E4						
4	Comments from E4						
5	Drafting of final SMEFF MBP report and submission to Consolidated MBP Report						

The evaluation will be carried out by a team consisting of the deputy project director, a key expert, other senior and junior experts, and short-term technical specialists (SSTS), both international and local. Since the Facility exercise is an in-depth evaluation, the total resource envelope available for this exercise amounts to 90 man-days.

Annex 2. Evaluation Plan

This document defines the scope of the evaluation, the approach to fieldwork, the construction of the evaluation sample and the questionnaire to be administered to the participating banks/leasing companies etc. It is supported by working documents giving primary sources of evidence and evaluation criteria for each evaluation question.

Phase (1, 2 or 3)	1 – Multi-Beneficiary Programme (1999-2001)[55]	**Subject**	**Small and Medium-Sized Enterprise Finance Facility (the Facility)**
Level of Evaluation ('standard' or 'in depth')		In-depth	
Evaluation Conclusions	A three-point rating system (satisfactory, barely satisfactory and unsatisfactory) will be used to rate effectiveness and impact of the instrument. No rating will be applied to the thematic/cross-cutting questions.		
Evaluation questions	<u>Performance criteria</u> 1. Needs assessment and design 2. Extent to which inputs/activities have produced outputs 3. Extent to which results/impacts contributed to achieving wider objectives 4. Long term viability of institutional reforms following the withdrawal of Phare support <u>Thematic/Cross-cutting questions</u> 5. Extent to which Phare support improved the performance of the CC beneficiaries 6. Complementarity of the Facility to other SME financial support measures 7. Effectiveness and efficiency of the MBP as a delivery mechanism		
Sampling	A sample of participating banks/leasing companies etc. will be selected in consultation with the Steering Group[56]. This sample will aim to: a) follow-up the participating banks surveyed in the 2002 Interim Evaluation Report (R/ZZ/SME/02.146); b) be representative of the distribution of funds between the international financial institutions (IFIs); c) be representative of the new Member States and Bulgaria and Romania and; d) include participating banks/leasing companies address the rural farm business sub-objective. Overall, the sample should represent **over 33%** of total funding, depending on the number of participating banks etc. Note that where the sample size is small, this will reduce the confidence in the data and conclusions that can be drawn therefrom.		
Sources of evidence	The potential sources of evidence are desk review of implementation documents and monitoring reports (as compiled by D2), a questionnaire to participating banks/leasing companies etc., analysis (e.g. of available databases), and interviews. In the sources of evidence document (see attached), a score is used to indicate for each evaluation question and each source whether it is dominant i.e. a major dependency on information from one source, or whether several sources support each other, giving good triangulation, or whether difficulty is expected in accessing data or the question is predominantly qualitative.		
Interviews **1 Commission staff**	Present and former task managers from ELARG D2, and any former/current staff from the EC Delegations in the period 1998-2004 that can be located.		
2 NMS and CCs	Participating banks; representatives of IFIs as available; SME agencies etc.		
3 IFIs	The three IFIs will be formally interviewed.		
3 Other stakeholders	A selection of participating banks to be decided with the Steering Committee		
Supporting documents	Table 1. (Working document) - Primary Sources of Evidence Table 2. (Working document) - Evaluation Indicators Questionnaire for participating banks/leasing companies etc.		

55 The evaluation will also take account of post-2001 allocations where appropriate, based mainly on IE reports.

56 This includes the Evaluation Unit of DG ELARG, D2, D3 (Horizontal Programmes Unit) and the three IFIs (EBRD, EIB, CEB/KfW).

Primary Sources of Evidence

The potential sources of evidence to answer the evaluation questions are desk review, questionnaire, analysis (e.g. of a database), and interviews. For each evaluation question, a three-point weighting score is used to indicate for each source whether it is **dominant** (●●●) i.e. a major dependency on information from one source, **not dominant** (●●) where several sources are expected to support each other (i.e. provide good triangulation), or **minor** (●) where difficulty is expected in accessing data or the question is predominantly qualitative. This is a planning tool and will be updated in the course of the fieldwork where new information sources become known, or a significant change in approach is required.

Performance Evaluation Criteria

Evaluation Criteria	Desk Review	Survey[57]	Analysis	Interviews	
				Brussels/ IFIs	NMS/CCs
1. Needs assessment and design					
1.1 Adequacy/suitability of the Facility design in the light of known market/sectoral needs	●●		●●	●●	●●
1.2 Link between the Facility and other Phare/donor instruments	●●		●●	●●	●●
1.3 The extent to which the design of the Facility ensures catalytic impact	●●	●●	●●	●●	
1.4 The extent to which the design of the Facility ensures additionality	●●	●●	●●	●●	
1.5 The extent to which the design of the Facility ensures sustainability	●●	●●	●●	●●	
2. Extent to which inputs/activities have produced outputs/results					
2.1 What were the tools/activities/resources[58] used to produce the outputs[59]?	●●		●●	●	●
2.2 Were there resources/tools provided that were under-used or not used?			●●		●●
2.3 What co-financing and leveraging resulted?	●●		●●	●●	
2.4 How cost effective was the production of outputs?	●●		●●	●●	
2.5 What factors influenced the delivery of outputs (e.g. internal management by IFIs, managed pipeline approach etc.)	●●		●●	●●	
2.6 Have there been any unanticipated results?	●	●●		●●	●●

57 The Survey will take the form of a questionnaire to 21 Participating Banks (as previously surveyed), plus an additional set, to be defined jointly with the Steering Group.
58 Equity Window, Loan Guarantee and Leasing Window and TA.
59 The SMEFF had three outputs: a) greater access to finance for SMEs; b) expanded capacity at the PBs to serve the needs of SMEs and; c) a demonstration effect.

3. Extent to which results/impacts contributed to achieving wider objectives					
3.1 To what extent is there evidence that the Facility induced financial intermediaries to maintain and/or expand their financial operations with SMEs and/or to develop their product offering?	●	●●●	●	●	●
3.2 To what extent did capacity building take place at the financial intermediaries?	●	●●●	●	●	●
3.3 To what extent did the Facility demonstrate additionality?	●	●●●	●	●	●
4. Long term viability of institutional reforms following the withdrawal of Phare support					
4.1 To what extent has a new business model been adopted by the PBs?	●	●●●	●	●	●
4.2 To what extent are there lasting results in terms of capacity building that has taken place and continued to evolve in response to market challenges?	●	●●●	●	●	●

Thematic/Cross-Cutting Criteria

Evaluation Criteria	**Desk Review**	**Survey**	**Analysis**	**Interview**	
				Brussels	**NMS/CC**
5. Extent to which Phare has supported the performance of the NMS/CC beneficiaries					
5.1 Did the Facility address *ex post* needs?[60]	●	●	●●●	●	●
6. Complementarity of the Facility with other instruments					
6.1 What was the ratio of the Facility funding compared with funding to SMEs via other instruments (e.g. Phare ESC)?	●		●●●	●	●
6.2 To what extent was the Facility complementary to other Phare initiatives, particularly those supporting development/capacity building in the banking sector?	●		●●●	●	●
6.3 To what extent did the Facility coordinate/cooperate with other programmes/instruments?	●		●●●	●	
7. Effectiveness and efficiency of the Facility MBP as a delivery mechanism					
7.1 How effective was the MBP approach to delivery of outputs?		●	●●●	●	●
7.2 How appropriate (efficient) was the division of tasks between the various actors?		●	●●	●●	●●
7.3 To what extent were good practices in the Facility outputs delivery shared across the NMS/CCs?			●●	●●	●●

[60] This will be derived from the analysis of the first four questions/issues.

Evaluation Indicators

The **evaluation indicators** are a wider concept than "performance indicators", and identify static and dynamic information and events for use in the evaluation. They are divided into three categories, **discrete**, where there are only two possible states (e.g. present/absent), **relative,** where more than two states are possible (e.g. satisfactory, barely satisfactory and unsatisfactory), and **qualitative,** where the expert judgment of the evaluator will be used to reach a conclusion based on all the evidence gathered for the evaluation criteria. This is typically in the areas of outcome and impact evaluation conclusions.

Evaluation Questions	**Evaluation Indicators**	**Assessment**		
		Discrete	**Relative**	**Qualitative**
1. Needs assessment and design				
1.1. Adequacy/suitability of the Facility design in the light of known needs	• Availability of financial sector analysis	•		
	• Integration with financial sector analysis			•
	• Availability of bank needs' analysis	•		
	• Integration with bank needs' analysis			•
	• Availability of SME needs' analysis	•		
	• Integration with SME needs' analysis			•
	• Availability of regional market needs' analysis	•		
	• Integration with regional market needs' analysis			•
1.2. Link between the Facility and other Phare/donor instruments	• Existence of other Phare activity in the SME/banking sector	•		
	• Existence of other donor activity in the SME/banking sector	•		
	• Identified niche for the Facility			•
	• Quality of dialogue between the Facility programming and other Phare/donor initiatives		•	
1.3. antification of need for SME finance across market segment/re • Quantification of need for SME finance across market segment/region • Quantification of availability of financing from the private sector and other IFIs • Identification of types of finance required/available	• •		•	
1.4. Extent to which the Facility design ensured additionality	• Follow up to recommendations in R/ZZ/SME/02.146 (see attached)	•		
	• Criteria for selection of PBs/PLCs and other institutions			•
1.5. Extent to which the Facility design ensured sustainability	• Follow up to recommendations in R/ZZ/SME/02.146 (see attached)	•		
	• Criteria for selection of PBs/PLCs and other institutions			•
2. Extent to which inputs/activities have produced outputs				
2.1 What were the tools/activities/resources[61] used to produce the outputs[62]?	• Quantitative description of tools /activities/resources			•
	• Qualitative description of tools /activities/resources			•

[61] Equity Window, Loan Guarantee and Leasing Window and TA.

