MIR 2 - Municipal Improvement and Revival
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United Nations Development Programme

Municipal Improvement and Revival Programme
for Southern Serbia (MIR 2)

The Guarantee Fund for Southern Serbia

Institutional Assessment

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MIR 2 - Municipal Improvement and Revival Programme is funded and implemented in partnership by The Government of Serbia, European Union through European Agency for Reconstruction (EAR), Embassy of Sweden through Swedish International Development Agency (Sida), Republic of Austria - Austrian Development Agency (ADC/ADA), Royal Norwegian Embassy and United Nations Development Programme(UNDP)

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MIR2
Municipal Improvement and Revival Programme

Bankakademie International

Content:

Annexes:

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Abbreviations:

AWA	Austrian Development Agency
CSD	Serbian Dinar
EAR	European Agency for Reconstruction
EBRD	European Bank for Reconstruction and Development
EFSE	European Fund for South Eastern Europe
EU	European Union
EUR	Euro
GF	The Guarantee Fund for Southern Serbia
IFC	International Finance Corporation
IFIs	International Finance Institutions
KfW	Kreditanstalt für Wiederaufbau
LE	District of Jablanica (capital city: LESKOVAC)
MIR	Municipal Improvement and Revival Programme
SMEs	Small and Medium Sized Enterprises
Sida	Swedish Agency for International Development Cooperation
TA	Technical Assistance
UNDP	United Nations Development Programme
VR	District of Pcinja (capital city: VRANJE)
WB	World Bank

1 Executive Summary

The Guarantee Fund for Southern Serbia ("GF") was established to facilitate access to credit for Serbian SMEs in two districts in South Serbia. It started its operations in 2004. The GF is established as a public entity under the Council of the Municipality of Leskovac. Apart from an initial capital contribution by the Council of the Municipality of Leksovac (EUR 76,500) upon creation, GF has been funded under the UNDP MIR Programme. The total contribution sums up to EUR 264,000.

The GF provides guarantees to banks, to meet their collateral requirements, in the form of a cash deposit. Through these guarantees, the GF facilitates an otherwise difficult access to credit for South Serbian SMEs.

Today, additional funding is necessary to allow business continuation for the GF. With reference to this need, UNDP MIR 2 assigned the Consultant to (i) assess the need for a GF in the South Serbian finance sector and (ii) suggest possible support measures.

The Consultant has through available data and information collected through an on-site four week assessment been able to set up a comprehensive set of proposals and recommendations for future action, which will be presented in this report.

In short, the Consultant assesses that there is a confirmed need for the GF in the region. However, the existing need can only be met through a significant further development of the GF operations. The Consultant therefore sees the need of necessary financial support to the GF by donors (through limited grants) and International Finance Institutions (through appropriate loans). However, the activity of the GF is being of a commercial market-oriented nature. Thus, the Consultant strongly advises a re-establishment of the GF as a commercial company, outside the authority of local Governments.

In addition, the Consultant recommends that sufficient Technical Assistance is provided to the GF, to contribute to the proper establishment of the fund and to help it reach self sustainability. Such assistance should also include a contribution to negotiations with financial partners (e. g.: local banks) as well as non financial partners.

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2 Report

2.1 Background Information:

The UNDP Project:

The UNDP Project "Southern Serbia Municipal Improvement and Recovery Programme (SSMIRP)" was initiated in 2001 to help South Serbia recover from difficulties resulting from the Kosovo conflict. The region of South Serbia includes two districts, Jablanica, (capital city: Leskovac), and Pcinja, (capital city: Vranje) and and one of the poorest and most underdeveloped parts of the country.

Following on from SSMIRP, UNDP in partnership with its stakeholders implemented the Municipal Improvement and Revival Programme (MIR) and is now in the process of implementing MIR 2. This program builds on the achievements of the previous programmes while at the same time looking to make real impact in the four following areas:

- Regional cooperation,
- Strategic planning,
- Municipal management,
- Municipal service delivery.

Despite the fact the main focus of MIR2 is with the development of local government, there is an aspect of the programme that (although linked to regional development) is specifically attempting to create jobs. Under this aspect, the creation and support of the GF has been done.

The Guarantee Fund: Concept and Creation

In mid 2004, SSMIRP, as a part of its support to economic development in the region, developed a guarantee fund.

The intervention was based on the following facts: while credit for small scale businesses (< EUR 5,000) was available, and large scale credits (> EUR 100,000) were also accessible, many SMEs struggled to obtain credit simply due to the fact that they did not have the collateral to guarantee the loan. This problem was compounded by the fact that:

1. Banks in Serbia generally request a collateral of 200% of the loan, sometimes more;
2. The value of the collateral offered is estimated by the banks themselves;

3. The vast majority of property and land, especially outside Belgrade, is not registered in the Cadastre. Thus, the title of ownership cannot be used as a guarantee.

The concept of the GF was therefore to address this fault in the market and through a public sector institution establish a fund that would provide guarantees to SMEs in the region.

The funds required for initial loan capital were provided to a limited extent by the Municipal Council of Leskovac, the largest city in the region. The larger part of the funds was provided by UNDP with the intention to secure other sources of funding in the longer term. The intention was to access both municipal and central government funding. Funds to cover the running costs of the institution were provided by the Municipal Council of Leskovac.

The Guarantee Fund: Operational Issues

The GF offers collateral to back medium sized loans (approximately EUR 20,000 to 100,000), to the extent of 50 % of the amount of the loan. The collateral offered is backed by a 100 % cash deposit with the partner bank. Loans may have a maximum tenor of 3 years and a maximum grace period of 6 months. The commitment of the Guarantee Fund is progressively released as and when the loan is repaid to the participating bank.

Three banks were selected to participate in the scheme; others may be included in the future. While the fund had some initial technical difficulties, these are now solved. The start up of the GF looked as follows:

Initial funding by the Municipal Council of Leskovac	EUR 76,500;
Additional funding under UNDP responsibility	EUR187,500.
Total available for collateralisation of loans	**EUR 264,000.**

As of today 27 operations were accepted for a total of EUR 234,000. No operation is reported behind schedule.

Although other Municipal Councils announced their intention to participate in the funding of the equity of the GF, no contribution has actually been effective. This may be linked to the consistent concern expressed by several mayors about the programme (in particular from the mayors which municipalities would be no beneficiary of the GF). The institution itself was established and funded by the largest municipality in the region. Sadly, it can be concluded that this has led to a situation where the GF faces by the similar problems as the majority of the public sector in the region faces, such as overstaffing and political interference. Therefore, the improvement of the governance of the GF would be of outmost importance for a future success.

The current weak situation of the GF is partly due to constant criticism from certain mayors of the region, and more importantly due to the recent dismissal of the GF director, a decision taken purely for political reasons. As a result, future cooperation with the GF is being put on hold from donors, despite the fact there is donor funding available.

An Independent Assessment

In order to prepare for a decision concerning future cooperation between the UNDP MIR 2 Project and associated potential donors on the one hand, and the Guarantee Fund for South Serbia on the other hand, the following tasks were performed by the Consultant:

- Analysis of the achievements of the Guarantee Fund;
- Recommendations as to the suitability of this type of Institution to contribute to the creation of steady jobs;
- Recommendations as to the most appropriate structure and related management methodology for such an Institution;
- Review of potential financial partnerships to allow future development of the Institution.

The onsite assessment took place in October and November 2006. The full ToRs for the Consultant can be found in Annex 1.

2.2 Situation of the Guarantee Fund as of 10 October 2006:

General Activity:

The Fund started operating in the very last days of 2004, and almost immediately committed most of the resource brought to the fund by the Council of Leksovac. Only when UNDP sourced capital became available, a new series of operations was accepted, again over a very short period of time until the capital was fully committed.

While many loans guaranteed in 2004 and 2005 were fully repaid to the banks since the beginning of 2006, thus rebuilding the guarantee capacity, no new operations were processed until the end of September 2006.

According to the Management of the GF, around 400 applications were received and analysed in 2004-2005, and 100 in 2006. While certainly a number of these applications did not meet eligibility criteria, the information supplied by the GF is that a significant proportion of the application was not accepted only because of the GF's lack of relevant resources.

A Real Potential Market:

When matching the information from the GF above, which reveals a real pipeline, with the fact that the GF is at this point, due to limited communication, not fully known among potential beneficiaries, one can concluded that a real market is available for fund-guaranteed loans. During interviews with managers of the participating banks, this view was confirmed; the banks all confirmed a large potential market.

