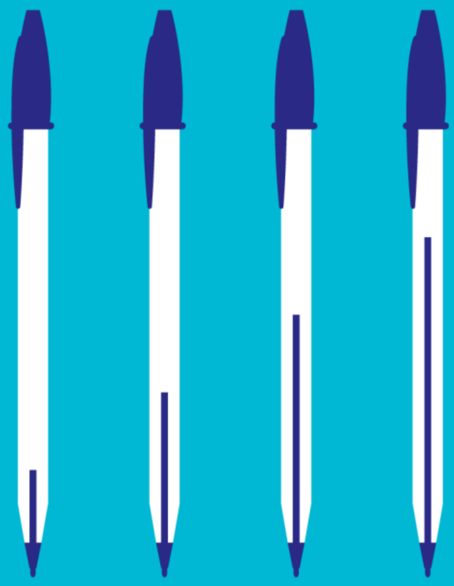
Small Business Initiative

Finance for Small and Medium-sized Businesses in the Caucasus

Small Business Impact Fund

1 January – 31 December 2018



European Bank
for Reconstruction and Development

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1 Description

Title of the Programme	Finance for Small and Medium Businesses in the Caucasus
Programme value	EUR 2 million
Funded by	Small Business Impact Fund (SBIF)
Start date and end date of the reporting period	March 2018 – December 2018
Target countries	Armenia, Azerbaijan, Georgia
Final beneficiaries / target group	*Small and medium-sized enterprises*

2 Executive Summary

The Programme was launched in March 2018. Its aim is to improve access to finance for SMEs in the Caucasus through the Risk Sharing Framework (RSF), which is one of the main tools that the EBRD utilises to work with local partner financial institutions ("PFIs") in financing small and medium-sized companies. Under RSF, the EBRD finances local SMEs together with local PFIs by sharing the risk of financing either under a funded participation (i.e. providing the share of the loan amount to an end-borrower) or under an unfunded participation (i.e. by guaranteeing a share of the end-borrower's risk). The funding made available by SBIF under this Programme provides a First Loss Risk Cover (FLRC) to enable PFIs to expand their SME portfolios by both reaching more underserved SMEs and by providing longer and better financing terms, helping SMEs grow. Part of the funding may also be used to support SMEs with direct financing to further expand the EBRD's outreach and to increase access to SME finance by broadening the range of financial products on offer in the market. Recognising that many SMEs with a growth potential still face challenges while trying to access finance from PFIs, the EBRD continues to provide direct finance to SMEs under the Direct Financing Framework (DFF). Such finance is offered in situations where the EBRD's financing is additional to that provided by local banks which typically only make available senior secured debt. Through DFF, the EBRD can offer tailor-made financial solutions, such as mezzanine finance. Moreover, the EBRD's direct financing is targeted to support emerging SME leaders to improve their corporate governance standards, become more bankable and ultimately reach new markets.

3 Activities and results during the reporting period

The implementation of this Programme in 2018 presented several challenges. The Programme started with a strong focus on Armenia, as the EBRD is trying to re-engage with the local corporate sector in the country after a few years of limited activity. The availability of these SBIF FLRC resources represents a big incentive, facilitating the conditions for the EBRD to engage. The team discussed five potential RSF transactions with local PFIs in Armenia (listed in the table below):

PFI	Potential Sub-transaction	EBRD Finance (USD)
Ameriabank	Ecotomato	5,880,000
	Armyanskiy Urajay	5,880,000
	Hayr ev Vordi Yeremyanner LLC	1,000,000
Ardshin Bank	Ran Oil LLC	1,000,000
	Green House	1,000,000

However, during the due diligence phase it was concluded that three of the above projects required further improvements of financial performance and corporate governance before the EBRD could invest. The other two projects had a positive feedback from different departments of the EBRD and were prepared to go ahead but the companies' shareholders ultimately decided on an alternative source of finance.

In light of the expected focus for this Programme to be initially given to Armenian projects, the team in 2018 turned to the EU for supporting projects in Georgia. In Azerbaijan, because of the volatile situation in the banking sector, co-financing with local PFIs under RSF is still not feasible.

The above factors caused a delay in the utilisation of the Programme's resources, which remain untouched as of December 2018. This is just a temporary situation, though, and a robust pipeline of deals for 2019 is being built. The team is confident that the Programme's resources will be committed by the end of its investment period, as planned.

4 Lessons learned

Scarce access to finance, particularly on longer terms, remains one of the key challenges for SMEs in the Caucasus. Collateral requirements as a percentage of loan value have been steadily increasing across the region, discouraging businesses from applying for financing, and resulting in an overall decline in demand for credit. This is particularly true for SMEs that face tough hurdles in accessing the long term financial resources required for business expansion and growth. This is primarily due to higher costs associated with transaction processing, which makes SME lending relatively costly.

In addition, large gaps related to business skills and standards of SMEs also persist, e.g. relatively low levels of financial literacy, which is used as a proxy for financial management skills of small firms, lack of certification and a limited desire to innovate.

The EBRD also learned that the market is lacking technical skills and financial reporting accuracy, and has therefore stepped up its capacity-building efforts with PFIs on this front, thanks to a separate programme funded by SBIF, i.e. 'Support for the expansion of the Risk Sharing Framework (RSF) and other risk-sharing products for SMEs', that is being implemented in parallel.

5 Conclusion and next steps

The EBRD is currently investing TC to advance SMEs in the region (to increase their financial transparency, accuracy of the reports, to improve technical skills and to share some best practices). As a result, the EBRD expects to catch up on the transactions, agreed under the Programme, by end-2019.

There is a strong pipeline of potential projects in Georgia, e.g. to finance CAPEX of a steel products manufacturer in the southeast of the country, the construction of a shopping mall in western Georgia, and up to seven other projects.

The team also expects to start working with at least one PFI in Azerbaijan, once the macro-economic situation improves and the banking sector recovers.