Evaluation Questions	Evaluation Indicators	Assessment		
2.2 What results/outputs were produced?	• Quantification of finance provided by PBs/PLCs • No of SMEs supported • No of SMEs supported including by market segment • Take up of model by other financial intermediaries	● ● ● ●		
2.2 Were there resources/tools provided that were under-used or not used?	• Allocation and disbursement rates by the IFIs to the PB s (including performance fees, TAs and other) • Disbursement rates by PBs and equity funds	● ●		
2.3 What co-financing and leveraging resulted?	• From IFI • From PB			● ●
2.4 How cost effective was the production of outputs?	• Cost per bank • Cost per employee trained • Cost per SME directly supported • Administration costs recovered from the Facility	● ● ● ●		
2.5 What factors influenced the delivery of outputs (e.g. internal management by IFIs, managed pipeline approach etc.)	• Qualitative analysis			●
2.6 Have there been any unanticipated results?	• PB records/questionnaire			●
3. Extent to which results/impacts contributed to achieving wider objectives[63]				
3.1 To what extent is there evidence that the Facility induced financial intermediaries to maintain and/or expand their financial operations with SMEs and/or to develop their product offering?	• Growth or decline in SME market share of PB • Growth or decline in farm business share of PB • Product development by PB • Investment return of investment funds supported by the Facility • SME share in PB balance sheet assets • Farm business share in PB balance sheet assets	● ● ● ● ●		●
3.2 To what extent did capacity building take place at the financial intermediaries (PBs)?	• Identification of strategic development of products and services targeting SMEs within PBs • Identification of strategic development of products and services targeting farm business within PBs • Identification of new permanent resources established within PBs and equity funds • SME credit/leasing application processing time reduced • Product and risk assessment adapted to rural business clients; • Services, terms and conditions of loans to farm business improved • Change in number of small loans or leases to SMEs • Amount of staff at PB/PLC familiar with concept • Results of TA components	● ● ●		● ● ● ● ● ●
3.3 To what extent did the Facility demonstrate additionality?	• Distribution of the Facility funding by form of PB/PLC ownership • Distribution of funding by market segment	● ●		

62 The 1999 and 2000 Facility had three outputs: a) greater access to finance for SMEs; b) expanded capacity at the PBs to serve the needs of SMEs and; c) a demonstration effect. The 2003 programme with the EBRD included a Rural Sub-Window.

63 As identified in Financing Memoranda.

Evaluation Questions	Evaluation Indicators	Assessment		
4. Long term viability of institutional reforms following the withdrawal of Phare support				
4.1 To what extent has a new business model been adopted by the PBs?	• Improved business processes (e.g. speed of decision and cost per applicant); • Loan loss patterns		● ●	
4.2 To what extent are there lasting results in terms of capacity building that have taken place and continued to evolve in response to market challenges?.	• Future intention of PB and investment fund to participate in the sector • Link between future intentions of PB and use of TA/TC			● ●
5. Long term viability of institutional reforms following the withdrawal of Phare support				
5.1 Did the Facility address *ex post* needs?	• *This will complement the analysis of questions 1-4 above, therefore no new indicators are envisaged.*			
6. Extent to which Phare support improved the performance the country's pre-accession process				
6.1 What was the ratio of the Facility funding compared with funding to SMEs via other instruments (e.g. Phare ESC)?	• Ratio of the Facility /Phare ESC funding	●		
6.2 To what extent was the Facility complementary to other Phare initiatives, particularly those supporting development/capacity building in the banking sector?	• Ratio of the Facility /banking sector funding • Ratio of the Facility /private sector financing			●
6.3 To what extent did the Facility coordinate/cooperate with other programmes/instruments?	• Quality of dialogue with other Phare programmes during programming • Quality of dialogue with other donors during programming • Clear niche identified for the Facility		● ● ●	
7. Effectiveness and efficiency of the Facility MBP as a delivery mechanism				
7.1 How effective was the MBP approach to delivery of outputs?	• Admin costs • Resources engaged for delivery (complexity of delivery structures) • Speed of decision	● ● ●		
7.2 How appropriate (efficient) was the division of tasks between the various actors?	• Clarity of task allocation • Speed of decision-making processes		● ●	
7.3 To what extent were good practices in the Facility outputs delivery shared across the NMS/CCs?	• Good practices identified • Mechanisms in place for transfer of good practices	●		●

Annex 3. Follow-Up to Recommendations of Previous Report

Recommendations from R/MIER/SME/02146 dated 18 February 2003

	Recommendation	Expected Output(s)	Decision taken at the Facility Steering Committee
1	A review of the needs for finance of the SMEs should be developed by Commission Services (with the possible participation of the IFIs). It should focus on the identification of regional differences between the countries and the segments of SMEs that have difficulties to be reached should be taken into account. It should be accompanied by indicators that would serve as base for an historical comparison in the next stages of the project. A starting point could be the indicators developed in the Annex 8.	Improve the objective and quantifiable measurement of the needs and its improvements. Identify the real needs.	EBRD and KfW will provide studies on access to finance of SMEs for Bulgaria, and Romania (EBRD) and Turkey (KFW) before the end of 2003.
2	The wider objective of the programme should improve in precision, as well as the intermediate objectives that are nearly self-fulfilling at this stage. Any further SMEF programme should adapt its wider objective to the evolution of the needs of the financial intermediaries, and focus on the sustainable development of the SME lending capacity.	More precision in the design for an increased efficiency of the programme	No further follow up is required. The revised objectives will be included in the new CAs to be signed with the Sponsors. New indicators of achievement have been added and the Sponsors have to monitor them.
3	Sustainability should be clearly identified by the Commission Services for each selection of a new PB. It should be a clear focus in the agreements between the Commission Services and the IFIs, which could include the need to demonstrate how institutional building is integrated in the process. Those projects which show good prospect for sustainability because institutional development has taken place, should be analyzed and their replication considered.	Improved sustainability	Following discussions at the Technical Meeting it was agreed that all Sponsors will address “Project specific” additionality, sustainability and impact in future proposals to allow an evaluation of results.
4	The Commission Services and the IFI should reflect on the concept of additionality in the SMEF concept and envisage a tighter interpretation, which has and impact of the definition of the target PBs.		Following discussions at the Technical Meeting it was agreed that all Sponsors will address “Project specific” additionality, sustainability and impact in future proposals to allow an evaluation of results.
5	For new PBs, the additionality should be clearly demonstrated. in particular for PBs with foreign active shareholder. Priority should be given to niche players and regional banks, where the additionality and the effectiveness is likely to be higher. For other players, criteria such as the existence of a group strategy towards SME, the training systems and resources in place could be taken into account. For the existing projects, the IFIs that do not propose TC should be asked to	Improved conditions on additionality	

	Recommendation	Expected Output(s)	Decision taken at the Facility Steering Committee
	demonstrate, after a reasonable period of time (e.g. after one third of the elapsed time for the loan), which are the impact and sustainability on the activities of the PBs.		
6	Efficiency of the programme with TC component can be improved by the financial participation of the PB. A greater role of the PB in the selection and the monitoring of the TC could improve its general efficiency. Clear deliverable and milestones should be a minimal monitoring tool by the project manager. Additional specialized and dedicated resource need to be mobilized by the EBRD, specifically on the management of the consultants.	Increased efficiency	EBRD did not find this proposal acceptable for new clients. If the PBs see the positive results of TA they may consider co-financing as an option at a later stage when requesting a second credit line. It was agreed to continue discussions on this issue at the next technical meeting.
7	The ERC only makes sense when it covers specific risks on a one to one basis rather than general traded portfolio risks.		
8	Projects are more at risk than other, and a base of knowledge could be developed to make a good usage of the lessons learned from the weakest and strongest projects. Consideration should be undertaken for the PeKaO (Poland) and SZRB (Slovakia) with a view to establishing corrective actions or suspend the projects.	Increased efficiency	
9	There should be uniform reporting from IFIs (the EBRD gives much more detailed information), with minimum requirements for semi-annual reports: number of loans, number of SMEs, and what is in the EBRD report. The first part should be on the results, the second on the main achievement in the period, third on the main difficulties and pending problems and risks, fourth part on the pipeline, fifth part other specifics (i.e. the special comments on regional coverage of the EBRD semi-annual report 2002). It should also include tracking of actions agreed to be taken on new problems, actions on previous problems reported and current status.	Easier management for the Commission Services	
10	Commission Services and IFIs should agree on simple transparent conditions what is offered to the PB, and what are the negotiation rules. PBs should have an overview of terms and conditions offered by all participating IFIs and then chose the most appropriate package.	Avert reputation risk on the image of the Facility	
11	The creation of a multi-bank school for credit to SME (at regional level) could be an effective way to insure the sustainability of the transfer of skills of bankers. This should be co-financed by the banks and an EU grant (on the principle that people value more something they pay than something they are offered). Modalities of the implementation could involve a banking training centre for SME lending in one bank shared by the others, or proposed by the national Bankers associations, or the specialized banking trainers.	Diversification	

	Recommendation	Expected Output(s)	Decision taken at the Facility Steering Committee
12	The use of the ERC should be confined to those PBs where the ERC enhances the overall credit risk of the PB and should not be extended to those PBs that are able to manage their exposures on a pooled basis from existing market sources.	Improvement of the efficiency of the incentives	
13	The EW should be given clearer objectives: either to freeze the further efforts to sell more the window to other potential fund managers or to offer a more flexible solution to them (e.g. relax the max investment size, resolve the domicile issue etc). Its additionality needs closer examination The EW is drifting without a firm management direction. A strategic review should be undertaken by the stakeholders and clear objectives set for the EW. The main choices are : a) to suspend further efforts to establish new IFs and redirecting the committed funds to other programmes. A decision should also be made on what action to be taken in respect of the slow rates of investment by the 3 existing funds; or b) to promote the EW more aggressively with the intention of establishing new funds and introducing corrective actions to ensure an acceleration in the rate of investments made by the existing funds.	Improved possibility to achieve immediate objectives	

Annex 4. List of Participating Financial Institutions Interviewed

Country	No	Bank	IFI
Bulgaria	1	Hebros	EBRD
	2	United Bulgaria Bank	EBRD
	3	Pro Credit Bank	CEB-KfW
	4	Union Bank	EBRD
	5	Encouragement Bank	EIB
Czech Republic	6	Volksbank Leasing	EIB
	7	Volksbank	EIB
	8	Ceska Sporitelna	EBRD
	9	CSOB Leasing	EIB
	10	CMZRB	CEB-KfW
Hungary	11	Volksbank	EBRD
	12	CIB	EIB
	13	Raiffeisen Bank/	CEB-KfW
	14	Raiffeisen Leasing	CEB-KfW
	15	IKB-Leasing	CEB-KfW
Latvia	16	Unibanka	EBRD
	17	LHZB	CEB-KfW
Poland	18	Raiffeisen	EBRD
	19	Franfinance/SGEF	EBRD
	20	BOS	CEB-KfW
	21	BRE Leasing	EIB
	22	Citi Handlowy	CEB-KfW
	23	WZBK	EBRD
	24	Pekao	EBRD
Romania	25	Bancpost	EBRD
	26	Alpha Bank	EBRD
	27	Banca Romanesca	CEB-KfW
	28	BRD	EBRD
	29	BCR	EBRD
	30	Banca Transilvania	EBRD
	31	Banca Transilvania Leasing	EBRD
	32	Volksbank	EBRD
Slovak Republic	33	SZRB	CEB-KfW
	34	VUB	EBRD
Slovenia	35	Banka Koper	EBRD
	36	NLB	EIB
	37	SEC/SID	CEB-KfW
	38	Postna Banka Slovenia*	CEB-KfW on-lending bank
	39	Abanka*	CEB-KfW on-lending bank

* On-lending banks which have received finance for lending through SEC/SID

Annex 5. Questionnaire

For Participating Banks, Leasing Companies and Other Financial Institutions[64]

1. General Information on the Respondent

1.1	Name of the IFI	
1.2	Name of participating institution	
1.3	Short description of the participating institution	
1.4	Ownership (e.g. foreign shareholding)	
1.5	Position in national market	
1.6	Position in SME market	
1.7	Evolution of this market share (since participation in Facility)	
1.8	Total value of loan portfolio to SMEs	
1.9	Proportion of loans to SMEs in total loans	
1.10	Department managing the Facility	
For Technical Assistance/Technical Cooperation/Capacity Building Instruments		
1.11	Name of Consultant	
1.12	Budget of TA/TC/capacity building contract	
1.13	Date of signature	
1.14	Brief description of TA activities	

2. Relevance

2.1	How/why did the Respondent come to participate in the Facility?	
2.2	Was the respondent active in the SME market ***prior*** to receiving facilities under the Facility?	
2.3	Average loan life of corporate client/average loan life of the Facility portfolio?	
2.4	Short description of market segment supported by the Facility	
2.5	What is the ***added value*** of participation in the Facility to the Respondent?	
For Technical Assistance/Technical Cooperation/Capacity Building Instruments		
2.6	How were your organisational needs for TA/TC/capacity building defined?	
2.7	To what extent is the TA/TC/capacity building meeting these needs?	
2.8	What are the main expected results of the TA/TC/capacity building activities?	
2.9	What % of training and development is Phare providing compared to in-house supports?	
2.10	Number of staff trained/overall % of staff	

[64] This was a confidential questionnaire. Individual respondents were told that they would not be identified, and that information would be included in the ex post evaluation in summary form only.