In a context of fragile growth of recently created businesses, such as in South Serbia, banks may maintain strict prudential rules. When this results in a request for large amounts of collateral, there is room for a guarantee fund that will contribute to an easier access of SMEs to finance, and as a matter of priority, to investment finance. When banks will have a better knowledge of their clients in the context of a market economy and a larger experience, new needs will emerge (e. g. international trade) that will justify further the existence of a business oriented credit insurance system.

The example of the processed applications in the GF under the last three years outlines that selected investors have the capacity to reimburse the loans, thus offering a clear possibility to grant guarantees to other users with new business- and credit-worthy projects.

Proper Funding is Needed

As mentioned above, several municipalities committed funds to strengthen the issuance capacity of the Guarantee Fund. This is also stated in a report dated May 2005. However, the GF did not process any operation until the end of September 2006. This once again highlights the fact that the commitments of the municipalities remained ineffective. Here, two major conclusions can be drawn:

-→ Funding should be sourced outside local governmental entities.

-→ A key issue will be the management of the fund. An essential requisite of potential financial partners (including donors and commercial institutions) will be that the beneficiary must be entirely free from any influence, in particular influence from political entities.

Operational Constraints

In terms of operating expenses, the GF is at present subject to constraints that do not allow self-sustainability, neither at present, nor in a foreseeable future.

On the staffing side, the staff was initially set to five employees. After a high of 13, the current number of employees is 11. It can be noted that permanent staff covers some activities that do not necessitate more than maximum ½ day once a month (for example payroll or legal advice). Undoubtedly an excess of idle personnel may only result in perturbations for those who actually perform activities in the GF. In addition it can only be discouraging for the active staff, who does not receive a better salary than the more passive staff.

At managerial level, conflicts outside professionalism have led to major changes, including the leave of the general manager as mentioned above. After the absence of a person in charge for several months, it will be a real challenge to rebuild the working spirit that is necessary to maintain the fund operational.

Present staff selection is not made on criteria based on professional experience. This has resulted in the absence of basic knowledge (risk assessment, financial issues, commercial approach), of know-how, of organisation, of plan of activity and of objectives.

Operations approved

The table attached in Annex 3 provides a resume of the activity of the GF from its creation up until October 10th, 2006. The comments in Annex 3 address each accepted operation; specific additional comments are included for the 8 operations that were visited in field visits, selected at the initiative of the Consultant.

While the GF builds and maintains a comprehensive file on each operation, there seems to be no simple efficient tool available at the GF to summarize the situation, and inter alia to determine the capacity to grant new guarantees (in consideration of registered loan repayments). The Consultant has made the following calculation on the financial operational capacity as of 10 October 2006:

Outstanding amount:

This is the amount of capital that remains due (as concerns the loan) or guaranteed (as concerns the guarantee) as of 10 October 2006.

Financial Operational Capacity:

When referring to the grand total, the outstanding amounts may be compared with respective funds pledged and made available by the donors (Municipality of Leskovac and UNDP at present).

Items / Amounts:	CSD	EUR
Municipality of Leskovac		
Funds pledged:	6,115,096	76,438.70
Funds used:	1,075,000	13,438.00
Funds available	5,040,096	63,000.70
UNDP		
Funds pledged	15,000,000	187,500.00
Funds used:	9,109,600	113,870.00
Funds available	5,890,400	73,630.00
Total		
Funds pledged:	21,115,096	263,938.70
Funds used:	10,184,600	127,308.00
Funds available	**14,930,496**	**136,630.70**

The overview shows that an amount of ca. EUR 136,630 is available to guarantee loans. This absence of use of available resources, naturally also results in an absence of fees received. Calculated on the average amount of processed operations (233,846/27=8,660), close to 16 new operations would be possible. The funds available represent 51.8 % of the funds pledged. Detailed figures for these calculations can be found in Annex 4.

External influence:

It should be noted that a comparative review by the Consultant revealed that external influence has affected the objective approval of several of the 27 operations processed in the GF. While the identified guaranteed loans are repaid according to their contractual schedules, the bias introduced, which influence in the course of the assessment is not acceptable as per best practice. The objective approval is an essential issue when dealing with risk and financing projects using third parties' money.

Excessive Flexibility:

A potentially related issue to the partly subjective approval resides in the fact that several operations consist in guaranteeing loans with unjustified (and excessive) grace periods. Such practice may lead some entrepreneurs to take advantage of the situation, and when time comes for repayment, difficulties that could and should have been avoided could occur.

Inappropriate Loan (and Guarantee) Tenor:

A second potentially related issue is the financing of raw material meant for an almost immediate use with medium term loan (e. g. : flour for a retail bakery). Short term lending, possibly on a renewable basis, addresses such needs of finance for working capital; it may be twinned as and when necessary with a specific guarantee.

Loose Code of Ethics:

A third related issue is that at least one guarantee was granted in favour of an investor whose business is large enough to offer sufficient collateral to match bank requisites, thus "freezing" a capacity that could advantageously be used to support the growth of several businesses for a long period.

While the risk involved in the specific project can be assessed as low upon preliminary investigations, this clearly isin breach of the ethics that should govern GF activities.

2.3 A Self-Sustainable Guarantee Fund: Some Key Issues

General Considerations

Created at the initiative of the Council of the Municipality of Leksovac, then supported by the UNDP managed SSMIRP Project, the GF has since the end of 2004 assisted a total of 27 SMEs in obtaining loans and thereby assisted in the creation of around 115 jobs. From a regional development perspective, these achievements show the need for the institution. However, a detailed analysis of the GF reveals that its organisation and its performances are not in line with the level of professionalism that can be expected to reach self-sustainability. The criteria and thresholds described in this chapter should line out the way for the redefinition of the GF to make it an independent local key partner in SME finance.

Market Assets and Constraints

Basic data:

These figures represent the current situation in the 2 districts where the GF operates:

Total population	470,000
Active population	205,000
Self employed	21,000
Private companies	6,100
Other Private businesses (no “detailed activity”)	1,100

Over 90 % of the private companies are SMEs. Investment addresses simple renewal of equipment, and/or additional equipment to meet market demand.

Banks request collateral in a proportion that may reach 300 % of the principal of the loan, and use their own evaluation criteria. As a consequence, managers/owners of SMEs may not be in a position to provide enough collateral and cannot invest, although the business is business-worthy and (outside the level of collateral offered) credit-worthy. Although no statistics are available, it is clear that while a proportion of the investment projects can be addressed through micro-credit, in most cases the solution resides in an application for a traditional bank loan.

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Competition:

Micro-credit:

As mentioned above, some smaller investment projects are eligible to micro-credit. ProCredit Bank is now present in the area, and offers such finance. Although the rate of interest is higher than for standard bank loans, the solution offered, rapid and easy in terms of collateral, meets the expectations of businessmen who expect a rapid return on investment. It can be foreseen that other banks will offer similar conditions in a near future. However, the GF is meant to address primarily larger operations, and although several operations were processed for amounts that are now covered through micro-credit, overlapping should be limited in the future.

The “Republican” Guarantee Fund:

The Republican Guarantee Fund is a state operated structure based in Belgrade. While a few operations are reported in the area where the GF is operating, there seems to be some hesitations from the SMEs to use its services. The perception from the SME is that the Republican Guarantee Fund is meant for larger projects, of a greater significance, and at national level. There is therefore room for more than one institution, and “complementary” seems to be more appropriate than “competing” to qualify the relationship between the two funds.

Commercial Banks:

Visited commercial banks already mention that for some well known clients, their requisites in terms of collateral may be eased, in particular when a previous loan was repaid according to the planned schedule. Undoubtedly, as and when banks – and in particular credit managers – will acquire a better perception of the clients in their portfolio, they will progressively accept a collateral / debt coverage ratio that will reflect the real level of risk exposure, at least for selected clients. However, smaller enterprises might not be a priority when the banks are ready to reduce their collateral requirements. .

In addition, fund guaranteed operations would still benefit from privileged lending rates (since the bank is not bearing the risk on the guaranteed tranche of the loan). As long as also when including the cost of the guaranty, the total cost of the loan will remain below the cost of a standard loan with standard collateral, there will be an interest for the investor in working with the GF. Banks will also at one point be interested in sharing risk with a third party to improve their Capital Adequacy Ratio.

A Renewed Institution

In consideration of market opportunities and of competition (and partnership opportunities with commercial banks), and on the basis of the achievements evidenced so far in this report, there is an opportunity to maintain and develop the GF to a level of self-sustainability. However, in consideration of the weaknesses evidenced in the detailed analysis of the portfolio, the decision to go ahead with the GF should be conditioned by significant amendments to the present organisation and mode of operation.

