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DCA LOAN GUARANTEE RUSSIA

IMPACT BRIEF

On the Cover: The city of Rostov-on-Don

BACKGROUND

In 2003, small and medium enterprises (SMEs) in Russia accounted for 94 percent of the total number of businesses in the country. However, despite their numbers, SMEs produced only 13 percent of GDP in 2004 and commercial credit available to help SMEs grow met only one percent of demand. High transaction costs, perceived riskiness of commercial lending to SMEs, lack of sound risk assessment methodology, and unfavorable regulations governing collateral possession in case of default discouraged banks from lending to SMEs. SMEs that wanted to borrow did not have sufficient collateral to meet bank requirements and faced burdensome interest rates.

USAID responded to the lack of SME finance in 2004 by providing a $6 million, 5-year loan portfolio guarantee (LPG) to a regional Southern Federal District (SFD) bank, Bank Center-Invest. USAID had discovered that Center-Invest was planning to expand its SME lending to other oblasts in the SFD and agreed to support the bank with an LPG under the Agency's Development Credit Authority (DCA). The program proposed to cover 50 percent of Center-Invest's principal losses on a portfolio of loans made to SMEs through its new branches in Krasnodar and Volgograd, with the objective of providing credit to SMEs who would not otherwise have access to formal financial markets.

ABOUT DCA

USAID's Development Credit Authority (DCA) was created in 1999 to mobilize local private capital through the establishment of real risk sharing relationships with private financial institutions in USAID countries. The tool is available to all USAID overseas missions and can be used as a vehicle for providing much needed credit to an array of enterprises and underserved sectors. The evaluation in Russia is part of a set of evaluations that EGAT/DC is undertaking in different countries, to test a series of developmental hypotheses related to the DCA guarantees.

EVALUATION OBJECTIVES

USAID's Office of Development Credit (EGAT/DC), which administers the DCA guarantees, commissioned an evaluation of the Center-Invest guarantee in 2009. This evaluation assesses the performance of the guarantee relative to its objectives as defined in the Action Package developed by USAID/Russia, i.e., increasing access to credit for SMEs in Rostov, Krasnodar, and Volgograd. The evaluation assesses the outputs, outcomes, and impacts of the guarantee.

The evaluation covers Center-Invest's lending behavior and potential demonstration effects in the banking sector. It does not examine EGAT/DC's or USAID/Russia's administration of the guarantee, nor does it examine the guarantee's contribution to USAID/Russia's strategic objectives.

EVALUATION METHODOLOGY

This evaluation used a mixed methods approach, including statistical analysis of loan data, key informant and group interviews, and document review. It began with a review of background documents on Center-Invest and its DCA guarantee, and continued in Russia from June 15-26 with semi-structured interviews with Center-Invest staff and clients, the USAID Mission, and other financial sector experts. The lead evaluator used comparative analysis, statistical analysis, and content pattern analysis to draw findings from the collected data, from which she drew conclusions.

Data limitations included: (1) unavailability of and non-response from several Center-Invest staff members; (2) lack of data on Center-Invest's non-guaranteed lending; and (3) no interviews with recipients of guaranteed loans. However, the evaluator does not believe these limitations significantly impact the evaluation conclusions.

CENTER-INVEST DCA LOAN GUARANTEE

Starting Year	Ending Year	Ceiling Amount ($)	Number of Loans *(as of 6/2009)*	Aggregate Amount ($)	Utilization Rate	Median Loan Size ($)	Average Loan Tenor (months)
2004	2009	6 million	137	4,570,886	76.18 %	17,809	9





KEY FINDINGS AND CONCLUSIONS

OUTPUTS

Conclusions The DCA guarantee purpose—to expand lending to Krasnodar and Volgograd—fit perfectly within Center-Invest's business strategy. However, due to its risk aversion and the challenging SME environments in Krasnodar and Volgograd, the bank decided it was not ready to lend to these markets right away and therefore used most of the guarantee funds to loan to collateral-poor SMEs in the Rostov region.

Center-Invest's lending portfolio has performed well since the DCA guarantee began. The guarantee's influence on Center-Invest's portfolio characteristics was minimal, simply because the guaranteed loans represented a small proportion of the Bank's SME portfolio and the bank made no procedural changes to accommodate the guarantee.

Findings in support of these conclusions include:

- The Purpose of the signed Guarantee Agreement between USAID and Center-Invest was "To strengthen the Guaranteed Party's ability to expand its SME loan portfolio through its newly opened branches in two Russian regions: Krasnodar and Volgograd…." This purpose is consistent with Center-Invest's objective for the guarantee: developing relationships with clients in Krasnodar and Volgograd, which was also part of Center-Invest's 2003-2008 business plan.
- Center-Invest provided eight of its 137 DCA guaranteed loans to businesses in the Krasnodar region and five in Volgograd.
- Center-Invest's Head of the SME Lending Department explained that the bank had not scrutinized the markets in Krasnodar and Volgograd prior to receiving the DCA guarantee and was hesitant to risk lending to unknown markets. By the time Center-Invest felt more comfortable lending in Krasnodar and Volgograd, it had already come to within 76 percent of the maximum portfolio amount allowed under the guarantee.
- Representatives of Center-Invest and the European Bank for Reconstruction and Development (EBRD) in Rostov said that since the SME sector in Krasnodar and Volgograd does not receive much government support, the environment is less conducive for SME lending.
- Center-Invest principals said the bank used its standard processes to assess the creditworthiness of SMEs and to calculate the collateral requirement for each loan. In cases in which otherwise solid businesses could not meet the collateral requirement, Center-Invest made loans under the DCA guarantee.
- Center-Invest's average collateral requirement is 150 percent of the value of the loan. The average collateral percentage among DCA guaranteed loans was 111 percent.
- The value of Center-Invest's SME portfolio increased from RUR 3,206 million in 2003 to RUR 10,045 million in 2008, a 213 percent growth.
- Together, the total value of the DCA guaranteed loans represented one percent of Center-Invest's SME portfolio value as of January 1, 2009.