3. Efficiency

3.1	Total number of loans outstanding to SMEs by respondent institution	
3.2	Total number of loans outstanding under the Facility	
3.3	Balance sheet value of the Facility loans outstanding/balance sheet value of all SME credit outstanding	
For Technical Assistance/Technical Cooperation/Capacity Building Instruments		
3.4	Has the TA/TC/capacity building component been delivered in a timely manner? If not, why not?	

4. Effectiveness/Impact

Evidence that the Facility has induced participants to maintain/expand operations with SMEs		
4.1	Rate of growth /decline in SME assets (from beginning of participation in the Facility)?	
4.2	Rate of growth /decline in SME assets ***in segment targeted by the Facility*** (from beginning of participation in the Facility)?	
4.3	Rate of growth /decline in SME market share of respondent (from beginning of participation in the Facility)?	
4.4	Rate of growth /decline in SME market share of respondent ***in segment targeted by the Facility*** (from beginning of participation in the Facility)?	
4.5	SME share in respondent's balance sheet	
4.6	Rate of growth/decline in farm business share of Respondent (*for Rural Sub Window participants*)?	
4.7	In what way has the Facility been an incentive to maintaining/enhancing operations with SMEs at the Respondent institution?	
For Technical Assistance/Technical Cooperation/Capacity Building Instruments		
4.8	To what extent has the TA/TC/capacity building instrument contributed to new product development? How has it done so?	
4.9	To what extent has the TA/TC/capacity building instrument helped to improve services to SMEs? How has it done so?	
Evidence that the Facility has contributed to capacity building at participating institutions		
4.10	Average application to approval time (weeks) at the respondent institution for loan/leasing applications under the Facility compared to SME approval time before the Facility?	
4.11	Has the Facility contributed to new product development? How has it done so?	
4.12	To what extent have product and risk assessment been adapted to rural/farm business clients? (for *Rural Sub Window only*)?	
4.13	To what extent have services, terms and conditions of loans/leasing agreements to farm business changed since participation in the Facility? (for *Rural sub-window only*)	
4.14	Number of staff familiar with new concepts/ products	
4.15	What have been the main impacts of the Facility in terms of capacity building at the respondent institution?	
4.16	In general terms, what has the respondent changed because of the Facility?	

For Technical Assistance/Technical Cooperation/Capacity Building Instruments		
4.17	What have been the main impacts of the TA/TC/capacity building activities at the respondent institution?	

5. Long-term viability of results

5.1	% of the Facility portfolio at risk[65]	
5.2	% of total SME portfolio at risk	
5.3	Loan write offs as a % of the Facility portfolio	
5.4	Is the Respondent likely to maintain SME/ rural lending/leasing operations in the medium period? If not, why not?	

6. Proposals for Change

6.1	What changes would the respondent make to enhance the effectiveness and impact of the Phare support?	
6.2	What additional supports would the respondent consider useful to assist in developing the SME sector?	
For Technical Assistance/Technical Cooperation/Capacity Building Instruments		
6.3	How would the respondent improve the design and delivery of TA/TC/capacity building instruments for future projects?	

65 For the purpose of this exercise "risk" is defined as: any loan where any payment due is over 30 days in arrears or the loan has been downgraded to a classification with risk of loss such as special watch, substandard, doubtful or bad.

Annex 6. Note on Interview Methodology

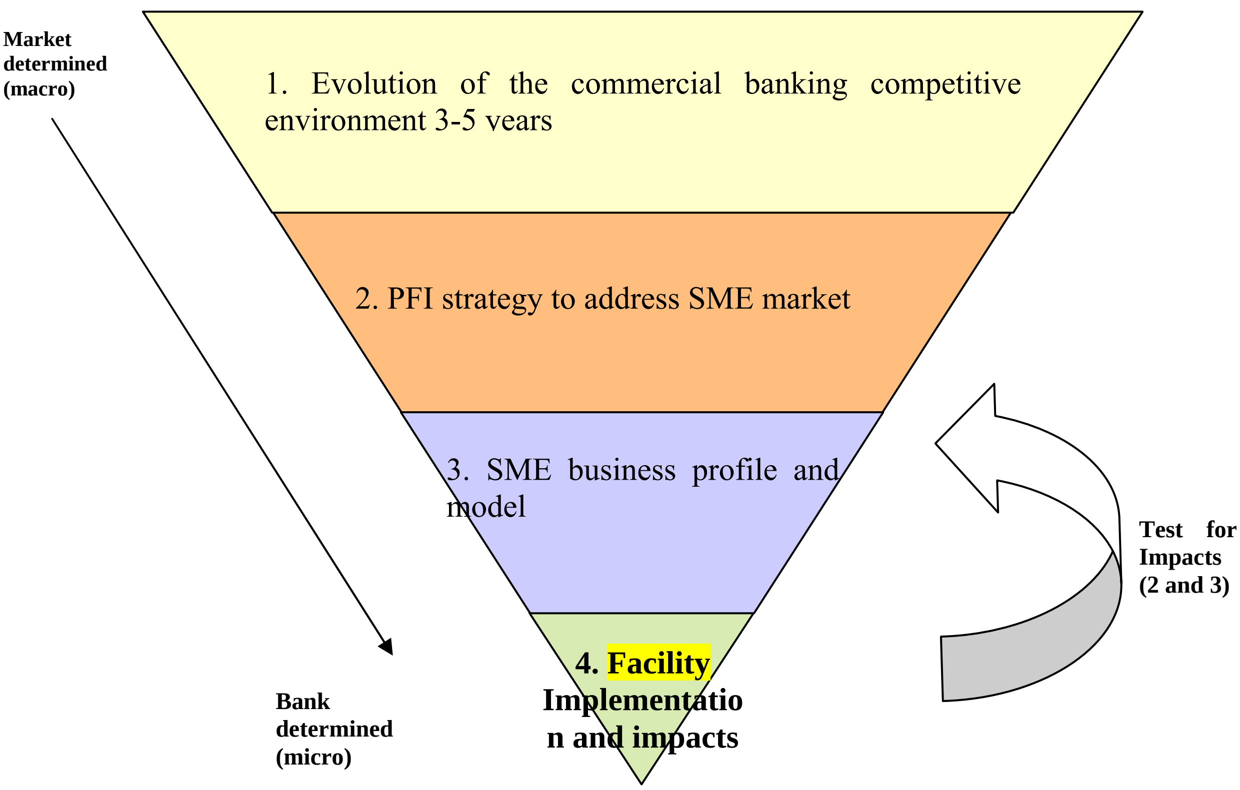
<u>Overview of Interview Methodology</u>

Interviews with Participating Financial Institutions (PFIs) were undertaken using a structured interview methodology designed to:

- Establish the linkage between the strategic priorities of the respondent and the objectives of the Facility;
- Differentiate between wider influences of the competitive environment and the capacity of the Facility to induce behavioural changes;
- Identify the method of the Facility implementation and its impact of the SME business model used by the PFIs).

Each interview was conducted around four core modules, commencing with the wider SME competitive environment, how the PFI addressed commercial opportunities and competitive pressures at the strategic and operational level and finally implementation of the Facility itself and its impact (short and medium term) at the strategic and operational levels.

The interview structure was highly complementary to the questionnaire in that it allowed significant opportunity to explore strategic and commercial imperatives of the SME business within the bank. The interview structure can be presented schematically as follow



The interview hierarchy under each of these categories is presented in the following sections.

Competitive Environment

- Trends over previous 3-5 years in commercial banking market
- Impact on SME lending / leasing sector
- Indicators:
  - Pricing (margins and fees)
  - Terms (collateral, tenor, covenants, size)
  - Service (speed, understanding of SME needs)
- Competitor analysis (SME market)
  - Leading players; 2nd and third tier players
  - Estimated market shares or niche strengths
  - Implications for competition and strategy – barriers to entry, winners and losers (critical mass)

PFI Strategy

- Bank background and recent history
- Opportunities for the PFI in the SME market
- Sources of competitive advantage
- Short and medium term objectives:
  - Client segments
  - Product markets
  - Geographical
- Critical mass

SME Business of the PFI

- Product offering and positioning
- Business model:
  (Front office)
  - Marketing and distribution
  (Mid office)
  - Application process and approval
  - Credit methodologies
  (Back Office)
  - Booking
  - Credit risk management
- Bank funding
  - Asset / liability management
  - Availability of medium – long term wholesale funding for banks (liquidity)
  - Pricing of medium / long term funding
  - Interest risk exposures / matched funding considerations

Facility Implementation and Impact

- Objectives of participating in the Facility
- Internal management and sponsorship
- Linkages between the Facility and:
  - Transfer of technology, know-how, processes or procedures from the Facility portfolio to wider portfolio (front, mid or back offices)
  - Transfers to other business units or departments
- Booking the incentives – which department / how managed
- Tangible uses of incentives (especially performance fees)
- Intangible uses of incentives (change in bank behaviour / policies)
- Persistence of methods, procedures, behaviour, policies (capacity building) adopted under the Facility over time.