On the path to self-sustainability:

The project is only viable if it, within a reasonable period of time (4 to 5 years), reaches a level of income that is sufficient to address a) operating expenses including staff training and b) financial independence (coverage of losses on delinquent operations, increase in equity through retained results).

When looking at the needed levels of income the following conclusions can be made:
Based on the experience of the Consultant, a risk coverage fee of 1.50 % p. a. on outstanding operations (in the active portfolio) would be reasonable. On the basis of a permanent portfolio of EUR 5 Mio, this would represent a yearly income of EUR 75,000. A permanent portfolio of EUR 5 M, considering an average tenor of 2 ½ years for the guaranteed loans, is generated and maintained on the basis of a yearly "production" of EUR 2 Mio.

On the basis of an average loan amount of EUR 40,000, i. e. an average amount of EUR 20,000 per guarantee issued, this represents 100 accepted applications per year. In consideration of the evidenced activity taking place in the GF until now (the first 18 operations were processed within 6 months, in 2 lots, and processing was stopped twice because of the lack of equity), and of the confirmed willingness of partner banks to offer more operations for risk sharing, this objective can be seen as reasonable.

Other expected sources of income from the GF are:

- A flat front fee for each application received ("reasonable" amount, to be determined),
- A proportional front fee for each application approved (possibly within a range of 2 to 3 % of the initial amount of the guarantee, but this needs to be assessed more precisely),
- Remuneration of the funds deposited with participating banks and representing the equity (at a rate expected very close to the interest paid on State debt, in consideration of the amount deposited and the permanency of the deposit),
- Donors' funding (progressively decreasing), to address operating expenses during an interim period covering the period of time necessary to reach self-sustainability.

Building sufficient equity:

The GF operates at present with equity of ca. EUR 264,000. Within the scope of developing the GF outside political authorities, the equity brought by the Council of the Municipality of Leskovac should be returned and duly replaced.

As per 31 December 2006, one single operation will remain guaranteed using the equity from the Municipality of Leskovac. Although it is the object of specific comments in the case-by-case analysis in Annex 3, there should be no major difficulty in transferring the responsibility of the coverage of the guarantee issued to the part of equity funded under the UNDP Project.

With a yearly production objective of EUR 2 Mio, and equity outside public funding topped at EUR 187,500 and committed to the extent of ca. EUR 120,000 after repayment of scheduled instalments until the end of 2006, it is necessary to organise a proper "initial" funding of the (renewed) GF. In consideration of the existing pipeline of unsatisfied applications on the one hand, and of the necessary progressive evolution towards a rhythm in production corresponding to EUR 2 Mio per year on the other hand, the need for capital can be estimated at EUR 1.5 Mio to be fully utilized by the end of 2007.

Progressive funding should allow a level of equity of EUR 0.5 Mio. as per 1 January 2007 (i. e. a contribution of EUR 312,500, outside operating expenses), thereafter EUR 1 Mio. by 30 June 2007 (subject to evidenced thorough use of funds already available), and EUR 1.5 Mio. by 31 December 2007 (same conditional payment). Further progressive funding should be planned until the EUR 5 Mio. threshold is reached.

While part of the equity could be brought in the form of a grant up to a limited level (preferably EUR 0.5 Mio. or possibly EUR 1 Mio.), it is recommended that further funding should be in the form of loans, with a rate of interest not exceeding 1.00 % p. a. whenever acceptable by the donors. The challenge of an intensive reliable production of new operations will find strong support if there are financial obligations towards the financers, while grants provide a form of "comfort" that is a counter-incentive to full professional dedication (and occasion a distortion of fair trade conditions).

A Compact Professional Staff:

In order to meet the challenge of sustained steadily growing production, a limited team showing intense solidarity in a context of high professionalism is needed. Whereas the original project designed and implemented under the responsibility of the local Government rapidly resulted in overstaffing, staying initial concept with a staff of 5 would make sense, when looking at the size of the GF. The Consultant suggests to hold a team of 4 people in the future.

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For the staff, experience is of paramount importance in lending (or guaranteeing a loan) in favour of SMEs. When processing an application to finance the main residence of a family of salaried persons, a simple framework can be the basic rule: loan does not exceed 80 % of the total project, tenor does not exceed 15 (sometimes 20) years, repayments do not exceed 30 % of the net income, etc. As opposed to this, each SME is a unique, specific case. There are similarities between projects across a variety of fields of activity, and there are often remarkable differences between what could at first sight be twin companies. Financial analysis is learnt from books, and the comments it generates are specific of the individual environment of each loan applicant. Operating conditions, Suppliers, Clients, Management etc. vary, and all these items have a significant influence on the final evaluation of the proposed project. The necessary experience of the staff would mean a limited team of analysts, who process a large quantity of applications, and can memorize typical and extraordinary situations, learn lessons, and use the acquired knowledge to improve their perception of new projects.

On the assumption that a reasonable activity level would be one accepted analyzed application per week per analyst, a team of two under the responsibility of a manager would be sufficient to progressively meet the objective described above of 100 accepted applications per year. Their scope of responsibilities would also include the verification of the relevance of legal data provided by the applicants.

The Team Leader/Manager, necessarily well aware of risk-bearing related issues, should show a real entrepreneurial spirit, necessary to lead a genuine mini-SME dedicated to supplying a financial service to other SMEs. His/her duties would include a direct participation in the analysis of applications, as the workload generated by other responsibilities cannot represent a full time occupation.

An assistant (secretary), well organised, is enough to address registration of incoming applications, follow-up of processing, preparation of contracts after a standard model, archives, collection and processing of feedback data from partner banks (disbursement, repayment, etc) and the preparation of standard tables for regular reporting.

The evaluation of the applications will necessitate the creation of an independent Credit Panel. Members should not be appointed as permanent staff, but receive a simple indemnification for their contribution. This panel should meet as and when necessary, not less than once a month, probably every two weeks on the average. Operations approved by the panel would be processed for commitment.

Independence and Partnership:

The operational team of the GF, as well as the members of the Credit Panel, must be free of any influence to avoid biased decisions. Otherwise, the situation would undoubtedly sooner or later result in non-performing operations. Therefore, the role of the Councils of the Municipalities (and in particular as concerns Leskovac) must be reconsidered. The key financial issue, participation in the equity, can be dealt with through the restitution of the pledged capital for reallocation to other Municipal projects, which should facilitate the approach. The other financial contribution, current expenses, would also be withdrawn from the responsibility of the local Government, with donors covering operational expenses (including staff, transportation, premises etc.) until self-sustainability is reached.

In turn, the GF would need facilitation actions, likely to increase the recognition of the GF among the business community. This can easily be the object of a contribution on the part of the Councils of the Municipalities, providing space and related services for communication events.

The role of the banks in the GF is naturally expected to develop, with an ever-increasing number of operations in their respective portfolio. It is already at their initiative that several applications were processed, and their role in recommending partnership-based operations with the GF should therefore develop easily. By signing partnership agreements with a larger selection of banks (only three at present) the GF would be less exposed to "amicable" influence. The contractual agreement between the GF and the partner banks set up in the past could be interpreted in various manners, where maximum thresholds (tenor, grace period) being considered as a minimum/mandatory limit in the negotiations with clients. The future contracts should therefore be more precise regarding the meaning and the use of such limits.

Future Developments:

As explained above, it can be expected that as and when banks will accumulate experience regarding financing of SMEs in a market economy, the requisites in terms of collateral will be amended and easier terms will be proposed.

However, the GF will still be needed in a more SME-friendly financial environment:

- Businesses expanding rapidly, businesses recently created, will still be likely to lack sufficient collateral, even though the proposed investment projects will be business- and credit-worthy.
- Businesses seeking better lending rates will have a possibility to have access to cheaper loans if the banks are relieved from bearing 100 % of the risk
- Businesses operating with cross-border activities, importing a proportion of their supplies, will need sufficient collateral to back the Letters of Credit
- Businesses participating in large projects as sub-contractors, paid only when their part in the complete project is terminated, will need to guarantee their own suppliers against payment failure
- Businesses participating in tendered contracts, on the domestic or on a foreign market, requested to produce a tendering guarantee or a performance bond, will need a partner that knows them well, to endorse the related risk

- And finally partner banks themselves, seeking a better capital adequacy ratio, will want to share the risk borne on their clients, in particular on the more exposed SME market.

