Ex post evaluation – Turkey

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Sector: Financial intermediaries in the formal sector (CRS code 24030)
Project Support for small businesses, BMZ no.: 2005 65 192 (originally trustee funds), Co-financing promotional loan, BMZ no.: 2020 92 856 Complementary measure, BMZ no.: 1998 70 080 (“SBF” and “Betriebsmittelfonds)
Project Executing Agency: A private sector Turkish commercial bank

Ex post evaluation report: 2014

		Project (Planned)	Project (Actual)
Investment costs (total)	EUR million	15,00	15,00
Counterpart contribution	EUR million	0,00	0,00
Funding	EUR million	4,00	4,00
of which BMZ budget funds	EUR million	4,00	4,00
Cofinancing (KfW)	EUR million	11,00	11,00
Complementary Measure	EUR million	2,00	2,00

*) Random sample 2013

Description: The project comprised of the provision of a subordinated loan in the amount of EUR 4 million to a private sector Turkish commercial bank (the executing agency) for the purpose of supporting micro and small enterprises (MSEs). The loan was provided out of the budget funds of the Federal Ministry for Economic Cooperation and Development (the BMZ) as trustee funds, since the option to exchange for equity capital was available; this option was later removed. KfW provided co-financing in the form of a Financial Cooperation (FC) promotional loan of EUR 11 million to the executing agency. In addition, a complementary measure was put in place at the project agency to promote MSE business. This had a volume of EUR 2 million and was implemented by an external consultant between 2007 and 2008.

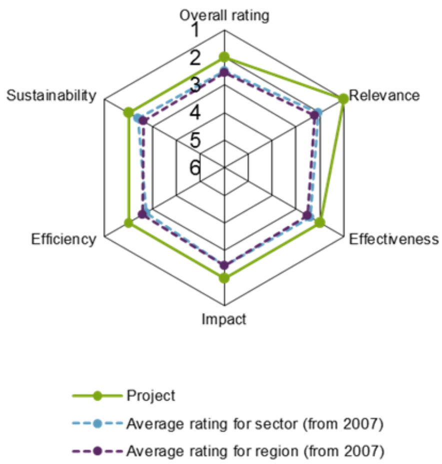
Objectives: The FC measure and the complementary measure were designed to help the executing agency expand its financial services offer for MSEs in terms of both quality and quantity (downscaling), this being the module objective. The aim in doing so was to increase the number of MSEs that could access financing under market conditions. The programme objective was to develop and deepen the local financial sector in a way which focused on the target group. This was to be achieved by setting up effective structures within the financial system, thereby helping to close the deficits in the offer of financial services available to MSEs. It was expected that this would, at the same time, improve target group incomes and create additional jobs in the assisted MSEs.

Target group: The target group consisted of privately held micro enterprises (1-10 employees) and small enterprises (10-100 employees) in all sectors.

Overall rating: 2

Rationale: As a general rule, a primary condition for an MSE to borrow from a private sector Turkish commercial bank is a satisfactory credit history of six to twelve months with another lender (e.g. a state-owned commercial bank). This means that young MSEs in particular are, or have been, largely excluded from financing by private sector banks. The support provided to the executing agency has succeeded in breaking this pattern. Today, the agency is providing appropriate credit products to established MSEs, and even to MSE start-ups.

Highlights: The executing agency is still the only private sector bank in the Turkish market which is addressing the MSE market and using cashflow-based lending technology.



Rating according to DAC criteria

Overall rating: 2

The project has been given a good overall rating, principally because of its very high relevance and beneficial developmental impact. The project has made a particular contribution to the financing of MSE start-ups. These have often faced financing constraints, due to the limited appetite for risk and collateral-based lending technologies seen at other private commercial banks.