Annex 7. Reconstructed Intervention Logic for the Facility

What we control | **What we influence directly** | **What we influence indirectly**

Inputs	Outputs	Immediate Impacts	Intermediate Impacts	Wider impacts
<u>Credit Line</u> • Performance fee • Technical assistance • Exchange and interest risk cover • Other incentives <u>Equity finance</u> • Enhancements	• Loans/leases to SMEs • Outputs of TA – training delivered, manuals and processes designed and implemented • "Soft capacity building" e.g. PFI reporting procedures to IFIs for the Facility in place, new funding options or risk management instruments utilised.	• Loans / leases to SMEs meeting certain criteria (maturity, size etc.) accepted as a target market • Improved product delivery by PFIs to service SME clients • Improved management of SME lending e.g. marketing, product design, credit risk, procedures and business process etc.	• Wider bank strategy towards SMEs in place • Models for sustainable SME business based on the Facility model, skills or experience in place	• SMEs in CCs and new Member States have access to finance on terms and conditions converging to those available in (old) MS

Annex 8. Overview of the Facility Objectives 1999-2005

Based on Financing Proposals

Prog. No.	Prog. Title	Overall Objective	Immediate Objective(s)
ZZ-9901	1999 SME Finance Facility	• To induce financial intermediaries in the ten Applicant Countries to expand and maintain in the long term their <u>debt and equity financing</u> of SME operation.	(i) Greater access to finance among participating SMEs in the region; (ii) Expanded capacity of participating banks and investment funds to serve the needs of SMEs; and; (iii) Example to other potential financial intermediaries that operating with SMEs is possible.
ZZ-0007 ZZ-0013 ZZ-0106 ZZ-0108 ZZ-0126	2000 SME Finance Facility Phase 2 - CEB 2000 SME Finance Facility Phase 2 - EBRD 2001 SME Finance Facility Phase 2 - EBRD 2001 SME Finance Facility Phase 2 – CEB 2001 SME Finance Facility - EIB	• To induce Financial Intermediaries in the ten CCs to expand and to maintain in the long term their <u>financing operations</u> to SMEs. Through this Financing Proposal, the Commission intends: i) To further expand the current range of participating financial intermediaries from the candidate countries in the Facility as well as; ii) To expand the existing operations under the Loan and Guarantee Window of the Facility to meet the new and maturing needs of SMEs in the applicant countries.	(i) To leverage the largest amount of co-financing with the Community grant through co-financing with the International Financing Institutions (IFIs), and; (ii) To ensure greatest efficiency of the management of this complex financial scheme by delegating implementation to the respective IFIs, whose expertise is extensive in these areas.

2002-000-621 2002-000-622 2002-000-629	2002 SME Finance Facility - EBRD 2002 SME Finance Facility - CEB-KfW 2002 SME Finance Facility - EIB	• To assist the candidate countries in meeting the Copenhagen criteria and to contribute to the reform and strengthening of the financial sector.”	• To build further the confidence of financial intermediaries to engage in financial operations with SMEs; • To enhance the capacity of financial intermediaries to assess and monitor the related risks and to manage their financial exposure; • To deepen country coverage at a regional level by concluding more Projects within each country; • To sustain and maximise the impact of existing Projects under the Loan, Guarantee and Leasing Window by providing additional credit lines to the financial intermediaries concerned and`; • Thereby to continue to induce financial intermediaries to expand and maintain in the long term their financing operations with SMEs.
2003-005-745 2003-005-765 2003-005-766	2003 SME Finance Facility - EBRD 2003 SME Finance Facility - EIB 2003 SME Finance Facility - CEB-KfW	• To assist the acceding and candidate countries in continuing the reform and strengthening of their financial sectors in order to cope with the competitive pressure and market forces within the Union.	• To build further the confidence of financial intermediaries to engage in financial operations with SMEs; • To enhance the capacity of financial intermediaries to assess and monitor the related risks and to manage their financial exposure; • To deepen country coverage at a regional level by concluding more Projects within each country; • To sustain and maximise the impact of existing Projects under the Loan, Guarantee and Leasing Window by providing additional credit lines to the financial intermediaries concerned and; • Thereby to continue to induce financial intermediaries to expand and maintain in the long term their financing operations with SMEs.

2005-017-220 2005-017-221 2005-017-222	2005 SME Finance Facility - EIB 2005 SME Finance Facility - EBRD 2005 SME Finance Facility - CEB	• To assist the acceding and candidate countries in continuing the reform and strengthening of their financial sectors in order to cope with the competitive pressure and market forces within the Union.	• Strengthening financial intermediaries in expanding and maintaining in the long-term their financial operations with SMEs: • To build further the confidence of financial intermediaries to engage in financial operations with SMEs, including leasing; • To enhance further the capacity of financial intermediaries to assess and monitor the related risks and to manage their financial exposure; • Promote geographical diversification of the SME loan portfolio and improve financial intermediation at regional level; • To sustain and maximise the impact of existing Projects under the Loan, Guarantee and Leasing Window by providing additional credit lines to the financial intermediaries concerned.

Annex 9. Overview of the Facility Operations 1999-2005

A dynamic SME sector had been identified by the European Commission (EC) as a necessary condition (Agenda 2000, New Phare Orientations 1999) for the accession of the Candidate Countries (CCs)[66] to the EU. Access to finance has been identified as one of the key constraints restricting the development of SMEs in these countries.

The Commission Services has developed a number of different programmes to improve the environment for SME[67] development within the framework of the Phare national programmes. To address the need to ensure a stable supply of finance, together with a functioning financial sector, capable of meeting the needs of SMEs, the Commission Services created a Working Group comprising the EC, the European Bank for Reconstruction and Development (EBRD) and the European Investment Bank (EIB). Based on the conclusions of the Working Group, the SME Finance Facility (the Facility) started operations in March 1999 with the signature of an agreement between the EBRD and the Commission Services.

The original overall objective was "… *to induce financial intermediaries in all ten CCs to develop and maintain over the long term their debt and equity financing of SMEs*". This was first expanded in 2000 to cover "…financing operations" with SMEs and in 2002 was further broadened to locate the Facility in the wider context of the accession process as follows: "… *to assist the candidate countries in meeting the Copenhagen criteria and to contribute to the reform and strengthening of the financial sector.*" In light of the imminent accession of eight of the ten CCs, in 2003 the overall objective became "… t*o assist the acceding and candidate countries in continuing the reform and strengthening of their financial sectors in order to cope with the competitive pressure and market forces within the Union.*" No funding was allocated under the 2004 Phare programme and in 2005, the Facility was restricted to Bulgaria and Romania and expanded its geographical coverage to Croatia and Turkey[68]. The overall objective remained the same.

A pilot Phase 1 of the Facility was launched by Phare in co-operation with the EBRD, whereby Phare and EBRD funds were jointly mobilised through a special fund to provide two types of support through two "windows": (i) the Loan and Guarantee Window (LGW) and (ii) the Equity Window (EW). Within the LGW, Phare funds were used as incentives to support the efforts of Participating Financial Institutions[69] (PFIs) in their penetration of the SME market, whilst EBRD funds were used to provide PFIs with credit lines to be used for SME loans. In theory, this combination of incentive + credit line provided an opportunity for 'learning by doing' and the possibility to demonstrate how lending to SMEs can be an attractive segment for the PFIs, at minimum risk to the PFI. In the EW, funds were invested in investment funds (IF) managed by financial intermediaries, who then provided equity to their SME clients.

Phase 1 was evaluated by the OMAS Consortium between June and November 2000 and the report was distributed in January 2001. The evaluation stated that that achievement of objectives was Unsatisfactory, principally due to the slow pace of implementation in the start-up phase. The Report provided several recommendations, which aimed to lead to a higher

66 Estonia, Bulgaria, Czech Republic, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia.

67 The national Phare programmes provide support for SME policy development (alignment with the *acquis*), institution building directed at SME support agencies, grant financing schemes for direct support to SMEs and different forms of credit financing. These credit financing schemes have generally not been entirely successful in achieving their immediate objectives, notably because they were implemented in isolation from the institutional framework

68 For EIB and CEB-KfW interventions only.

69 Initially Participating Banks (PBs) and later extended to leasing companies. Collectively these are known as Participating Financial Institutions.

degree of achievement of the objectives and acknowledged that many of these recommendations were already being implemented by the stakeholders.

In Phase 2 of the Facility (post –1999) additional co-financing International Finance Institutions (IFIs) joined the programme. In December 2000 a Contribution Agreement (CA) was signed with the Council of Europe Development Bank (CEB) in association with the *Kreditanstalt für Wiederaufbau* (KfW). The EIB signed its first Contribution Agreement in December 2001. The LGW (then renamed LGLW) was modified to include leasing activities through support to Participating Leasing Companies (PLCs) and no further funds were allocated to the EW.

The EMS Consortium completed an Interim Evaluation (IE) of the Facility in 2003. The IE Report, finalised in February 2003[70], concluded that while the Facility was a good concept, with a high potential for success, it required fine-tuning across a range of areas to respect Phare Guidelines related to catalytic effect, additionality and sustainability. Key issues identified in the IE Report included: the need to ensure catalytic impact by identifying and addressing market failures; the need to ensure additionality, particularly where the PFIs have major active foreign shareholders; to ensure sustainability by focussing on capacity building at Financial Institutions and the use of institution building to develop successful business models for addressing the SME market and; the need to clarify the role of, and approach to, the EW. Operational issues identified included: a) the need to ensure a uniform quality of reporting from the participating IFIs to the Commission Services and; b) more transparent management of the PFI pipelines, including the availability of information on terms and conditions offered by all participating IFIs to the PFIs and leasing affiliates.

The IE report concluded with 13 recommendations which focused *inter alia* on: the need to fine-tune the Facility to be more responsive to regional and sectoral variations; to re-examine how the Facility projects are delivering additionality and catalytic impact and to improve the quality of reporting by the IFIs (see Annex 3). While some changes were introduced (e.g. more attention to tracking indicators and greater standardisation of reports from the IFIs to the Commission Services), the underlying rationale and intervention logic, despite the fast pace of change in the CC's competitive environments, remained largely unchanged. Importantly, the recommendation for an updated analysis of the situation in the countries in which the Facility operated was only partially acted on. The Steering Committee[71] for the Facility downgraded the recommendation to focus only on Bulgaria and Romania, despite plans for second credit lines in the soon to be member states. Even this downgraded recommendation was only partially implemented.

To date the three implementing IFIs have an exclusive position within the Facility which is described in the 2005 PFs as follows: "*The technical nature and the multi-country approach of the SME Finance Facility required the involvement of highly-specialised financial institutions, with a long track record in international finance and SME development. Also the preference was for financial institutions with the status of international public-law bodies, who shared the values of the EU, in particular, in relation to enlargement and had similar public policy objectives, rather than private-sector financial institutions looking for commercial investment terms…In terms of the Financial Regulation applicable to the general budget (Art.110), and its Implementing Rules (Art.168), the characteristics of these financial institutions as public-law bodies, pursuing European public policy objectives not just for profit, as well as their track*

[70] R/ZZ/SME/02.146 issued on 18 February 2003.
[71] 4 July 2003.

record and specialisation in financing international development, therefore put them in a monopoly situation leaving no other choice as partner for the Commission in these actions."