In addition, while the GF was created to address the needs identified in two districts of Southern Serbia, there is a clear opportunity to let it expand its business to neighbouring areas. In particular, it would be interesting to include Nis, where a large population of SMEs is likely to be interested in using the services of a regional partner well aware of local constraints.

Funding

As mentioned above, the necessary independence of the GF, essential to its reputation and to its reliability, means that existing public funding must be abandoned, and that donors are to be sought to cover financing operational expenses (until profitability ensures self-sustainability) and equity.

The Project needs sufficient funding:

In terms of operational expenses:

Funding would be needed in the range of EUR 75,000 per year, for staff, premises, office expenditures and related expenses, decreasing progressively as and when the active portfolio grows to reach EUR 5 M;

This calculation is based on the following data:

1 Project Manager	EUR 1,000 / month
2 Credit Officers	EUR 700 / month each
1 Secretary	EUR 500 / month
Social contributions	EUR 2,000 / month
Premises ((rent)	EUR 300 / month
Miscellaneous	EUR 800 / month (including rates, telephone, petrol etc.)
Total	**EUR 6,000 / month or EUR 72,000 / year**

Additional funding needed would be:

- EUR 50,000 in the first year, not renewable, for a service car, computers, programmes, office furniture, installation, advertising.

- EUR 250,000 to 300,000, of which ca. 150,000 in the first year, for technical assistance, to provide initial staff training, then regular (monthly) monitoring and additional training. The technical assistance provider would, inter alia, contribute to the negotiation of new contracts with the participating banks, addressing lending procedures, but also the remuneration of the deposited funds, and when the flow of new files becomes more significant a satisfactory leverage ratio.
Monitoring would be intensely needed over the first year of operation, and then progressively reduced as and when professionalism is acquired over the next two following years.

In terms of equity:

- EUR 312,500 (approximately, to reach an equity of EUR 500,000) in the form of a grant when the plan of operations is implemented (estimated date 31 December 2006), to release the funds earmarked by the Council of the Municipality of Leskovac and to provide adequate funding to ensure a smooth development of the portfolio,

- EUR 500,000 either as a grant or as a soft loan, as and when the development of the outstanding portfolio will make it necessary, possibly around 30 June 2007,

- EUR 4 Mio., preferably in the form of a progressively disbursed soft loan, to meet necessary funding to accompany the growth of the portfolio. The first tranche of EUR 500,000 would be needed around 31 December 2007, other similar amounts should be releasable every 6 months approximately, conditionally upon production of portfolio analyses.

Potential Donors and Finance Providers:

Several partners can contribute to the reestablishment of the GF, and thereafter to its development as and when equity will be sought. For the fist year, institutions participating in the MIR 2 Project could provide the support that is necessary to give a powerful boost to the GF. Thereafter, in consideration of the initial commitment of international institutions, finance institutions would be able to step in.

At this stage, prior to any official or informal contact, potential partners are identified as follows:

Initial funding:

- UNDP, "founding partner",
- AWA, "founding partner", MIR 2 partner,
- SIDA, MIR 2 partner,
- Norwegian Govt., "founding partner", MIR 2 partner,
- EAR, MIR 2 partner,
- Dutch Govt., MIR partner.

Development funding:

- The World Bank,
- IFC,
- EBRD,
- KfW,
- AWA,
- SIDA,
- EFSE,
- Other Government related Financial Agencies.

The organisations mentioned above should be contacted when a decision is reached to go ahead with the development of the GF as a private independent institution.

Legal Issues:

The separation of the GF from the local Governments will transform it into a private company.

Ownership:

As concerns ownership, several solutions are available, including a foundation. As an example (which is not a recommendation as such), business managers of private enterprises based in the area that are too large to be potential beneficiaries of guarantees issued by the GF could establish such a foundation for the benefit of SMEs. In the future, should the GF be either closed or simply sold to a specialised partner, a statutory clause negotiated with initial Donors could earmark the profit – if any –for "social" projects to a certain extent.

Other legal solutions would need further review.

Taxation:

It is important that profits generated through the activity of the Guarantee Fund can remain tax-exempt as long as they are retained, to enable strengthening of the equity.

Legal provisions would need further investigation. However, with profit tax rate now set at only 10 % in Serbia, the impact on equity strengthening of a possible taxation would remain limited.

Technical Issues:

This section offers brief descriptions of mechanisms mentioned in the report.

Leverage Ratio:

A guarantee fund is de facto a credit insurance institution. Like for an insurance company, if there is one single client of the company and this client is affected by the risk covered through the contract, the entire portfolio will be affected. As soon as the portfolio comprises a large number of clients in various geographical areas and with an extended range of activities, the possibility that a client will be affected by the risk covered through the contract does not mean that other clients are going to be affected; the impact of the evidenced risk on the total portfolio is low, and probably covered through other income.

In order to back the risk sustained in the first example a 100 % deposit is necessary;
In order to back the risk sustained on the entire portfolio in the second example, a deposit only sufficient to back the estimated final risk is necessary. With a portfolio of 27 operations committed to the extent of EUR 233,000, the risk accepted is high, in consideration of the reduced experience of the GF and a limited diversification.

As and when the portfolio is going to expand, experience in guaranteeing will accumulate and the portfolio will be more diversified, meaning in particular that each operation will only represent a very small percentage in the total risk exposure.

In consideration of these explanations, and on the basis of experience, it is considered that negotiations could lead to the following thresholds:

Portfolio size	Leverage ratio	Need for equity
EUR 1 Mio.	1:1	EUR 1 Mio.
EUR 1.5 Mio.	1.3:1	EUR 1.2 Mio.

EUR 2.5 Mio.	1.5:1	EUR 1.7 Mio.
EUR 3.5 Mio.	1.8:1	EUR 2 Mio.

These figures are quoted as examples and will depend on the negotiations with participating banks. Such negotiations will be based on a careful case by case analysis of the past and existing portfolio, and leverage ratios could be lowered in consideration of the estimated risk exposure.

Grants and Loans:

The estimated need for initial equity is of EUR 0.5Mio. This should be in the form of a grant, incorporating existing allocated resources.

To meet the needs of the GF through the early months of operation, an additional EUR 0.5 Mio is considered necessary, to avoid a "stop and go" activity cycle.
This could be either in the form of a grant or in the form of a "soft loan".

Further development in order to meet the self-sustainability threshold estimated at a portfolio of EUR 5 Mio. will necessitate additional funding, most probably to the extent of a total of EUR 5 Mio, in consideration of the time necessary to negotiate a sufficient leverage ratio with participating banks. This additional funding should be in the form of soft loans.

The loans would be reimbursed progressively, as and when the activity of the GF generates enough profits to address loan repayment without affecting the stability (and the necessary growth) of the necessary equity. A preliminary approach would lead to consider a tenor of 15 to 20 years, a grace period of 7 to 10 years for the first tranches, 5 to 7 years for the latter ones, a rate of interest not exceeding 1.0 % pa.

It should be noted that these figures necessitate careful adjustment in consideration of the development pace of the GF.

2.4 Proposed Legal Structure and Respective Responsibilities:

The following chapter briefly outlines a possible legal structure for the future GF: A more detailed review before the actual implementation would be needed.

Draft Legal Structure

An Association promotes the establishment of a Foundation. The Foundation creates an Institution, a registered company (Ltd, i. e. DOO) with the Foundation as a unique shareholder. The Institution is the GF and organises credit insurance.
Additionally, professional staff is recruited to develop the activities of the GF; staff members should not be able to become shareholders.

The Association:

The Association is (ideally) created at the initiative of private business managers willing to show their concern regarding the development of the SME sector. In particular, but not only, the aim of the Association is to facilitate access to credit and similar financial services for SMEs. The founding members of the Association are active in companies that are large enough, not to need assistance from the institutions is willing to promote.

The Association decides on the establishment of a Foundation, to perform one or several of the tasks the Association considers useful to the Business Community. The Association may be for example created at the initiative of the managers of foreign-owned large businesses in the area to be addressed (at present the Districts of Jablanica and Pcinja). It may also, for example, incorporate the managers of private large businesses with Serbian capital.

Another solution could be to let the Association be created at the initiative of the Council of Foreign Investors in Serbia, leaving open the possibility to let representatives of investors present in the area to take a leading part. A development similar to the solution described above could be done within the original mission of the GF.

The Foundation:

The Foundation should have its own (nearly symbolic?) equity. It may create, inter alia, an Institution, possibly a company, to house a specific commercial project in favour of the Business Community (in this specific case, the GF).

