SME Financing Programme
Summary of the mid-term review

THE PROGRAMME

The Programme, first approved by the EBRD's Board in April 1999, provided loans and European Community-funded technical assistance to banks in 10 accession countries[1] to improve access to financing for small and medium-sized enterprises (SMEs). The Programme provided term loans to participating banks (PBs) of up to US$ 450 million and grants for technical cooperation and performance fees of up to US$ 110 million. The Programme is overseen by a Steering Committee on which sit the Vice President Finance of the EBRD and senior European Community representatives, including the Director Generals of Enlargement and Enterprise. This Mid-term Review evaluated only the loan window and the related technical cooperation programme.

PROGRAMME RATIONALE

The Programme sought to address the poor access of SMEs to term finance by improving PBs lending skills, policies and procedures and by helping PBs build profitable, well performing SME loan portfolios. Past experience showed the need to systematically improve lending skills in the transition countries and to demonstrate that skilled lending could build sound banking businesses. The Programme's main purpose was not to enable the Bank to finance SMEs or to use the PBs to channel Bank financing to SMEs. Rather, the Programme correctly focused on skill transfer and institutional development of private sector banks to enable them to lend to SMEs on a sustainable basis. To this end, the Programme limited the availability period of Bank loans and subsidies for the PBs, and put a definite term to the consulting engagements that it funded for each PB.

ACHIEVEMENT OF OBJECTIVES

The Programme had *Good* overall achievement of the following objectives:

- ensure that financial intermediaries with broad regional coverage are able to bear the costs of lending to SMEs
- train bankers to make sound credit appraisals, based on cash flow and without relying excessively on collateral
- streamline documentation and approval procedures of banks to improve the efficiency of the loan process.

The objectives focused on skill transfer and institutional development for sustainability. Outreach to SMEs would be a result of successful institution building.

OVERALL ASSESSMENT

The Programme was rated ***Successful***[2] overall. Achievement of objectives was rated *Good* based on progress made in training loan officers and in getting them to make SME loans in a way that fits the culture of each PB. The Programme has not, however, formally assessed, and the evaluation team could not systematically verify, the quality of the skill transfer and institution building. Nevertheless, anecdotal evidence and testimonials strongly suggest good progress in skill transfer and toward graduation and successful institution building among the leading PBs. As a result, transition impact was rated *Good*.[3] This rating comprises a rating of *Satisfactory* for verified transition impact but gives greater weight, consistent with a mid-term review, to

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[1] Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

[2] The ratings for overall performance are: *Highly Successful, Successful, Partly Successful, Unsuccessful*.

[3] The ratings for transition impact are: *Excellent, Good, Satisfactory, Marginal, Unsatisfactory*.

potential for transition impact (rated *Good)*. Demonstrating that skilled lending can build sound SME banking businesses will take more time: loss experience is tied to business cycles and the portfolios have to mature through a full cycle to reveal their true loss potential. Low arrears rates are encouraging, although this single indicator offers an incomplete view of portfolio performance (see the lessons learned section). At the time of evaluation, few PBs had been discouraged by loan arrears or losses to cut back SME lending under the Programme. Indeed, reports of good portfolio performance have attracted a number of new PB candidates to join the Programme. Environmental performance was *Good* and the extent of environmental change was *Some*.

TRANSITION IMPACT AND BANK'S ADDITIONALITY

The Programme has had *Good* transition impact overall giving weight to *Good* potential transition impact if the skills transfer and institution building of SME lending is confirmed and sustained over the next few years. The rating is based on *Satisfactory* verified transition impact and *Good* remaining transition impact potential that depends on future events. Some events, such as assessing the depth of skills transfer and institution building, are within the power of the Bank, while others, such as changing the PB's SME policy frameworks, depend on actions by independent parties. The overall rating gives more weight to remaining potential impact, consistent with a mid-term review. Additionality is *Verified at large*: none of the banks participating in the Programme could have raised five-year term loans themselves, without strong parent guarantees, on reasonable conditions.

BANK HANDLING

The Programme's overall success owes a great deal to the quality handling by the EBRD's Banking Department. At mid-term, however, staff resources are being strained to cope with the large number of PBs. In addition, the PBs reviewed here will soon lose their consultants, presenting a new monitoring challenge to the Banking Team for controlling eligibility of the loans and paying performance fees. Also, the experience gained with the early PBs has shown that the banker's need to approach programme design more pro-actively, monitor the early phase of each PB's work more closely, and respond more vigorously to shortfalls in PB performance.

LESSONS LEARNED AND RECOMMENDATIONS

SME loan portfolios are likely to exhibit non-investment grade loss rates. Cumulative loss rates furnished by the rating agencies for loans rated Ba to B, or EBRD ratings 5 and 6, should be a good leading indicator of loss expectations on SME portfolios. SME loan portfolios could be benchmarked accordingly.

The Bank should require intermediary banks to report their SME loan portfolio quality in accordance with Basle standards. Full standard portfolio reporting supports institutional development and enables the assessment of skills transfer in SME lending programmes. Limiting portfolio reporting to a single unaudited loan performance indicator, such as the cumulative arrears rate, increases risk to transition impact by signalling that limited reporting is adequate practice and by weakening the demonstration effects of good performance.

SME programmes require independent assessment of institution building impacts. The Bank could take steps to assess, through independent on-site reviews, the quality of the portfolios, lending policies and processes at each PB to measure the degree of institution building. It could follow best practice of leading international banks that regularly use professionally-led review teams to perform such assessments of their own portfolio and processes.

The EBRD can influence a participating bank's environmental policy and practice by requiring adherence to its own environmental standards and by providing training. The international sponsors of participating banks may adopt best practices globally after testing them locally. The Bank could ask PB sponsors to formally adopt lessons learned from EBRD environmental best practice across their global bank network.

Targets against which to benchmark performance should be clearly stated. The Bank should clearly quantify the criteria against which the performance of the programme is to be benchmarked. To merely state the criteria, such as the number of loans, without defining a target number of loans to be achieved and what that achievement would signify, adds little value.

In SME programmes, the EBRD should ensure strong commitment from senior and mid-level management of PBs and discontinue the TC package if commitment fails. Due attention should be paid to monitoring the commitment of PB management in the early months of an engagement. The Bank must be prepared to make the final call and cancel the TC component if PB management does not comply with previously agreed targets regarding programme development and credit process changes.

SME programmes require enhanced programme features that commit senior management of PBs to set targets. An action plan agreed prior to loan signing and appended to the loan agreement could set out clear targets for starting training, making the first loans, and determining the numbers of loans per loan officer by a target date. It could identify key senior managers in key support units. Banks that do not commit to clear action plans signal low commitment to programme success.

Ensure that the participating bank's SME lending unit has sufficient "status" within the bank, is co-sponsored by senior members of legal and other support departments, and has the full support of the CEO. The likelihood of achieving a successful SME programme at a PB increases if SME financing is organised under a "heavy weight" department within the bank. Likewise, a decisive factor is the degree of support that the SME programme commands from key managers in key support units such as credit, legal and branch management.

Better leverage of TC can be ensured by implementing a consulting effort prior to signing the loan. Consultants, engaged prior to signature, could analyse SME process, policies and needs. They could help management draft an action plan to be able hit the ground running if and when the loan is signed. Timing this effort prior to signing will focus PB management attention on making the necessary tough decisions that too often get delayed post-signing.