Description and organisation of the SMEF

The SME Finance Facility is a Programme whereby Phare provides a grant contribution, which serves as an incentive (under different forms) for local banks, leasing companies or investment funds to establish and utilise credit lines provided and financed by the Sponsor IFIs (EBRD, and later CEB with KfW, and EIB). The grant contribution is a small, but highly important proportion of the total contribution to the SME Facility, whereby the sponsor IFIs (EBRD, the CEB in co-operation with KfW, and the EIB), are the main financial contributors. The IFI's contribution is not a grant but is a part of their commercial credit operations and therefore IFI funds are returned with interest. Because of the specificities of the co-financed element, authority was delegated to the IFIs by the Commission Services to administer and manage the Facility, including the Commission's grant contribution, in return for a flat management fee of 1.25% of total funding over the period. The incentives to PFIs are in the form of Performance Fees, Technical Assistance (TA), Guarantees, or other tailored incentives as mentioned in the next paragraph.

Table 11.- Phare contribution allocated in the period 1999-2005 - by IFI

	1999	**2000**	**2001**	**2002**	**2003**	**2005**	**Total**	
LGLW	**(M€)**						**(M€)**	**%**
EBRD	25	30	30	20	15	18	138	48.8
CEB/KFW	0	21	30	15	10	9	85	30
EIB	0	0	30	15	10	5	60	21.2
Total LGLW	*25*	*51*	*90*	*50*	*35*	*32*	*283*	*100*
EW								
EBRD	25	0	0	0	0	0	25	100
Total EW	*25*	*0*	*0*	*0*	*0*	*0*	*25*	*100*
RSW								
EBRD	0	0	0	0	10	0	10	66.4
CEB/KFW	0	0	0	0	5	0	5	33.4
EIB	0	0	0	0	0	0	0	0
Total RSW	*0*	*0*	*0*	*0*	*15*	*0*	*15*	*100*
Totals	**50**	**51**	**90**	**50**	**50**	**32**	**323**	

LGLW

Each IFI proposes a different set of incentives for utilisation of the Phare Grant) accompanying their credit line.

- **EBRD** links its credit line with Technical Assistance (TA), also called Technical Cooperation (TC). This is a 12-24 months input from consultants recruited by EBRD to promote and administer the credit line and deliver capacity building to the PFI. In addition, each PFI can avail of Performance Fees (PFs), which are calculated as a percentage of each loan to each SME, under conditions of eligibility (including average size of loan and maturity) and risk (general risk of the portfolio must be less than 6 %). The incentive decreases over time, thus serving to reward PFIs that draw down their credit line promptly. The consultants are residents in the PFIs during the mission and have a supervisory role in relation to the credit line, and in the reporting to the EBRD;

- **CEB** in collaboration with **KfW** (CEB/KfW) provides a wider range of incentives:

  (i) **Fees for Smaller Loans** (FSL), relates to loans up to € 50,000 and a flat fee is provided to the PFI of 3% on loans up to € 30,000 (minimum € 300 flat fee) and 1% flat for the amount from € 30,001 to € 50,000;

  (ii) An **Exchange Risk Cover** (ERC) facility was introduced by KfW in response to requests from PB/PLCs and modest commitments have been made to date. The intention is that by making the PFI less sensitive to the risk of taking a hard currency loan from the IFI (on which the PFI would have exchange risk), the PFI will be more willing to take the facility. The ERC offers two types of cover: a) the cost of implementing forward foreign exchange transactions to reduce currency risk and; b) a currency swap (in fact a simplified but effective version compared to that traded on the inter bank market). Since most Projects under the LGLW comprise only a few percent of the PFIs' balance sheet, a one-off hedge facility will do very little to change its risk profile. Therefore it should be recognised that the ERC is mainly an <u>educational</u> tool and a small palliative for the PFI and not in itself an effective hedge measure for credit exposure to the PFI by the IFI;

  (iii) A **Loan Guarantee** (LG) facility and;

  (iv) **TA** specific to the requirements of the PFI. This however is not a central feature of the CEB-KfW support and is marginal compared with what is offered by EBRD TA and;

  (v) **Interest Rate Cap** (IRC) the main component of which is the Performance Fee, based on the same principle as the one used by the EBRD.

EIB offers a unique incentive: a flat subsidy of € 5,000 for each eligible SME loan on condition that it does not exceed 10% of the loan. The incentive is therefore optimised for loans of € 50,000.

Each of the IFIs receives a management fee for the management of the facility. The amount is paid at each payment of a tranche of the Phare Grant and comprises 1.25% for EBRD and CEB/KfW, and 1.2 % for EIB.

Table 12.- Overview of packages offered by the three IFIs under the Facility

Sponsors	EBRD	CEB/KfW	EIB
Type/name of account	Interest bearing account	"Phare account"	"Trust account"
Total Phare contribution (in M€ 1999-2005)			
Total sponsor contribution (in M€)			
Type of intervention	Credit Line and investment	Loan to KfW by CEB, parallel financing of KfW and CEB, exclusive financing of KfW	Credit Line
Eligible countries	10 CC up to 2003 2005 Romania, Bulgaria, and Croatia	10CC up to 2003 Turkey (additional 4 M€ from MEDA)	10CC+MEDA later
Projects (at 10/07/2006)			
Size of project with PFI	Between M€ 5 and 15	Between M€ 5 and 15	Between M€ 3 and 30
Limits of the micro-loans			
Maximum for small loan	Contractually: 250 Thousands of € (K€), with a voluntary cap of 125 K€	K€ 2	K€ 250
Obligation of reporting	Monthly financial statement Quarterly pipeline reports 6 monthly operational progress report Annual operational report	Monthly financial statement Quarterly pipeline reports Semi-annual PR Annual operational report	Monthly financial statement Quarterly pipeline reports Semi-annual PR Annual operational report
Ceiling	No more than 50% of PG to Performance Fee	No more than 50% of PG to Performance Fee	No more than 50% of PG to TA TF< 25% of SA
Management fee	1.25%	1.25%	1.20%+ cost of auditing
Termination of the Fund	31/12/2011	31/12/2011	10 years from the date of receipt of the 1st tranche
'Leverage' of Phare contribution	General: min 3 to 1, with an objective of 5 to 1	Per project: min 3 to 1, with an objective of 5 to 1	Per project: min 5 to 1, 10/1 when the TF is the only incentive

Source: Contribution Agreements, Annual Operational Reports of EBRD, EIB and CEB-KfW (latest dated 31.12.2005) and data from DG ECFIN dated 10.07.2006.

Table 13.- Overview of the results of the Facility per country

Country	Credit lines		
	Committed	Disbursed by IFI to PFIs	Outstanding payment
	M€	M€	M€
Bulgaria	27.592	10.434	17.158
Czech Rep.	39.946	13.292	26.654
Estonia	13.316	7.245	6.071
Hungary	39.917	14.266	26.651
Latvia	10.587	7.609	2.978
Lithuania	9.025	5.77	3.255
Poland	68.012	33.371	34.641
Romania	32.026	16.522	15.502
Slovakia	22.509	11.021	11.488
Slovenia	12.542	6.075	6.467
Grand Total	275.472	125.605	149.867

Source: Data from semi-annual reports from IFIs as of 31/12/2005

Table 14.- Overview of the results of the Facility per IFI

IFI	Credit lines			Phare Grant commitments to PFIs								
	Signed	Signed for incentives	Disbursed of incentives	PF	TA	TC	FSL	ERC	LG	ICap	Other	Total Phare Grant
	M€	M€	M€	M€	M€	M€	M€	M€	M€	M€	M€	M€
EBRD	918.50	156.69	83.42	98.19	42.25	5.36	0	0	0	0	16.25	156.69
CEB-KfW	611.75	69.96	33.26	50.08	3.99	0	4.97	1.16	4.04	0.35	0	69.96
EIB	391.00	39.10	9.95	0	0	39.10	0	0	0	0	0	39.10
Total	1921.25	265.74	125.63	148.27	46.24	44.46	4.97	1.16	4.04	0.35	16.25	265.74

Source: Data from DG ECFIN as of 10/07/2006

Equity Window

The following table presents an overview of the EW.

Table 15.- Overview of the EW financial elements

Component	Start Date	Expiry Date	Amount (M€)	Committed by EC to Facility %	Committed by SC to Projects %	Disbursed
Equity	16/03/1999	31/01/2001	25	100	39%	18.8%

Source: Annual Operational Report of EBRD, 12/01

Aims

The Equity Window (EW) is only sponsored through the EBRD. Its aim is to facilitate access to equity investment by SMEs in the ten CCs. Independent Fund managers are appointed as partner FIs to manage the funds on a fee plus profit sharing basis. The ability of the FI to introduce private sector investors as co-investors in the fund, and ability to generate a deal flow are amongst several other important criteria used in evaluating a fund manager.

Functioning

The Phare EW funding provides "seeding" for the fund by investing alongside the EBRD, usually in matching amounts. Other investors can be public sector bodies (e.g. the EIF) or private sector investors. The EW aims to attract a minimum of 1/3 private sector investment in the fund. Therefore, since Phare will invest 1:1 with the EBRD, the Phare contribution to the fund should be not more than 1/3 of the committed capital and is usually less than this.

Phare contributions usually share the same risk as the other investors for distribution of the initial capital commitment but Phare accepts a reduced rate of return if the fund is generates profits arising on the liquidation (exit) of successful investments.

Distributions from each liquidation have a hierarchical ranking. The capital committed to each investment is returned first, pro rata to the investors' contribution to the IF. Hence Phare shares an equal capital risk with the other investors if the exit value is below the original investment value.

If an exit takes place above the initial investment cost, profit distribution allows the other investors agreed minimum rates of return (and a profit share element in the case of the fund manager) before the Phare investment shares in any profit element (the Hurdle Rate). Once the hurdle rates are achieved, Phare share in the profits on an equal basis with the other investors.
It should be noted that the high Hurdle Rates (e.g. 18% in the case of the Baltic SME Fund whereas most Hurdles rates are 8-9%) and the profit related management fees mean that it is highly likely that Phare will see little or no return on its share of the investment in an IF, whilst the co-investors will receive an enhancement of their return. This is a classic and highly appropriate method for seeding a fund by influencing the reward rather than the risk element on the underlying investment portfolio. By not distorting the risk profile the seeding mechanism continues to reward the use of good investment methodologies.

In addition to its investment, Phare may make a grant contribution for funding part of the management cost associated with establishing and running the fund, up to 25% of total available Phare funding (Management Cost Funding or MCF). Management costs comprise both (i) Management Fees charged by the Fund Manager, out of which the Fund Manager covers wages, office costs and overheads and (ii) transaction costs of pursuing and holding completed investment deals. In private equity funds, management costs are usually born by the fund directly. In the early period when there are no liquidations, management costs are a direct erosion of the value of the capital invested.