The Foundation is established with a Managerial Body (Board of Administration). The members of the Board are elected, and remain permanent members through their statutory mandate. The members of the Board decide on every key issue regarding each entity they create. In particular, as concerns the GF, they decide of general orientations, define a plan of operations, discuss and approve related reports, approve yearly accounts (and interim situations), are responsible for personnel issues. In addition, they are the ultimate decision makers regarding every large operation (over a pre-determined amount). The members select between themselves a Managerial Panel, to address current operations for each entity they create. As concerns the GF, this panel will constitute the Credit Panel, or at least the core team in the Credit Panel.

The members of the Credit Panel participate (possibly taking turns) in Credit Panel meetings. The decisions are final unless the operation is above a pre-determined amount; in this case the Panel issues an advice, for a final decision by the Board (see above). In the case a conflict of interest appears (family links, professional links or similar), the member of the Panel refrains from participating in the decision meeting; another member is then replacing him/her.

In the case when the Institution is closed or sold, the Foundation is responsible for the reallocation of the available funds to other community-oriented projects, as per a charter to be signed between the Foundation and the Equity providers (and in particular the Foreign Donors) who contribute to the proper funding of the Institution.

The Institution:

The Institution should be a commercial enterprise, registered as a limited liability company ("DOO") with a unique shareholder, the Foundation. The Institution is designed to grant guarantees in order to back commercial operations, in the form of bank credit or in any other appropriate form. This is meant to facilitate access of SMEs to finance.

The Foundation funds The Institution with an initial (symbolic?) grant. Various foreign donors fund it additionally, to the extent of EUR .0.5 Mio -1 Mio. Part of this funding consists in the reallocation of the funds granted by foreign donors to the existing GF.

International Finance Institutions will thereafter provide additional equity as and when needed to the extent of a total of EUR 5 Mio. in the form of soft loans (the EUR 5 Mio. threshold is retained in consideration of self-sustainability criteria). Progressive funding is conditioned by satisfactory audited performances.

The Institution recruits, through a procedure managed by the Foundation (and under the supervision of Foreign Donors, as they are key contributors) proper personnel.
The staff cannot become shareholder of the Institution. The personnel may benefit from a profit-based incentive scheme after self-sustainability is reached, as an element to favour staff stability (in consideration of important training costs).

Foreign Donors appoint a Senior Long Term Advisor to train the personnel and participate in the organisation of the Institution. It participates in the decisional process with a veto power (progressively limited to larger operations).

The Staff:

The Staff consists in 4 persons, with relevant professional background and qualifications and a high level of commitment to the success of the GF.

The Manager:

- The Manager/Team Leader is the Legal Representative.
- He/she has authority as concerns ordinary implementation issues.
- He/she is responsible for the analyses and comments concerning statistics reflecting the activity.
- He/she prepares annual activity plans, submits proposals to the Board of the Foundation.
- He/she is the leading participant in negotiations with partners (Banks, Donors, IFIs, other business partners). (The Advisor brings assistance).
- He/she is responsible for the organisation of daily development activities.

2 Credit Analysts:

- They produce qualified recommendations for decisions on applications.
- They monitor operations in process (routine checks, and special detailed reviews whenever difficulties are evidenced or expected).
- They are responsible for assessment field visits to projects proposed for decision.
- They participate in development through relationships with application providers and with clients.

The Assistant:

In addition to a standard secretarial position, he/she is trained to be a responsible partner in the team, with functions comprising:

- Registration and basic sorting of applications received,
- Implementation of operations (administrative tasks),
- Portfolio monitoring, displaying alert warnings on delinquent operations,
- Collection, organisation and production of statistics,
- Collection of relevant data (press releases, data on economic sectors, on clients).
- Thorough scanning of legal publications..

Additionally, the Technical Advisor should work with the team over a longer period, more intensively under the first year. In short, he/she should:

- Support the GF in its reconstruction, including the set up of procedures, streamlining of operations, MIS, and institution building,
- Perform training and coaching of staff (class room training as well as on-the—job training and coaching),
- Reviews of applications, whether proposed for approval or discarding,
- Participate in the Credit Panel (veto power),
- Participate in negotiations with banks (interest on deposit, leverage ratio) and IFIs.

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3 Recommendations

The report has outlined that while there is a need for the GF in the region, there is a need to reorganise the GF and take it from its current form, connected to the local government, to become a commercial, self-sustainable institution. This will require additional funding from donors and other financial insitutions, both to provide funds and to cover operational costs until self-sustainability has been reached. To change the currently weak governance, and the thereby modest efficiency of the fund, technical assistance will be needed. In short, the recommendations from the Consultant can be summarised as follows:

The Situation:

- The GF is a needed partner in SME finance in Southern Serbia.
- The GF needs additional funding to operate.

Conditions:

- A decision to further fund the GF implies that it must reach self-sustainability.
- Self sustainability for the GF would require:
  - a new legal structure,
  - operational profitability,
  - accumulation of sufficient own capital.

Solutions:

1) Clarify legal setup:

At present GF is a public institution. Due to its activity, being commercial, it must be transferred to the private sector. Specific precautions must be organised to preserve the funds granted for reallocation to a "social" project in the case of a sale or of a closure of the GF.

2) Organise proper funding:

A combination of grants and (soft) loans is necessary to enable sufficient activity. A satisfactory leverage ratio on deposits towards guarantee endorsement should be negotiated.

3) Organise proper income:

This would include to obtain improvement in remuneration of deposit, revise guarantee fees, improve the GF team productivity and diversify activities.

4) Provide Technical Assistance:

The Technical Assistance should include institution building and restructuring, training and transfer of experience and participation in negotiations with partners.

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Annex 1

Terms of Reference

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MIR2
Municipal Improvement and Revival Programme

Sida

Bankakademie International

UNITED NATIONS DEVELOPMENT PROGRAMME
MUNICIPAL IMPROVEMENT AND REVIVAL PROGRAMME (MIR)

TERMS OF REFERENCE – International Consultant on Guarantee Fund
(INTERNATIONAL CONSULTANT)

Project:	**Municipal Improvement and Revival Programme Phase II**
Location:	**Vranje Municipalities in Southern Serbia**
Type of Contract:	**SSA**
Duration:	**One short term mission during the second half of 2006**

1 – Project Background

United Nations Development Programme (UNDP) has been present in South Serbia since 2001 at which point a peace agreement had just been signed between Albanian secessionists and the at that time Federal Republican Government of Yugoslavia. Initially UNDP was involved in implementing post conflict, peace and reconciliation type programmes such as the Rapid Employment Programme (REP) and the Southern Serbia Municipal Improvement and Recovery Programme (SSMIRP) however gradually with SSMIRP phase II and the Municipal Improvement and Revival (MIR) programme activities have gradually moved towards focus on the capacity development and reform of local government. This is a particularly demanding task in a region such as South Serbia that has been historically underdeveloped and one of the poorest parts of the country and has in more recent times been beset by an ethnic conflict. With SSMIRP phase II and MIR I coming to an end UNDP is seeking with its stakeholder and partners to develop a new intervention that would bring all the various donors together behind one programme document.

This programme, MIR II, would build on the achievements of the previous programmes while at the same time looking to make real impact in the four following areas:

1. Regional cooperation
2. Strategic Planning
3. Municipal Management
4. Municipal service delivery

The project is operational in the thirteen municipalities of Jablanica and Pcinja districts of South Serbia with a main office in Vranje, a sub office in Leskovac and project implementation offices in all of the thirteen municipalities.

Despite the fact the main focus of MIR2 is with the development of local government there is an aspect of the programme that although linked to Regional Development is also specifically attempting to create jobs. This is the creation and support of a guarantee fund and more information on what exactly has been done is provided in the section below.

2 – Background

In mid 2004 the South Serbia Municipal Improvement and Recovery Programme (SSMIRP) programme as part as of its support to economic development in the region developed a guarantee fund. The basic premise of the intervention was that while credit for small scale businesses was available (< 5,000 Euro) and large scale credits were also accessible (> 100,000 Euro) many SMEs struggled to obtain credit simply due to the fact that they did not have the collateral to guarantee the loan. This problem was compounded by the fact that

1. Banks in Serbia generally request a collateral of 200% of the loan
2. The vast majority of property and land, certainly that outside Belgrade, is not registered in the Cadastre and therefore the title of ownership cannot be used as a guarantee.