Relevance

At the time of project appraisal in 2006, micro and small enterprises (MSEs) in Turkey faced difficulties in obtaining finance due to the private banks' stringent requirements regarding credit histories and collateral, especially in the case of new business concepts. At the same time, the MSE sector had substantial potential for growth and for the new jobs that go with it, partly because of the low average age of the Turkish population. However, the private banking sector showed little interest in developing MSEs as a customer segment or in overcoming the deficits of information that existed in this regard. The MSE sector did not seem profitable enough, considering the refinancing costs prevailing at the time and the perceived risks. Furthermore, setting up suitable lending technology for issuing loans to the MSE segment without typical bank collateral – which particularly affected young MSEs and the micro enterprise sub-segment, where loans are often lower than EUR 10,000 – seemed too expensive. In addition, there was limited incentive for the commercial banks to penetrate the MSE sector as a new market segment, as there was enough other profitable or more profitable business in the rapidly growing Turkish economy.

The private sector Turkish commercial bank identified as the project-executing agency was thus seen as a suitable development partner. As early as 2002 it had started to go beyond the traditional business focus on medium and large business customers to offer a wide range of financial services to other customer groups, including MSEs in particular. However, its lending to MSEs was at that time almost exclusively based on the existence of collateral typically accepted by banks.

The bank identified seemed suitable for the executing agency role in an MSE project – not only by virtue of its proven capability for innovation and its interest in new products, but also because it was of a medium size. For Turkey's largest private sector banks, the market volumes in the lower MSE segment would probably have been too small to induce a sustainable level of interest in the new lending technology needed to develop the segment.

In the Turkish context, using a cashflow-based lending technology does not mean that lending to MSEs is a matter of issuing microloans for minuscule loan amounts with a completely standardised process. Even with a very small business, a typical loan amount is likely to be in the area of several thousand euros. Yet MSEs frequently lack knowledge about their margins and their business cost structures and often do not know how to properly prepare their profit and loss accounts and balance sheets. This is typical in micro-lending. Due to the volume of lending, it is, however, usually not possible to dispense with this information during loan pro-cessing. As a result, the lending process involves a substantial expenditure of time on the part of the loan officer. For the banks, the ongoing costs of being active in the MSE segment are correspondingly high. Added to this are the start-up costs of initially penetrating that segment of the market which consists of particularly small and young businesses.

Against this background, the plan – to support MSE access to financing through the provision of refinancing, and to help set up appropriate lending technology at the partner bank, thereby lowering the costs of developing this market segment – is considered highly relevant. The complementary measure was an indispensable component of the plan as it supported the implementation of the institutional changes needed. These included the establishment of an MSE department, staff training and the production of an MSE manual. The results chain, which assumed that this would lead to improving the MSEs' financing situation and thereby help raise income and employment within the sector on a more long-term basis, is sound. It is equally reasonable to assume that the pilot/ demonstration role which the project-executing bank played in MSE financing has contributed to increasing the depth of the financial market. The project plan conforms to the BMZ sector strategies that were in force then and now.

Because the project addressed a serious financial constraint of significance to the Turkish economy, i.e. the highly restrictive conditions applied by other private banks which effectively excluded young MSEs from access to credit; we have assessed relevance as very good.

Relevance rating: 1

Effectiveness

The provision of FC financing and staff support was intended to help the executing agency to expand the offer of financial services available to MSEs ("downscaling") in terms of both quality and quantity (the module objective). To this end, the following indicators were formulated:

Indicator	Status at ex post evaluation
(1) The executing agency is offering loans to MSEs in 20% of its branches.	Exceeded
(2) The portfolio at risk level (PaR, 60 days) for MSEs remains below 5%.	Revised. Portfolio quality is satisfactory.
(3) In addition to the funds provided, the executing agency's MSE portfolio has increased by the same amount from its own funds.	Fulfilled
(4) At least 70 % of loans refinanced are MSE loans (< EUR 10,000).	Fulfilled
(5) The executing agency is using appropriate lending technology.	Fulfilled

Indicator 1: Only 5 of just under 300 bank branches are specially geared towards medium and large businesses. In all its other branch locations, there is at least one loans officer working for medium, small and micro enterprises (MSMEs). Presently, around 190 branch offices (>60 %) are active in the MSE segment (i.e. businesses with an annual turnover below EUR 2 million). The majority of the branch offices are located in the western part of the country. The branch network in the rural regions in the east of the country is still sparse. For example, the country's capital, Ankara (which is the city with the largest number of branches after Istanbul) has as many branches as almost 20 eastern provinces combined.