The Phare contribution is a lump sum amount paid into the fund on an agreed schedule. The Phare contribution therefore further enhances the potential return on the fund available to the investors by covering part of the costs that would otherwise have to be covered out of the investors' capital.

This mechanism has only been used in one of the three IFs established under the EW so far, as the EBRD has not generally found an adequate case for making it available.

Other typical characteristics of the IFs are :

Maturity :	8 years, closed end, with up to 2 years extension.
Exit :	Through liquidation of the investment portfolio before the final maturity date.
Investment Period :	Years 1 to 4 (all investment to be made by the end of year 4)
Divestment Period :	Years 5 to 8
Portfolio Investments:	SMEs (EU definition). Maximum investment M€ 1. Minimum equity stakes of 10%, maximum 49%.

Activities

The Financing Memorandum for the SME Facility, dated 26 March 1999 (BDS99-32) presented an indicative disbursement schedule suggesting the EW would be fully disbursed by the end of 2001 (M€ 25 EBRD and M€ 25 Phare). Recognising the long lead times for IFs to be fully invested, it is possible that the terminology was intended as the EW being fully committed. As of 31 December 2005, M€ 14.75 had been committed of which M€4.71 had been disbursed. Due to difficulties in committing to suitable projects in the time period (see below) M€ 4.75 was re-allocated to the LGLW in January 2003. The July 2003 meeting of the Steering Committee approved the reallocation of the outstanding M€ 4 to the LGLW.

Implementation of the EW was slower than originally anticipated. The reasons identified, by the recent IE and more recently (in the 2005 Annual Operational Report) include:

- Management issues within the EBRD at the time the EW was established, which were resolved at the time of the first interim evaluation by bringing management of the EW under the Financial Institutions Group;
- Reduced interest from private sector co-investors in the CCs (at least for the Baltic States), resulting from the Russian crisis of 1998;
- Collapse of boom markets generally and the loss of appetite by investors for what are perceived as high risk or low return funds;
- Decline in interest in the technology and "new economy" sectors, which was a potential fertile ground for the Ifs;
- Fund structures that were more complicated and time consuming to resolve than originally anticipated[72];
- Unexpected delays in early stage markets to educate entrepreneurs in the benefits of involvement of private equity providers.

The signed projects under the EW are as follows:

Table 16.- Equity window: the signed projects

Country Coverage	Date	Financial Intermediary	EBRD Investment	Phare Investment	Phare MCF	Phare Total	Other Investors	Total
Signed								
Czech Rep. & Slovakia	05/00	GIMV Czech Ventures	3.00	3.00	0.00	3.00	6.00	12.00
Hungary& Slovenia	05/01	Euroventures Danube B.V.	3.75	3.75	0.00	3.75	7.50	15.00
Baltics	10/01	Baltic SME Fund	3.00	2.25	0.75	3.00	8.50	14.50
		Sub-total A	**9.75**	**9.00**	**0.75**	**9.75**	**22.00**	**41.50**

Source: Annual Operational Report of EBRD, December 2005. All amounts in M€

The 2005 Annual Report from the EBRD to the Facility Steering Committee indicates:

- The range of sectors covered by the investments made (e.g. lead battery recycling, software, auto components, paint distribution) appear highly appropriate to the SME Facility. The EBRD reports provide evidence that the investments are made in conformity with the EW eligibility criteria.
- Three new funds are identified as being under various stages of consideration by the EBRD. If the pipeline is concluded, this would fully commit allocation of the EW and extend coverage to all ten CCs. However caution has been expressed that the availability

[72] The proposed domicile of one Fund in a tax-evading jurisdiction lead to the refusal of the proposal and to the transfer of the domicile from Jersey to the Netherlands.

of private sector co-financing for the pipeline is limited. Therefore there must be considerable doubt at this time that significant further commitments will take place under the EW, including the approved but unsigned First Hungarian SME Fund.

Results

Phare contributions have achieved the required objective of raising slightly more than the 1:1 co-financing ratio with EBRD. Total Phare commitments (including MCF) have achieved a co-financing ratio of 3.3:1 (including EBRD).

However the rate of private sector participation is 50 % in two of the three operational equity funds must be noted as disappointingly low. In the case of the Baltic SME Fund, for example, private sector participation is nominally 30% but this has been committed through another fund under the same fund manager and cannot be considered new participation.

This being the case, it is essential that the EW is able to reach an adequate number of SMEs, generating an acceptable quality of deal flow, in order to make a meaningful impact in the countries in which it operates.

In keeping with the demand driven nature of the EW, if funds invested by the active IFs do not reach a critical mass within a satisfactory period of time this may raise questions over the genuine level of underlying demand. It also raises questions over the viability of the fund as management charges are paid on the value of funds committed not the level of funds invested. Therefore a situation may arise where a full management charge is being paid but only a modest level of funds actually invested.

Annex 10. Achievement of Immediate Objectives 1999-2005

Prog. No.	Prog. Title	Immediate Objective(s)	Achievement of immediate objectives (comments at *ex post*)
ZZ-9901	1999 SME Finance Facility	• Greater access to finance among participating SMEs in the region; • Expanded capacity of participating banks and investment funds to serve the needs of SMEs; and; • Example to other potential financial intermediaries that operating with SMEs is possible.	Greater access to finance • Amounts involved *de mini*mis • Step changes in competitive environment (rather than the Facility) caused banks to enter SME market Expanded capacity • Attributable Impacts greatest where EBRD model appropriately applied, plus some 'soft' impacts in CEB-KfW model • No capacity building observed in EIB model Example to other potential financial intermediaries • Increasing competitive pressures in markets forced banks to respond quickly, the Facility moved too slowly to be effective
ZZ-0007 ZZ-0013 ZZ-0106 ZZ-0108 ZZ-0126	2000 SME Finance Facility Phase 2 - CEB 2000 SME Finance Facility Phase 2 – EBRD 2001 SME Finance Facility Phase 2 – EBRD 2001 SME Finance Facility Phase 2 – CEB 2001 SME Finance Facility - EIB	• To leverage the largest amount of co-financing with the Community grant through co-financing with the International Finance Institutions (IFIs), and; • To ensure greatest efficiency of the management of this complex financial scheme by delegating implementation to the respective IFIs, whose expertise is extensive in these areas.	'Leverage' • Phare grant enabled EBRD to commit credit line by enabling EBRD to satisfy internal definitions of additionality (through provision of TA support, rather than Performance Fee) • No 'leverage effect' under EIB where Global Loan already existed • Unclear the extent to which Phare grant leveraged CEB-KfW funding Efficiency • Not an appropriate immediate objective.
2002-000-621	2002 SME Finance Facility - EBRD	• To build further the confidence of financial	Confidence building

2002-000-622	2002 SME Finance Facility - CEB-KfW	intermediaries to engage in financial operations with SMEs; • To enhance the capacity of financial intermediaries to assess and monitor the related risks and to manage their financial exposure; • To deepen country coverage at a regional level by concluding more Projects within each country; • To sustain and maximise the impact of existing Projects under the Loan, Guarantee and Leasing Window by providing additional credit lines to the financial intermediaries concerned and`; • Thereby to continue to induce financial intermediaries to expand and maintain in the long term their financing operations with SMEs.	• PFIs had already begun to put in place strategies and resources to address the SME market Capacity to assess and monitor related risks and to manage their financial exposure • Credit-related objectives addressed through TA • Some good examples in EBRD projects of achievement of this objective • For non-TA interventions, very limited contribution Deepen country coverage • Did not allow for the Facility to reflect regional and sectoral variations Sustain and maximise existing projects under LGLW • Unclear objective • Justification for additional credit lines rather than based on needs' analysis Thereby to continue to induce and expand financial intermediaries to maintain in the long-term their financing operations with SMEs
2002-000-629	2002 SME Finance Facility - EIB		
2003-005-745 2003-005-765	2003 SME Finance Facility - EBRD 2003 SME Finance Facility - EIB	• To build further the confidence of financial intermediaries to engage in financial operations with SMEs;	Note: 2003 projects at early stage of implementation

2003-005-766	2003 SME Finance Facility - CEB-KfW	• To enhance the capacity of financial intermediaries to assess and monitor the related risks and to manage their financial exposure; • To deepen country coverage at a regional level by concluding more Projects within each country; • To sustain and maximise the impact of existing Projects under the Loan, Guarantee and Leasing Window by providing additional credit lines to the financial intermediaries concerned and; • Thereby to continue to induce financial intermediaries to expand and maintain in the long term their financing operations with SMEs.	
2005-017-220	2005 SME Finance Facility - EIB	• Strengthening financial intermediaries in expanding and maintaining in the long-term their financial operations with SMEs: • To build further the confidence of financial intermediaries to engage in financial operations with SMEs, including leasing; • To enhance further the capacity of financial intermediaries to assess and monitor the related risks and to manage their financial exposure; • Promote geographical diversification of the SME loan portfolio and improve financial intermediation at regional level; • To sustain and maximise the impact of existing Projects under the Loan, Guarantee and Leasing Window by providing additional credit lines to the financial intermediaries concerned.	Too early to comment
2005-017-221	2005 SME Finance Facility - EBRD		
2005-017-222	2005 SME Finance Facility - CEB		

Annex 11. List of Interviews

Institution	Interviewee	Date
European Commission, DG ELARG, Brussels, Belgium.	Nathalie Boutin, Administrator, IFI Facilities, Unit D3 Regional Programmes	02.02.2006
European Commission, DG ECFIN, Wagner Building, Luxembourg.	Philippe Tarillon, Administrator	27.01.2006
European Commission, DG ECFIN, Wagner Building, Luxembourg.	James McGing, Head of Unit	27.01.2006
European Commission, DG ECFIN, Wagner Building, Luxembourg.	Dennis Wernerus, Administrator	27.01.2006
European Commission, DG ECFIN, Wagner Building, Luxembourg.	Joseph Salacz, Principal Administrator,	03.02.2006
The Council of Europe Development Bank 55 Av. Kleber, Paris. France	Theodore Ivanov, Directorate General for Loans, Director of Department, Projects Department	31.01.2006
The Council of Europe Development Bank 55 Av. Kleber, Paris. France	Michael Lixenfeld Directorate General for Loans, Senior Country Manager, Projects Department	31.01.2006
KfW Palmengartenstr. 5-9 60325 Frankfurt Germany	Dr. Michael Ruffing Vice President Global Loans Central and Eastern Europe	31.01.2006
EBRD, One Exchange Square, London, United Kingdom.	Nora Kocsis, Senior Banker – Financial Institutions,	2.02.2006/ 09.06.2006
EBRD, One Exchange Square, London, United Kingdom.	Jean-Marc Peterschmitt, Director, Bank Relationships, Financial Institutions	09.06.2006
EBRD, One Exchange Square, London, United Kingdom.	Jose Carbajo, Office of the Chief Economist, Director, Project Design and Appraisal	09.06.2006
EBRD, Husova 5, 110 00 Praha 1 Czech Republic.	Zdenka Vicarova, Head of Prague Resident Office	28.04.2006
EIB 100 Boulevard Konrad Adenauer, Luxembourg.	Heinz Olbers, Head of Division, Lending Operations in Poland	03.02.2006