The concept of the guarantee fund was therefore to address this fault in the market and through a public sector institution establish a fund that would provide guarantees to SMEs in the region. The funds required for initial loan capital were provided by UNDP with a view that in the longer term other sources of funding would be secured. The intention was to access both municipal and central government funding. The running costs of the institution were provided by one of the municipalities in the region.

During the last 18 months up until the end of 2005 15 guarantees have been provided allowing 17 local companies to access credit leading to the creation of 71 jobs. The total value of the loans were approximately US$ 430,000 with collateral for half this amount being provided by the fund. Three of the private banks operating in the region have been involved.

Certain mayors from the region have consistently voiced their concerns about this programme which in the majority of cases are linked with there being no guarantees in their municipalities. Initially there were huge problems with the private banks but in the majority of cases these were overcome except in certain instances particularly in one municipality where internal conflict between branch managers prevented guarantees being issued.

The institution itself was established and funded by the largest municipality in the region. Sadly this led to a situation whereby the institution has been beset by the same problems that the majority of the public sector in the region face such as overstaffing and political interference.

The current situation is that due to constant critiscm from certain mayors of the region and more importantly the recent dismissal of the guarantee fund director for purely political reasons, future cooperations with this institution is being put on hold despite the fact there is donor funding available.

3 – Duties and Responsibilities

Under the overall guidance of the MIR2 programme manager the consultant will review the performance of the current Regional Guarantee Fund and develop recommendations as to suitability of such a methodology as a means of developing the SME sector and creating jobs in South Serbia. Furthermore the consultant will make recommendations as to the most appropriate means of managing an institution such as a Guarantee Fund.

4 – Objective

To provide practical technical advice on the use of the Guarantee Fund as a methodology for supporting the development of SMEs and creating jobs in South Serbia.

5 – Scope of Works

The consultant will be responsible for the following tasks

1. Review the performance of the existing guarantee fund and the loans that were provided.
2. Make recommendations as to the suitability and feasibility of this methodology as a means of developing the SME sector in South Serbia and creating jobs.
3. If the above is positive then developing a paper investigating the most appropriate means of developing a guarantee fund to serve the SME sector in South Serbia. This paper would focus specifically on the following points
   - The most effective means of managing the fund that is the entity/institution and its structure that would take responsibility for it.
   - Possible sources of equity/loan capital for the fund

- The legality of establishing such a fund under Serbian law (the relevant support from a local lawyer would be provided here) and possible options
- Develop a simple strategy/plan for the fledgling institution
- Play a lead role in drafting and negotiating contracts with the Banks that are present in the region.

The timing of the trip will depend on the recommendations that are made with regard the suitability of this methodology as a means of developing the SME sector in South Serbia. However it is anticipated the first two parts of the mission will take approximately ten days. The third task it is anticipated would require an additional ten days.

6 – Outputs

One report on activities one and two and if necessary a second report focusing on activity three

7 – Qualifications and Experience

Experience	A relevant degree in economics/finance or equivalent experience Practical experience of having worked in the banking sector or associated industries, with a focus on the development of the SME sector Experience of guarantee funds (desirable) Experience of having worked in the Balkans (desirable)
Skills	Good communication skills both oral and written Strong negotiation skills Strong analytical skills Ability to apply practical solutions when implementing processes

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Annex 2

Agenda of Meetings

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MIR 2 Municipal Improvement and Revival Programme

Bankakademie International

Time Table:

Date	Time	Institution/Person	Activity
09.10.06	14:00	GF (LESKOVAC)	Start of Assignment
11.10.06	10:00	Alpha Bank (LESKOVAC)	Branch Mgr – Use of GF
11.10.06	11:30	Agrobanka (LESKOVAC)	Branch Mgr – Use of GF
11.10.06	14:00	GF (LESKOVAC)	Detailed Portfolio Review
16.10.06	10:00	Komercijalna Banka (VRANJE)	Branch Mgr – Use of GF
16.10.06	16:00	EU/EAR Inspector (VRANJE)	Description of Assignment
20.10.06	11:00	Austrian Com'l Attaché Norwegian 1st Secretary (UNDP MIR 2 Donors)	Presentation of Findings & Preliminary Recommend°
30.10.06	11:00	SIDA Head, Swedish Emb'y (UNDP MIR 2 Donor)	Presentation of Findings & Preliminary Recommend°
31.10.06	11:00	USAID Cross-Border Prog'me	Co-operation Opportunities
01.11.06	N. A.	Visits: 4 GF guaranteed Projects	Assessment
02.11.06	N. A.	Visits: 4 GF guaranteed Projects	Assessment
02.11.06	12:00	Komercijalna Banka (PRESEVO)	Branch Mgr – Use of GF
03.11.06	11:00	EFSE (Potential Fund Provider)	Presentation of Findings & Preliminary Recommend°
06.11.06	11:00	EBRD (Potential Fund Provider)	Presentation of Findings & Preliminary Recommend°
06.11.06	14:00	WB + IFC (Potential Fund Providers)	Presentation of Findings & Preliminary Recommend°
10.11.06	11:00	UNDP MIR Steering Com' Members + EFSE Rep.	Presentation of Findings & Final Recommendations

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Annex 3

Overview of GF Operations I

MIR 2 – Municipal Improvement and Revival Programme is funded and implemented in partnership by The Government of Serbia, European Union through European Agency for Reconstruction (EAR), Embassy of Sweden through Swedish International Development Agency (Sida), Republic of Austria – Austrian Development Agency (ADC/ADA), Royal Norwegian Embassy and United Nations Development Programme(UNDP)

Operations approved: Specific Items in the Tables and Related Comments:

Final due date:

This date, when marked with * in the comments, is estimated using the date of approval of the guarantee and the proposed tenor.

Technical delays (transmission to the bank, preparation of the loan disbursement, quarterly repayment schedule, delays in supplying the equipment) may slightly alter it. The date is precise concerning fully repaid loans.

Outstanding amount:

This is the amount of capital that remains due (as concerns the loan) or guaranteed (as concerns the guarantee) as of 10 October 2006.

Financial Operational Capacity:

When referring to the grand total, the outstanding amounts may be compared with respective funds pledged and made available by the Donors (Municipality of LESKOVAC and UNDP at present).

Items / Amounts:	CSD	EUR
As concerns the Municipality of LESKOVAC,		
Funds pledged:	6,115,096	76,438.70
Funds used:	1,075,000	13,438.00
Funds available	5,040,096	63,000.70
As concerns UNDP,		
Funds pledged:	15,000,000	187,500.00
Funds used:	9,109,600	113,870.00
Funds available	5,890,400	73,630.00
Total		
Funds pledged:	21,115,096	263,938.70
Funds used:	10,184,600	127,308.00
Funds available	14,930,496	136,630.70

An amount of ca. EUR 136,630 is available to guarantee loans, i. e. on the basis of the average amount of processed operations (233,846/27=8,660) close to 16 new operations (detailed figures for these calculations as par attached annex with tables). The funds available represent 51.8 % of the funds pledged.

Unused Resources:

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This absence of use of available resources results in an absence of fees received.

External influence:

A comparative review reveals that external influence affected the approval of several of the 27 operations processed.

While the identified guaranteed loans are repaid according to their contractual schedules, the bias introduced using influence in the course of the assessment is not acceptable as per "Best Practice"; this is an essential issue when dealing with risk and financing projects using third parties' money.

Excessive Flexibility:

A potentially related issue resides in the fact that several operations consist in guaranteeing loans with unjustified (and excessive) grace periods.

Such practice may lead some entrepreneurs to take advantage of the situation, and when time comes for repayment, difficulties may be experienced, that could and should have been avoided.

Inappropriate Loan (and Guarantee) Tenor:

Another potentially related issue is the financing of raw material meant for an almost immediate use with a medium term loan (e. g. : flour for a retail bakery).

Short term lending, possibly on a renewable basis, addresses such needs of finance for working capital; it may be twinned as and when necessary with a specific guarantee.

Loose Code of Ethics:

A third related issue is that at least one guarantee was granted in favour of an investor whose business is large enough to offer sufficient collateral to match bank requisites, thus "freezing" for a long period a capacity that could advantageously be used to support the growth of several businesses.

While the risk involved in the specific project can be assessed as low upon preliminary investigations, this clearly comes in breach of the ethics that should govern Fund activities.