Indicator 2: As an indicator, "Maximum PaR values in sections of a loans portfolio", which is applied here to the MSE portfolio, makes limited sense, because the portfolio sections have not been clearly demarcated. Without relevant information on actual defaults and necessary write-offs, PaR values have little meaning. It is more important that there is an appropriate relationship between risk and return. This can vary between different segments of the portfolio, because ultimately it is the PaR and write-off values for the total portfolio which are crucial for a bank. For that reason, this evaluation has relied on broader indices in assessing progress made towards the objective. For the a priori highest-risk segment of the MSE portfolio, namely that classed as the micro segment (i.e. businesses with a turnover of less than approx. EUR 400k, loans to which were principally issued on the basis of cashflow forecasts), the bank recorded a PaR (60 day) value higher than the above benchmark. This was also above the PaR value for the bank's total portfolio, which was under 5%. However, the partner bank itself considers that the higher level of delays seen in the micro segment is not a cause for concern. It states this is due to the fact that payments in the MSE sector have traditionally been slower and more frequently delayed, and that this does not necessarily lead to similarly high levels of default. This is confirmed by the figures regarding actual write-offs for outstand-ing accounts in the micro segment. Default rates here are very low, and consequently a satisfactory portfolio quality is being achieved – both overall and in the micro segment, which is considered particularly high-risk.

Indicators 3 and 4: The executing agency's overall MSE portfolio almost tripled between 2009 and 2012 (from approx. 800 million Turkish lira [TL] to approx 2,400 million TL). At present, roughly 40 % of the loans in the business customer portfolio have a volume of less than 50,000 TL (EUR 18,000). The bank has therefore significantly expanded its MSE sector port-folio during the course of the project. This growth is being financed partly from the bank's own funds, but also, and in particular, by funds from other development finance institutions (DFIs). Even in its external publications (for example, its annual report) the bank actively promotes its position as a private bank operating in the MSE segment. The executing agency, unlike most other private commercial banks, is therefore active in the small, non-consumer loan segment, even though this involves particularly high transaction costs due to high staff expenditure. More than 80 % of these cashflow-based business loans are for amounts below EUR 10,000 (average of the values at individual branches). Indicators 3 and 4 are therefore considered fulfilled.

Indicator 5: The executing agency uses a variety of lending technologies to serve its customers in the MSME segment. These are differentiated from the bank's perspective according to loan volumes and other characteristics (especially credit history). A loan procedure based on cashflows is used for new customers (including new business customers) with a volume of lending less than 100,000 TL (at present, approx. EUR 50,000). Information used in the analysis includes the costs and margins of the customer's business and the preparation of a balance sheet, which is produced on the spot by the customer and the loans officer. Accordingly, the technology for new customers is associated with high personnel costs in relation to the volume of lending.

After inputting a few items of standard data, a centralised computer system decides which technology to use. Only in the case of small volumes of lending is the lending decision taken at the branch. In other cases the decision is made at the regional office or at the head office, with the process being largely automated. If the decision is negative, the loan officer can activate a reassessment. Even though the lending technology used means that the volume of lending is heavily dependent on the customer's repayment capacity, about 95 % of all loans also require collateral. This is frequently in the form of land or residential property. The requirements for collateral in the micro segment were relaxed after the complementary measure was implemented.

In spite of some negative points (delayed payments in the micro segment and the continuing requirement for collateral, wherever available), effectiveness has been assessed as good overall. This is because of the introduction of creditworthiness checks based particularly on cashflow and because a major constraint on financing was addressed and relaxed in a professional manner.

Effectiveness rating: 2

Efficiency

The project's efficiency was largely determined by the choice of project-executing agency. In terms of its balance sheet, the agency was small enough to be induced by German FC to take a sustainable interest both in the micro segment of the MSE sector and in a lending technology tailored to that application. In fact, the MSE segment (including the micro segment) has not only been established as a profitable field of business at the partner bank; in addition, MSEs are also viewed by the management as a core customer group. Since the bank already had a certain degree of experience and relevant expertise in the MSE sector before the project was implemented, it was not necessary to launch MSE business as a completely new field. Instead, the project was able to focus on the segment comprising smaller businesses and young enterprises as well as on the new lending technology. At the same time, it was possible to take advantage of the bank's branch network and its high production efficiency.