EIB 100 Boulevard Konrad Adenauer, Luxembourg.	Maris Briedis, Loan Officer, Lending Operations in Poland,	03.02.2006+
VB Leasing CZ, spol.s r.o Herspcika 813/5, 639 00 Brno	Ing.Pavel Rexa, Prokurista Ekonomicky reditel	26.04.2006
VB Leasing CZ, spol.s r.o Herspcika 813/5, 639 00 Brno	Ing.Petr Burian Prokurista Risk Management	26.04.2006
VB Leasing CZ, spol.s r.o Herspcika 813/5, 639 00 Brno	Dkfm.Waldemar Jacobsen Greschaftsfuhrer	26.04.2006
Volksbank CZ, a.s Herspcika 5, P.O Box 226 CZ – 658 26 Brno	Karel Necesal Deputy Head of Division Retail Department Head Sales Support	26.04.2006
Ceska Sporitelna, Na Perstyne 1 Prague 1, Czech Republic.	Petr Musil, FL Portfolio Management	27.04.2006
Ceska Sporitelna, Olbrachtova 1929, Prague 4, Czech Republic	Ing Tomas Halla, Director of Loan Business Dept.,	27.04.2006
CSOB Leasing, Na Pankraci, Prague 4 Czech Republic.	Martin Koubek, Strategy and Special Transactions,	27.04.2006
CSOB Leasing, Na Pankraci, Prague 4 Czech Republic.	Ing Lukas Bucek Specialist,	27.04.2006
CSOB Leasing, Na Pankraci, Prague 4 Czech Republic.	Ing Stepan Havlas Manager, Financial Leasing,	27.04.2006
Czech-Moravian Guarantee and Development Bank Jeruzalemska 964/4, Praha 1, Czech Republic	Dr Lenka Loudova, Department of Financing,	28.04.2006
Czech-Moravian Guarantee and Development Bank Jeruzalemska 964/4, Praha 1, Czech Republic	Vaclav Jakobe, Director, Dept. of Financing,	28.04.2006
Czech-Moravian Guarantee and Development Bank Jeruzalemska 964/4, Praha 1, Czech Republic	Lubomir Rajdl, Member of the Board of Directors, Head of Support and Strategy Division,	28.04.2006
Czech-Moravian Guarantee and Development Bank Jeruzalemska 964/4, Praha 1, Czech Republic	Jiri Jirasek, Member of the Board of Directors,	28.04.2006

Alpha Bank, 237B, Calea Dorobantilor. Sector 1 010566 Bucharest, Romania	Cornelia Dumitrescu, Manager, Risk Division	02.05.2006
Alpha Bank, 237B, Calea Dorobantilor. Sector 1 010566 Bucharest, Romania	Catalina Baltag, Head of Dept., Retail Division	02.05.2006
Bancpost, Calea Vitan 6, Bucharest, Romania.	Adina Bulgaru, Expert Institutional Relations Dept..	02.05.2006
Bancpost, Calea Vitan 6, Bucharest, Romania.	Doina Ionescu, Chief, International Services.,	02.05.2006
Bancpost, Calea Vitan 6, Bucharest, Romania.	Adrian Stefanescu, Credit Manager.	02.05.2006
Banca Romanesca, B-dul Unirii, nr 35 sector 3, Bucharest, Romania.	Georgeta Serbanescu, Head of Dept. Dept. of Financial Institutions	03.05.2006
BRD, Tour BBD 1-7, Blvd Ion Mihalache, Bucharest, Romania.	Petru Bindila, Director, Commercial Dept.	03.05.2006
BRD, Tour BBD 1-7, Blvd Ion Mihalache, Bucharest, Romania.	Patrice Begue, Director, Commercial Dept.	03.05.2006
BCR, 5 Regina Elisabeta Blvd., Bucharest, Romania	Cristina Maria Marin, Head of Dept. External Programmes	03.05.2006
BCR, 15 Calei Victorei Street, Bucharest, Romania	Andreea Florea, Corporate Business Development	03.05.2006
BCR, 5 Regina Elisabeta Blvd., Bucharest, Romania	Ramona Angela Ivan, Deputy Executive Director	03.05.2006
BT Leasing, Calea Turzii 134, Cluj-Napoca, Romania.	Titus Nicoara, Director General	04.05.2006
BT Leasing, Calea Turzii 134, Cluj-Napoca, Romania.	Ionut Calin Morar, Director Leasing Dept.	04.05.2006

BT Leasing, Calea Turzii 134, Cluj-Napoca, Romania.	Simona Sopon, Director Economic.	04.05.2006
BT Leasing, Str. G. Baritiu 8, Cluj-Napoca, Romania.	Marsela Petreus, Credit Manager Director Economic	04.05.2006
Volksbank, 171 Mihai Bravu Avenue Sector 2, Bucharest, Romania.	Klaus Mueller, Vice President	05.05.2006
Hebros Bank, 2 Knyanginya Maria Luiza Blvd., Sofia, Bulgaria.	Stanka Gancheva, Product Development Manager	09.05.2006
United Bulgarian Bank, 5 Sveta Sofia Str., Sofia, Bulgaria.	Hrisimira Malcheva	09.05.2006
United Bulgarian Bank, 5 Sveta Sofia Str., Sofia, Bulgaria.	Stefan Vassilev, Manager SME Credit Card Centre and International Lending Programmes	09.05.2006
ProCredit Bank, 131 Hristo Botev Blvd., Sofia, Bulgaria.	Susanne Decker, Executive Director	10.05.2006
ProCredit Bank, 131 Hristo Botev Blvd., Sofia, Bulgaria.	Kai Lim, Member of the Management Board	10.05.2006
ProCredit Bank, 131 Hristo Botev Blvd., Sofia, Bulgaria.	Mila Razsolkova, Compliance Officer	10.05.2006
ProCredit Bank, 131 Hristo Botev Blvd., Sofia, Bulgaria.	Rumiana Todorova, Head of Branch Network Dept	10.05.2006
UnionBank, 10-12 Damyan Gruev Str., Sofia, Bulgaria.	Ivo Gadev, Head of Corporate Lending Division	10.05.2006
UnionBank, 10-12 Damyan Gruev Str., Sofia, Bulgaria.	Ana Delcheva, Expert, Corporate Lending Dept.	10.05.2006
UnionBank, 10-12 Damyan Gruev Str., Sofia, Bulgaria.	Zhivko Zhivin, International Project Finance	10.05.2006

UnionBank, 10-12 Damyan Gruev Str., Sofia, Bulgaria.	Zdravka Furnadjieva, Head of International Division	10.05.2006
Encouragement Bank, 1 Dyakon Ignatiy Str., Sofia, Bulgaria	Zaharina Todorova, Senior Expert Credit Lines Dept.	11.05.2006
Encouragement Bank, 1 Dyakon Ignatiy Str., Sofia, Bulgaria	Krasimira Saeva Procurator and Head of Credit Administration and Monitoring Division	11.05.2006
Encouragement Bank, 1 Dyakon Ignatiy Str., Sofia, Bulgaria	Sasho Tchakalski, Executive Director	11.05.2006
Slovak Guarantee and Development Bank, Stefanikova 27, Bratislava, Slovak Republic.	Ing Michael Krajcovic, Deputy Chairman, Deputy General Director for Business Activities	09.05.2006
Slovak Guarantee and Development Bank, Stefanikova 27, Bratislava, Slovak Republic.	Miroslav Kunik, Dept. of Product Development,	09.05.2006
Slovak Guarantee and Development Bank, Stefanikova 27, Bratislava, Slovak Republic.	Juraj Topolcany, Head of Credit Lines Dept.	09.05.2006
Slovak Guarantee and Development Bank, Stefanikova 27, Bratislava, Slovak Republic.	Ing. Ludovit Konczer, Chairman of the Board of Directors	09.05.2006
VUB, Mlynske Nivy 1, Bratislava, Slovak Republic.	Roman Krajcir Head of Project Finance/Real Estate Financing Department	09.05.2006
VUB, Mlynske Nivy 1, Bratislava, Slovak Republic.	Patrik Tuleja, Executive Manager Project Finance, Syndications& EU Funds	09.05.2006
VUB, Mlynske Nivy 1, Bratislava, Slovak Republic.	Eliska Hupkova, Project Finance Specialist	09.05.2006
SEC, Josipine Turnograjske 6, Ljublijana, Slovenia	Sasa Keleman,	10.05.2006
SEC, Josipine Turnograjske 6, Ljublijana, Slovenia	Alesa Korencic,	10.05.2006
ABANKA, Ljubljana, Slovenia.	Vanja Jeraj Markoja, Director	10.05.2006

ABANKA, Dunajska 160, Ljublijana, Slovenia.	Marjana Cresnar Small Business Dept.	10.05.2006
Post Bank Slovenia, Ulica Vita Kraigherja 5, Maribor, Slovenia.	Boris Bobek, Head of Dept.	10.05.2006
Nova Ljubljanska Banka, Trg. Republike 2, Ljublijana, Slovenia.	Zdenka Koron, Regional Manager, Financial Institutions and International Industrialised Countries	11.05.2006
Nova Ljubljanska Banka, Trg. Republike 2, Ljublijana, Slovenia.	Damjana Lavric, Area Manger, Financial Institutions and International Industrialised Countries	11.05.2006
Nova Ljubljanska Banka, Smartinska 132, Ljublijana, Slovenia.	Patricija Papez, Marketing Manager, Marketing and Call Centre,	11.05.2006
Trg. Republike 2, Ljublijana, Slovenia.	Barbara Smolnikar, Senior Director, Branch Network	11.05.2006
SG Equipment Finance, Saski Point, Ul. Marszalkowska 111, Warsaw, Poland.	Tomasz Wlazlo, Director – Financing and Operations Dept.	16.05.2006
BOS, Al. Jana Pawla, Warsaw, Poland.	Malgorzata Dusza, Director, Financial Institutions Dept.	17.05.2006
BOS, Al. Jana Pawla, Warsaw, Poland.	Malgorzata Kowalczuk, Manager of European Integration and Financial Institutions Dept.	17.05.2006
Bre Leasing, Ul. Ks. I. Skroupki 5, Warsaw,. Poland.	Jacek Zajac, Financial Director	18.05.2006
Bre Leasing, Ul. Ks. I. Skroupki 5, Warsaw,. Poland.	Robert Urban, Products Specialist	18.05.2006
Bre Leasing, Ul. Ks. I. Skroupki 5, Warsaw,. Poland.	Danuta Wieleznska, Finance Specialist	18.05.2006
Citibank Handlowy, Ul. Senatorska 16, Warsaw, Poland.	Monika Kur, Specialist, Financial Assistance and European Integration Dept.	18.05.2006