Survey of the 27 operations processed as of 10 October 2006

2004-01 – OPAL - LE-LESKOVAC
2nd hand plastic extruder, manufacturing of medical items
Loan EUR 12,500, 27/12/04, 12 m, gp 3 m, 30/12/05
Guarantee EUR 6,250 (Resource: LESKOVAC Municipality Council)
Fully repaid
Standard operation, no further comment

2004-02 – PROMET - LE-LESKOVAC
2nd hand meat dryer + cutters, meat processing
Loan EUR 12,500, 28/12/04, 24 m, gp 3 m, *28/12/06
Guarantee EUR 6,250 (Resource: LESKOVAC Municipality Council)
Repayment as per schedule
Standard operation, no further comment

2004-03 – START - LE-LESKOVAC
Machine to produce crackers, food production (crackers)
Loan EUR 5,000, 28/12/04, 12 m, gp 0 m, 31/01/06
Guarantee EUR 2,500 (Resource: LESKOVAC Municipality Council)
Fully repaid
Standard operation, no further comment

2004-04 – TOMATEKS - LE-LESKOVAC
Import of raw material (from India) for the production of ropes and bags
Loan EUR 12,500, 31/12/04, 12 m, gp 3 m, 08/01/06
Guarantee EUR 6,250 (Resource: LESKOVAC Municipality Council)
Fully repaid

a) an investment in equipment just achieved is de facto refinanced through this loan;
b) there is a need to provide guarantees for international trade (e. g. to back letters of credit), and the scope of activity of the Guarantee Fund should allow this.

2004-05 – SIJA PROM - LE-LESKOVAC
Wood cutting machine for the production (export) of items for decoration + palettes
Loan EUR 5,000, 31/12/04, 12 m, gp 0 m, 31/01/06
Guarantee EUR 2,500 (Resource: LESKOVAC Municipality Council)
Fully repaid
Standard operation, no further comment

2004-06 – RANGELOVIC - LE-LESKOVAC
Wood processing machine for the production (export) of items for decoration
Loan EUR 15,000, 31/12/04, 12 m, gp 0 m, 31/01/06
Guarantee EUR 7,500 (Resource: LESKOVAC Municipality Council)
Fully repaid
Standard operation, no further comment

2005-01 – TEKSTRADE - LE-LESKOVAC
Van (80 %) + raw material (20 %) for the production of textile
Loan EUR 15,000, 16/05/05, 18 m, gp 3 m, *07/12/06
Guarantee EUR 7,500 (Resource: UNDP MIR 2)
Repayment as per schedule
Standard operation (including a reasonable proportion of raw material), no further comment

2005-02 – MANAMI - LE-LESKOVAC
Loom for the production of carpets and rugs
Loan EUR 2,500, 16/05/05, 12 m, gp 2 m, 07/04/06
Guarantee EUR 1,250 (Resource: LESKOVAC Municipality Council)
Fully repaid
Standard operation (small, in a context of social assistance), no further comment

2005-03 – TOKI - LE-LEBANE
Dough mixer + machine for croissants for bakery + pastries
Loan EUR 15,000, 23/05/05, 12 m, gp 0 m, 20/09/06
Guarantee EUR 7,500 (Resource: UNDP MIR 2)
Fully repaid
Standard operation, no further comment

2005-04 – DUSAN - LE-VLASOTINCE
Oven + mould for the production of plastic boxes + cups
Loan EUR 15,000, 14/06/05, 18 m, gp 3 m, *30/09/07
Guarantee EUR 7,500 (Resource: UNDP MIR 2)
Repayment as per schedule
Standard operation, no further comment

2005-05 – PIN - VR-VRANJE
Candy production machine (85 %) + raw material (15 %) for the processing of fruit and vegetable to manufacture bonbons
Loan EUR 15,375, 14/06/05, 12 m, gp 6 m, 03/10/06
Guarantee EUR 7,688 (Resource: UNDP MIR 2)
Fully repaid
Standard operation (including a reasonable proportion of raw material), but the grace period seems to be too long in the context of a production meant to be sold immediately (unless specific constraints were to be addressed)

2005-06 – KLAS - LE-LEBANE
2nd hand oven + accessories for bakery + pastries
Loan EUR 3,750, 21/06/05, 12 m, gp 2 m, 20/09/06
Guarantee EUR 1,875 (Resource: UNDP MIR 2)
Fully repaid
Standard operation, no further comment

2005-07 – PARTNERS - LE-LESKOVAC
Van (80 %) + raw material (20 %) for the production of sweets + chocolates
Loan EUR 15,000, 23/06/05, 18 m, gp 3 m, *16/09/07
Guarantee EUR 7,500 (Resource: UNDP MIR 2)
Repayment as per schedule
Standard operation (including a reasonable proportion of raw material), no further comment

2005-08 – SVIB PLAST - LE-LESKOVAC
PET extruder + accessories for the production of plastic and paper bags + gloves
Loan EUR 15,000, 24/06/05, 18 m, gp 3 m, *05/10/07
Guarantee EUR 7,500 (Resource: UNDP MIR 2)
Repayment as per schedule
Standard operation, no further comment

2005-09 – ZORA PLAST - LE-LEBANE
Extruder (85 %) + raw material (15 %) for the production of pipes
Loan EUR 15,000, 29/06/05, 18 m, gp 3 m, *20/09/07
Guarantee EUR 7,500 (Resource: UNDP MIR 2)
Repayment as per schedule
Standard operation (including a reasonable proportion of raw material), no further comment

2005-10 – HRAST PROM - LE-LEBANE
Comprehensive processing unit for the production (export) of carpentry
Loan EUR 62,085, 29/06/05, 36 m, gp 6 m, *28/07/08
Guarantee EUR 31,043 (Resource: UNDP MIR 2)
Repayment as per schedule
Standard operation, but the grace period seems to be too long in the context of a production meant to be sold rapidly (unless specific constraints were to be addressed),
Otherwise the object, the amount and the tenor are typical of the needs to be addressed by an SME oriented Guarantee Fund.

2005-11 – BANE PEK - LE-LESKOVAC
Dough mixer for bakery + byrek
Loan EUR 3,750, 30/06/05, 12 m, gp 2 m, 05/07/06
Guarantee EUR 1,875 (Resource: LESKOVAC Municipality Council)
Fully repaid
Standard operation, no further comment

2005-12 – MEGA METAL - VR-SURDULICA
Machine to build blades for agriculture for a producer (export) of machines
Loan EUR 15,625, 30/06/05, 12 m, gp 2 m, 03/10/06
Guarantee EUR 7,813 (Resource: UNDP MIR 2)
Fully repaid
Standard operation, no further comment

2005-13 – FAMILI - LE-LEBANE
Milk packing line (80 %) + building refurbishment (20%) for a dairy
Loan EUR 62,500, 22/07/05, 36 m, gp 12 m, 03/08/08
Guarantee EUR 31,250 (Resource: UNDP MIR 2)
Repayment not started
Standard operation, but the grace period seems to be far too long in the context of a production meant to be sold rapidly (even when specific constraints were to be addressed),
In addition the retained repayment scheme, with quarterly instalments, is certainly not appropriate for a business with daily income and monthly expenses (salaries, energy, etc. …), and monthly repayments should be the rule;
Otherwise the object, the amount and the tenor are typical of the needs to be addressed by an SME oriented Guarantee Fund.

2005-14 – MINA - LE-MEDVEDA
2nd hand machines + accessories for bakery + pastries
Loan EUR 15,000, 16/08/05, 24 m, gp 6 m, *31/12/07

Guarantee EUR 7,500 (Resource: UNDP MIR 2)
Repayment as per schedule
Standard operation, but the grace period seems to be far too long in the context of a production meant to be sold immediately (even when specific constraints were to be addressed)

2005-15 – NESHA - LE-LESKOVAC
Hairdressing equipment for a vocational school operated by an otherwise professional hairdresser
Loan EUR 15,000, 16/08/05, 24 m, gp 6 m, *21/12/07
Guarantee EUR 7,500 (Resource: UNDP MIR 2)
Repayment as per schedule
Standard operation, but the grace period seems to be too long in the context of an activity (VET) where fees are paid before the training starts (even when specific constraints were to be addressed)
The fact that the investor is the Chairman of the Association of Craft Workers in LESKOVAC cannot be dissociated from the evaluation process for this guarantee, and the impact on conditions accepted for this operation at bank and Guarantee Fund level.

2005-16 – JUG COMERTS - LE-LESKOVAC
Van + machines for a flour based food products factory
Loan EUR 36,750, 16/08/05, 36 m, gp 0 m, *25/08/08
Guarantee EUR 18,375 (Resource: UNDP MIR 2)
Repayment as per schedule
Standard operation,
Otherwise the object, the amount and the tenor are typical of the needs to be addressed by an SME oriented Guarantee Fund.