A change in the bank's ownership structure during the project slowed implementation com-pared to the original schedule. However, the loans were nonetheless paid out promptly once they had been sanctioned. Under the original plan, the budget funds were to be issued as an equity convertible loan (trustee funds). Following problems over recognising this as a component of the equity capital (supplementary capital), which is important in the context of the banking regulations, that plan was discarded. This did not adversely affect the project's efficiency to any significant degree.

The consultant's reports on the complementary measure note that a large number of staff who had been trained in the MSE segment subsequently left the bank. Staff turnover is generally very high at Turkish banks. However, this will only reduce the efficiency of the training measures if the knowledge gained cannot be put to use at the new employers. New appointments at banks which do not have a focus on the MSE sector will accordingly have an ad-verse effect on the project's efficiency. However, it can also be assumed that, in the case of some of the staff who change jobs, there will be a positive spill over of knowledge to other banks in relation to MSE business.

The project reached a substantial portion of the Turkish MSE segment while using a relatively small outlay of funds (compared to the bank's total portfolio). This was because the project-executing agency deployed its own funds and the funds of other DFIs for the same purpose. Overall, efficiency is therefore rated as good.

Efficiency rating: 2

Impact

The overall objective was to develop and deepen the local financial sector in a way that focused on the target group. The aim was that this would help close the gaps in the offer of financial services available to MSEs. It was expected that this would, at the same time, improve target group incomes and create additional jobs.

Indicator	Ex post evaluation
(6) Additional jobs are being created in the assisted /rMSEs.	Fulfilled
(7) At least two other commercial banks are actively addressing the MSE segment with appropriate lending technology.	Not fulfilled (for the private banking sector)

Indicator 6: Almost all the customers visited as part of the ex-post evaluation reported in-creased employment, created as a result of the investments that were financed. In the environment created by Turkey's flexible labour market, employers have no reservations in appointing new staff as their business expands. Given the general conditions in Turkey, and provided that loans are used for productive purposes, it is reasonable to assume there has been a positive effect on employment, even if this cannot be precisely measured. Compared to the crisis year 2009, the unemployment rate in Turkey has dropped by around 4 % – a significant fall. Developments under this project thus feed into the generally positive economic trend evident in Turkey.

Indicator 7: The project-executing agency remains the only private bank in the market to serve MSE customers through the use of cashflow-based lending technology. Only two of the largest public sector banks are actively addressing new and existing MSE customers in this way, foremost in the agricultural area. As it confines itself to the circle of private commercial banks, indicator 7 is therefore considered as not fulfilled. Hence for young MSEs it is still the case that they are unable to obtain financing from other private banks, due to their internal risk limits. After a certain period of time, when the profitability of these MSEs is proven, they are targeted by other commercial banks. Customers' options in their choice of financier increase. The executing agency tries to prevent customers from being enticed away by building close customer-bank relations. This is also encouraged by using a cashflow-based credit analysis system; this benefits not least the employer by increasing his knowledge of his business's financial situation.

Over recent years, the partner bank has significantly increased both its total MSE portfolio and the number of branch offices (from 256 in 2009 to 292 in 2013). In the sparsely populated regions in the east of the country, the branch network is nevertheless still thinly spread. Yet the presence of a branch office has traditionally been important for customers in the MSE segment. Accordingly, few or no customers have been reached in these provinces. As a con-sequence, the impact of the project on the MSE sector in these regions has also been small. Overall, developmental effectiveness is nonetheless rated as good.….