OUTCOMES

Conclusions The DCA guarantee has contributed to increased credit access for Center-Invest's borrowers and may have influenced the bank to participate in other guarantee funds. The full impact of the guarantee on Center-Invest's non-guaranteed lending business is larger than the one percent it directly contributed to the bank's growth, but we do not have sufficient data to make a reasonably accurate estimate.

Findings to support these conclusions include:

- Center-Invest's Head of SME Lending explained that clients who received DCA guaranteed loans would not likely have become clients without the guarantee, because they could not meet the collateral requirements. The bank retained all but three or four of these clients.
- The bank intends to participate in an upcoming tender from the Rostov regional government for a guarantee fund that backs loans to SMEs short of collateral. The bank also signed an agreement with the Regional Guarantee Fund of Volgograd for guaranteeing loans to SMEs lacking collateral.
- Center-Invest expanded its credit product offerings for SMEs between 2003 and 2009 from

fewer than six identifiable loan products to 13. The Head of SME Lending at Center-Invest said that the DCA guarantee inspired the bank to extend its credit product line.

- Center-Invest is now the largest provider of SME loans in the Rostov region in terms of volume, overtaking the previously dominant, state-owned Sberbank.
- Since clients who received a guaranteed loan received additional loans from the bank, the multiplier effect pushes the guarantee's direct one percent contribution to the bank's loan portfolio higher, but there is insufficient data to estimate the multiplier value.
- Reasons given for Center-Invest's success in the Rostov region SME market include: effective public relations, ties with the local administration and international partners, and an unwavering focus on the needs of regional SMEs, along with strong community ties.

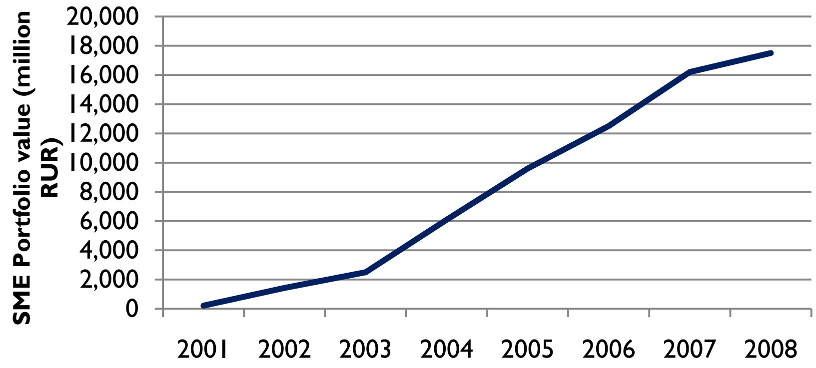
IMPACTS

Conclusions Other banks have increased lending to SMEs since 2004, especially in the SFD, because of a combination of favorable economic and infrastructure conditions that fueled SME development, government programs encouraging lending to SMEs, and experience with SMEs as profitable customers. However, SMEs' access to credit has not significantly improved. Center-Invest seems to be unique in its concerted efforts to make financing accessible to small businesses in the SFD, and it has significantly improved the environment for SME lending.

Findings to support these conclusions include:

- All interviewees, including Center-Invest clients, agreed that banks have increased lending to SMEs in Russia in general and in Rostov specifically since 2003 because: (1) banks expected SME lending to grow; (2) SME loans provide good yields; (3) the Russian economy was growing rapidly; (4) there was unmet demand for SME credit; (5) banks found that SMEs were reliable borrowers; (6) the regional Rostov administration supported SMEs through subsidies; and (7) the favorable economy in Rostov attracted more SMEs,

CENTER-INVEST BANK SME LOAN PORTFOLIO



which attracted banks to lend to them.

- SMEs said that it is still very difficult to obtain finance in Rostov and collateral requirements can be as high as 400 percent. The EBRD said that banks still see crediting SMEs as risky and therefore do not offer terms that are favorable to SMEs, or treat SMEs as corporate clients, with documentation, accounting, and collateral requirements that are too high for SMEs to attain.
- Since its founding, Center-Invest has supported SMEs through a variety of charitable and financial projects. Center-Invest has been providing free legal advice to clients via a hotline since 2006. With funding from the IFC, the bank introduced an energy efficiency program in 2005, which finances projects that reduce companies' operating costs and promote a greener economy.
- In 2006, the bank hosted its second international conference, "Russian and German Day for SME financing," in which it connected its SME customers with entrepreneurs and financiers in Germany. The bank recently hosted a workshop to instruct SMEs on how to obtain government contracts, to which it invited both SME clients and government officials.

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CONTACT INFORMATION

U.S. Agency for International Development
Office of Development Credit
1300 Pennsylvania Avenue, NW
Washington, D.C. 20523
http://www.USAID.gov

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