2005-17 – GRAFOS PRINT - VR-PRESEVO
2nd hand offset printer for a printing company
Loan EUR 15,821, 12/09/05, 36 m, gp 6 m, *08/09/08
Guarantee EUR 7,911 (Resource: UNDP MIR 2)
Repayment as per schedule
Standard operation, but the grace period seems to be too long in the context of a production meant to be sold rapidly (unless specific constraints were to be addressed),

2005-18 – HOTI - VR-PRESEVO
Dough mixer (shop 1) + vitrine (shop 2) (altogether 90 %) + raw material (10 %) for a bakery (+ pastries) extending into 2 additional shops
Loan EUR 13,285, 28/09/05, 36 m, gp 6 m, *28/09/08
Guarantee EUR 6,643 (Resource: UNDP MIR 2)
Repayment as per schedule
Standard operation, but the grace period seems to be far too long in the context of a production meant to be sold immediately (even when specific constraints were to be addressed)

2005-19 – ZENITI - VR-PRESEVO
Extruder + folder for the manufacturing and assembly of steel rods for construction
Loan EUR 12,500, 28/09/05, 36 m, gp 6 m, *28/09/08
Guarantee EUR 6,250 (Resource: UNDP MIR 2)
Repayment as per schedule
Standard operation, but the grace period seems to be too long in the context of a production meant to be sold rapidly (unless specific constraints were to be addressed),

2005-20 – SLOGA - VR-TRGOVISTE
Equipment + chicken + fodder for a poultry breeding plant
Loan EUR 16,250, 09/11/05, 36 m, gp 6 m, *14/12/08
Guarantee EUR 8,125 (Resource: UNDP MIR 2)
Repayment as per schedule
Standard operation, but the grace period seems to be too long in the context of a production meant to be sold rapidly (unless specific constraints were to be addressed),
In addition, in a context of potentially high disease risk ("flu"), and while no appropriate insurance is available to cover this risk, it should not be in the responsibility of a fragile institution using third parties' money and fully dependent to accept such a risk in its portfolio.
It seems that there was some form of pressure to accept an operation in the area where SLOGA is based; it certainly would have been more advisable to select another business- and credit-worthy project.

2006-01- ZILE - LE-LESKOVAC
Body straightener and painting room for a garage and service station
Loan EUR 25,000, 09/11/05, 36 m, gp 12 m, Not Disbursed
Guarantee EUR 12,500 (Resource: LESKOVAC Municipality Council)
Repayment not started
Standard operation, but the grace period seems to be far too long in the context of a production meant to be sold rapidly (even when specific constraints were to be addressed),
Otherwise the object, the amount and the tenor are typical of the needs to be addressed by an SME oriented Guarantee Fund.

However, the information obtained shows that the beneficiary owns property in an amount that largely exceeds the bank's requisite for collateral to back the loan.
In addition, the GF registered a mortgage on this property as a counter-guarantee.
Finally, it appears that this operation was processed upon renewed "amicable" request on the part of the management of the participating bank.
Altogether, this operation, in consideration of the specific financial standing of the beneficiary, does not meet the ethics that should be those of an SME oriented Guarantee Fund privileging operations with businesses that lack adequate collateral to succeed in obtaining investment finance from banks.

MIR 2 - Municipal Improvement and Revival
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Report on field visits to 8 guarantee beneficiaries

2005-10 – HRAST PROM - LE-LEBANE
Comprehensive processing unit for the production (export) of carpentry
Loan EUR 62,085, 29/06/05, 36 m, gp 6 m, *28/07/08
Guarantee EUR 31,043 (Resource: UNDP MIR 2)
Established 1981
Turnover EUR 250,000 – Staff: 14 (recruitments planned to meet market growth)
Semi-finished products for housing (flooring), kitchen
90 % of the production is exported to Italy
Development plans: machine to recycle sawdust into bricks for heating, direct forestry
Good apparent professionalism
Typical local enterprise with local employment

2005-12 – MEGA METAL - VR-SURDULICA
Machine to build blades for agriculture for a producer (export) of machines
Loan EUR 15,625, 30/06/05, 12 m, gp 2 m, 03/10/06
Guarantee EUR 7,813 (Resource: UNDP MIR 2)
Established 1999
Turnover EUR 150,000 – Staff: 6 (+ seasonal, 3-5; recruitment in process: 3)
Heavy duty metal parts and extruders for the industry (brick manufacturing, …)
60 % + of the production is exported to neighbouring countries
Development plans: additional equipment to meet market demand
Good professionalism
Local employment in a relatively remote town

2005-13 – FAMILI - LE-LEBANE
Milk packing line (80 %) + building refurbishment (20%) for a dairy
Loan EUR 62,500, 22/07/05, 36 m, gp 12 m, 03/08/08
Guarantee EUR 31,250 (Resource: UNDP MIR 2)
Established 2006 (Greenfield project) – 4 months of activity
Turnover EUR 30,000 per month since the start of operations – Staff: 16
Dairy products (bottled milk, yoghurt, sour cream, cheese)
Nominal capacity 4,000 l/day (used at present at 50 %)
Addressing the needs of the local fairly remote town,
and up to 20 km (fresh products) and 50 km (cheese)
Good professionalism
Local employment in a remote town seriously hit by the Kosovo issue

2005-16 – JUG COMERTS - LE-LESKOVAC
Van + machines for a flour based food products factory
Loan EUR 36,750, 16/08/05, 36 m, gp 0 m, *25/08/08
Guarantee EUR 18,375 (Resource: UNDP MIR 2)
Established 1990
Turnover EUR 1,000,000 – Staff: 47 (+ 5 including the restaurant, a diversification)

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Bread manufacturing (4,500 pieces of 500 g / day) represents 50 % of the turnover
10 shops owned, deliveries to 80 other retail places
Development plans: additional equipment
Good professionalism
Already a small industry with important valuable assets

2005-17 – GRAFOS PRINT - VR-PRESEVO
2nd hand offset printer for a printing company
Loan EUR 15,821, 12/09/05, 36 m, gp 6 m, *08/09/08
Guarantee EUR 7,911 (Resource: UNDP MIR 2)
Established 2006 as a continuation of an individual activity
Turnover announced EUR 125,000 in 9 months,
probably above EUR 250,000 in consideration of VAT implementation … - Staff: 3
Offset printing (Heidelberg/Luschner equipment)
Local weekly magazine, packaging, file folders, …
No activity during the visit as the activity is mostly night shift
Good professionalism on the basis of production samples
Development plans: additional office in a neighbouring town
Typical local enterprise with local employment

2005-18 – HOTI - VR-PRESEVO
Dough mixer (shop 1) + vitrine (shop 2) (altogether 90 %) + raw material (10 %) for a bakery (+ pastries) extending into 2 additional shops
Loan EUR 13,285, 28/09/05, 36 m, gp 6 m, *28/09/08
Guarantee EUR 6,643 (Resource: UNDP MIR 2)
Turnover EUR 100,000 – Staff: 15 (3 shops)
Bread, buns, croissants, rolls
Good professionalism
Typical local enterprise with local employment

2005-19 – ZENITI - VR-PRESEVO
Extruder + folder for the manufacturing and assembly of steel rods for construction
Loan EUR 12,500, 28/09/05, 36 m, gp 6 m, *28/09/08
Guarantee EUR 6,250 (Resource: UNDP MIR 2)
Established 2006
Turnover EUR 1,000,000 in 10 months – staff: 8 permanent (+ 8 seasonal)
Production of steel structures for reinforced concrete (cutting, welding)
50 % of the production is sold in Kosovo
Good professionalism on the basis of production samples
Already a small industry with important valuable assets
Typical local enterprise with local employment

2005-20 – SLOGA - VR-TRGOVISTE
Equipment + chicken + fodder for a poultry breeding plant
Loan EUR 16,250, 09/11/05, 36 m, gp 6 m, *14/12/08

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Guarantee EUR 8,125 (Resource: UNDP MIR 2)
Continuation and expansion of a 25-year activity
Egg production (increased from 1,000 to 10,000 hens)
No turnover disclosed, net profit EUR 250.00 / day – Staff: 3
Fully automated breeding units
Production (9,000 eggs / day) sold in neighbouring towns
Development plans: increase production by 50 % at least due to high demand
Good professionalism
Typical local enterprise with local employment in a very remote village

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Annex 4

Overview of GF operations II

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