Citibank Handlowy, Ul. Senatorska 16, Warsaw, Poland.	Jacek Szoroszyk, Commercial Banking and Investments	18.05.2006
BZWBK, PL. Wladyslawa Andresa, Poznan, Poland.	Mariusz Silingiewicz, Credit and Support Director	18.05.2006
BZWBK, PL. Wladyslawa Andresa, Poznan, Poland.	Andrzej Kurys, Manager	18.05.2006
BZWBK, PL. Wladyslawa Andresa, Poznan, Poland.	Michal Zielke, Head of SME Market	18.05.2006
BZWBK, PL. Wladyslawa Andresa, Poznan, Poland.	Andrzej Rosiek, Business Development Manager	18.05.2006
Pekao, 53 Grzybowska Street, Warsaw, Poland.	Tomasz Marek Tomaszewski, Head Office, Individual Banking Division	19.05.2006
Pekao, 53 Grzybowska Street, Warsaw, Poland.	Izabela Fotyga, Strategy, Marketing and Product Development Dept.	19.05.2006
Volksbank, Credit Risk Management – Corporate Clients, Rakoczi ut. 7, Budapest, Hungary.	Attila Biro, Head of Dept.	16.05.2006
Volksbank, Rakoczi ut. 7, Budapest, Hungary.	Dr. Laszlo Balazs, Chairman and CEO	16.05.2006
CIB Ltd., Medve ut. 4-14, Budapest, Hungary.	Teremi Bela, Director, International Dept.	16.05.2006
CIB Ltd., Medve ut. 4-14, Budapest, Hungary.	Zsuzsanna Strifler Fekete, Senior Product Manager, Business Support Dept.	16.05.2006
Raiffeisen Bank, Akademia ut. 6, Budapest, Hungary	Istvan Vass, Head of Correspondent Banking	17.05.2006
Raiffeisen Bank, Akademia ut. 6, Budapest, Hungary	Janos Laincsek, Head of SME Banking	17.05.2006

Raiffeisen Leasing, Vaci ut. 81-85, Budapest, Hungary	Ezster Horvath	17.05.2006
Raiffeisen Leasing, Vaci ut. 81-85, Budapest, Hungary	Pal Antall, CEO	17.05.2006
Raiffeisen Leasing, Vaci ut. 81-85, Budapest, Hungary	Attila Domotor, Deputy CEO	17.05.2006
IKB Leasing, Kapas Ut 6, Budapest, Hungary.	Thilo Sertel, Director	17.05.2006

Annex 12. List of Documents Consulted

Originator	Title of Document		Date
European Commission	Prog. No.	Prog. Title	FMs
	ZZ-9901	1999 SME Finance Facility	
	ZZ-0007	2000 SME Finance Facility Phase 2 - CEB	
	ZZ-0013	2000 SME Finance Facility Phase 2 – EBRD	
	ZZ-0106	2001 SME Finance Facility Phase 2 – EBRD	
	ZZ-0108	2001 SME Finance Facility Phase 2 – CEB	
	ZZ-0126	2001 SME Finance Facility - EIB	
	2002-000-621	2002 SME Finance Facility - EBRD	
	2002-000-622	2002 SME Finance Facility - CEB-KfW	
	2002-000-629	2002 SME Finance Facility - EIB	
	2003-005-745	2003 SME Finance Facility - EBRD	
	2003-005-765	2003 SME Finance Facility - EIB	
	2003-005-766	2003 SME Finance Facility - CEB-KfW	
	2005-017-220	2005 SME Finance Facility - EIB	
	2005-017-221	2005 SME Finance Facility - EBRD	
	2005-017-222	2005 SME Finance Facility - CEB	
European Commission	The Financing Proposals EBRD 1999, 2000 and 2001, with CEB/KfW 2000, 2001, and with EIB, 2001, 2002		1999-2001
European Commission	SME Finance Facility / Memorandum / Guidelines for co-ordination of the pipelines between Sponsors and for differentiation between PBs and OLBs		02/10/2001
European Commission	Note for the attn of the Members of the Steering Committee of the SME Finance Facility / Submission to the SME Finance Facility Steering Committee		29/09/2000
European Commission	SME in Europe, including a first glance at EU candidate countries		2002
European Commission	Several reports on the different projects of co-operation between the IFIs and the PBs or IFs, introduced by the IFIs for agreement of the Commission Services, accompanied with the commentary notes of the Commission Services		1999 to 2002
European Commission	Commission Staff Working Paper Enterprises' Access to Finance, Brussels, 19.10.2001 SEC(2001) 1667		October 2001

European Commission	Communication from the Commission to the Council and the European Parliament Access to Finance of Small and Medium-Sized Enterprises Brussels 1.12.2003 COM (2003) 713 Final	December 2003
European Commission	European Commission Staff Working Document Microcredit for European small businesses	September 2004
European Commission	Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions ‘Implementing the Community Lisbon Programme: Financing SME Growth – Adding European Value – Access to Finance – the Way Forward’ Brussels, Brussels, 29.6.2006 COM(2006) 349 final.	2006
European Commission	Commission Staff Working Document, Annex I to the Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions ‘Implementing the Community Lisbon Programme: Financing SME Growth – Adding European Value – List of Actions, Brussels, SEC(2006) 856	2006
European Commission	Commission Staff Working Document, Annex II to the Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions ‘Implementing the Community Lisbon Programme: Financing SME Growth – Adding European Value – Impact Assessment, Brussels, SEC(2006) 841	2006
European Commission	Commission Staff Working Document, Annex III to the Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions ‘Implementing the Community Lisbon Programme: Financing SME Growth – Adding European Value – List of Actions Brussels, SEC (2006) 842/	2006
European Commission, DG ECFIN –FOS	Minutes of the Facility Steering Committee	04.07.2003/28.05.2004/12.11.2004/02.02.2006
European Commission, DG ECFIN –FOS	SME Finance Facility Phase I and II EBRD Financial Statements as at 31 December 2002	31 December 2002
European Commission, DG ECFIN –FOS	Note – Budgetary programs reporting as at Feb 2006, July 2006	11/0720/01
European Commission DG Enterprise and Industry	How to Deal with the new rating culture A practical guide to loan financing for small and medium-sized enterprises,.	July 2005
European Commission DG Enterprise and Industry	Results from the survey of European banks Carried out for the guide “How to deal with the new rating culture: A practical guide to loan financing for small and medium-sized enterprises”	May 2005
European Commission DG Enterprise and Industry	Microcredit for small business creation: bridging a market gap	November 2003
European Commission (Author OMAS)	Assessment of the SME Finance Facility - R/ZZ/SME/00088	12/2000
European Commission (Author OMAS)	Interim Evaluation BSP - Assessment of the European Union Phare Programme - R/ZZ/PRI/01045	20/11/2001

European Commission (Author EMS)	Interim Evaluation SME - R/ZZ/SME/02.146	2003
Bank for International Settlements	The increased role of foreign bank entry in emerging markets	2003
EBRD	Memorandum / Annual Operational Report on the SME Finance Facility at end December 2001	31/12/2001
EBRD	Memorandum / EU/EBRD SME Finance Facility Operations Report for 2001	10/01/2002
EBRD	Memorandum / Semi-annual Operational Report on the SME Finance Facility at end June 2001	30/06/2001
EBRD	Memorandum / Annual Operational Report on the SME Finance Facility at end December 2001	31/12/2000
EBRD	Call off Notice for Framework Contract for Consultancy Services	
EBRD	Loan Agreement (SME Finance Facility) Operation No. 751	
EBRD	SME Facility Inception Report for Hebros Bank Bulgaria	12/2001
EBRD	Regional SME Finance Facility	26/3/1999
EBRD	TA Inception Reports and Quarterly Reports	2000-2005
EBRD	Semi-annual/Annual Reports	2001/2002/2003/2004/2005
EBRD	Transition Report (Ten years of Transition).	2000
EBRD	Transition Reports	2001-2005
EBRD	Project Proposals (Loan and EWs)	1999/2002/2003/2004
EBRD	Contribution Agreement in respect of SME Finance Facility Special Fund Phase 2 of the SME Finance Facility	25/02/2002
CEB	Project Proposals	2001/2002/2003/2004
CEB-KfW	Semi-annual/Annual Reports	2002/2003/2004/2005
CEB/KfW	Project proposal	2000/2002/2003/2004
CEB/KfW	Agreement of Responsibilities	11/12/2000
CEB/KfW	Amended Contribution Arrangement in respect of a SME Finance Facility Phase 2 Special Fund	
EIB	Contribution Agreement in respect of a SME Finance Facility Phase 2 Special Fund	13/12/2001
EIB	Semi-annual/Annual Reports	2003/2004/ 2005
EIB	Le Groupe BEI au service des PME	06/2002
EIB	Evaluation Report / Review of the Current Portfolio Approach for SME Global Loans	03/2002
EIB	The IEB Group / Activity Report 2001	2002
EIB	SMEF: Participating Financial Institutions Handbook	10/2002
KfW	Annual Operational Report on SME Finance Facility at end 12/2001	12/2001
KfW	Semi-annual Report of the SME Finance Facility on a Sub-project Level	12/2001
KfW	Semi-annual Report on the EU SME Finance Facility at end June 2001	

KfW	EU SME Finance Facility Phase 2 / other appropriate incentives	
KfW	Small Enterprises, Large impact	30/11/1998
KfW	KfW's Papers on Small and Medium-Sized Enterprises and Structural Policy	09/2000
McKinsey	McKinsey Quarterly, '*Eastern European Banking Matures*'	2003
National Bank Of Poland	Summary Evaluation of the Financial Situation of Polish Banks 2001	05/2002
National Bank Of Poland	Assisting the Development of the Banking System	2000
OECD	Financing Newly Emerging Private Enterprises in Transition Economies	2000
BEST Independent Expert Group	Guarantees and Mutual Guarantees BEST Report Report to the Commission by an Independent Expert Group	
GBRW Ltd. and the Good Corporation	Study on Asset-Backed Securities – Impact and Use of ABS on SME Finance, Final Report	November 2004
TNS Sofres/EOS Gallup	Flash Eurobarometre 184	July 2006
TNS Sofres/EOS Gallup	Flash Eurobarometre 174	October 2005
Various PBs	Various information from the PBs Web Site	2002
BA	East West / The Food Industry in the Czech Republic, Hungary and Poland / Initial Sign of Economic Recovery	2002
BA	Report / Konjunktur: Kein dynamischer Aufschwung	2002
BA	Does Foreign Bank Penetration Reduce Access to Credit in Developing Countries? / Evidence from Asking Borrowers	