Impact rating: 2

Sustainability

The executing agency continues to serve the MSE segment using the technologies described above and the processes implemented as part of the complementary measure. The agency orients its business towards this segment, even in its external presentation. In addition, over recent years the bank has automated many of the steps in the lending process. This automation is helping to limit the high operational costs seen in the MSE segment and is thus improving the sustainability of the measures enacted. Most market participants expect that the demand for MSE loans will exceed supply in the near future. Despite the huge growth in the MSE portfolio and the equal growth seen in the micro segment it contains, a marked decline in cashflow-based loan commitments by the bank in the micro segment has been observed since 2011. This trend cannot be explained simply by the very high level of cashflow-based loans granted in the years before the 2010 crisis that were used in the comparison. The decline is due to a mix of supply-side and demand-side factors. On one hand, this could be the result of a maturing portfolio with an increasing number of established customers. On the other hand, this section of the micro business field is expensive and frequently less profitable than other fields of business. Whether cashflow-based lending (which is predominantly used for new customers) recovers in the next few years depends on the refinancing options available, the general economic conditions and the executing agency's future focus in terms of customer groups. Despite this – or just because of the decline in this segment – the bank is in a position to keep defaults on lending in the cashflow-based micro segment and in the MSE portfolio as a whole, at a level that is appropriate for the Turkish market. There are no signs of any tendency towards excessive lending or of any over-indebtedness at the MSEs, which would contradict the principles of responsible finance.

At the present time, no other private commercial bank has yet started to serve the MSE segment using cashflow-based lending. Only public sector banks are similarly active in the MSE segment. At the moment there is no indication that interest in young MSEs has increased among the other private banks. On the contrary, they are seeking to profit indirectly from the partner bank's efforts to develop new customers by enticing "good" customers away, by means of teaser rates. It is therefore unlikely that the incentive for other banks to become active in this area will increase in the near future. Despite the contraction seen in the cash-flow-based portfolio and even though the project did not act as a guiding light for the private banking sector, the project's sustainability – based on the positive, sustainable impact on the bank's end borrowers – is still rated as good.

Sustainability rating: 2

Notes on the methods used to evaluate project success (project rating)

Projects (and programmes) are evaluated on a six-point scale, the criteria being **relevance, effectiveness, efficiency** and **overarching developmental impact**. The ratings are also used to arrive at a **final assessment** of a project's overall developmental efficacy. The scale is as follows:

Level 1	Very good result that clearly exceeds expectations
Level 2	Good result, fully in line with expectations and without any significant shortcomings
Level 3	Satisfactory result – project falls short of expectations but the positive results dominate
Level 4	Unsatisfactory result – significantly below expectations, with negative results dominating despite discernible positive results
Level 5	Clearly inadequate result – despite some positive partial results, the negative results clearly dominate
Level 6	The project has no impact or the situation has actually deteriorated

Rating levels 1-3 denote a positive assessment or successful project while rating levels 4-6 denote a negative assessment.

Sustainability is evaluated according to the following four-point scale:

Sustainability level 1 (very good sustainability): The developmental efficacy of the project (positive to date) is very likely to continue undiminished or even increase.

Sustainability level 2 (good sustainability): The developmental efficacy of the project (positive to date) is very likely to decline only minimally but remain positive overall. (This is what can normally be expected).

Sustainability level 3 (satisfactory sustainability): The developmental efficacy of the project (positive to date) is very likely to decline significantly but remain positive overall. This rating is also assigned if the sustainability of a project is considered inadequate up to the time of the ex post evaluation but is very likely to evolve positively so that the project will ultimately achieve positive developmental efficacy.

Sustainability level 4 (inadequate sustainability): The developmental efficacy of the project is inadequate up to the time of the ex post evaluation and is very unlikely to improve. This rating is also assigned if the sustainability that has been positively evaluated to date is very likely to deteriorate severely and no longer meet the level 3 criteria.

The **overall rating** on the six-point scale is compiled from a weighting of all five individual criteria as appropriate to the project in question. Rating levels 1-3 of the overall rating denote a "successful" project while rating levels 4-6 denote an "unsuccessful" project. It should be noted that a project can generally be considered developmentally “successful” only if the achievement of the project objective (“effectiveness”), the impact on the overall objective (“overarching developmental impact”) and the sustainability are rated at least “satisfactory” (level 3).