



KfW's Comprehensive Approach to Financial Sector Strengthening

The Case of Bosnia and Herzegovina

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KfW DEUTSCHLANDS GROSSE FÖRDERBANK

Overview of the Presentation

- Political and Financial Sector Framework in BiH
- KfW's Approach to Financial Sector Strengthening in BiH
- Financial Institutions and Instruments Promoted by KfW
 - Micro Enterprise Bank (MEB)
 - European Fund for Bosnia and Herzegovina (EFBH)
 - Credit Guarantee Fund (CGF)
 - Federal Deposit Insurance Agency (FDIA)
- Lessons Learnt & Challenges Ahead

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Bosnia and Herzegovina since 1995

- Civil war from 1992 until 1995
- 200,000 killed; 800,000 refugees and displaced persons
- Peace accord of Dayton 1995: inter-entity boundary line between the Federation of Bosnia and the Republika Srpska
- Multi-ethnic state with weak state-level Government structures



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Bosnia's Precarious Economy

- Although impressive gains have been achieved ...
 - Stable currency
 - Functioning central bank
 - Abolition of socialist-era payments' bureaus
- ... Bosnia's economic reality is still bleak
 - Low credibility of Bosnia's political establishment/corruption
 - Unreasonable tax and business regulations
 - Privatisation of strategic enterprises has yet to take place
 - Rising public debts
 - Faltering economic growth
 - Unemployment/poverty/brain drain

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Financial Sector Restructuring and Consolidation (I)

- **Bad banking in the recent past**
 - Most banks emerged from former Yugoslav bank branches and are weak and highly undercapitalised
 - Insufficient management capabilities, inadequate corporate governance, deficient credit technologies, wide-spread insider lending
- **Improvement of the institutional framework**
 - Handing over of payment transactions to the banking sector (2001)
 - Central bank: rising currency reserves; acceptance of the KM
 - Federal Banking Agency (FBA): banking supervision and regulation
 - Federal Deposit Insurance Agency (FDIA)

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Financial Sector Restructuring and Consolidation (II)

- **Increase of minimum capital requirements in steps**
- **Market entry of foreign banks**
 - Takeover of local banks by Raiffeisen and Zagrebacka Banka
 - Greenfield approach by Volksbank
- **Competition and Consolidation**
 - Ongoing reduction of the number of banks
 - Integration of banking beyond entities
 - Downward trend in interest rates
 - Growth is concentrated in the Federation and in the private sector
 - Banking in the Republika Srpska is dominated by public banks

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KfW's Approach to Financial Sector Reform in Bosnia and Herzegovina (I)

- Promotion of SMEs – KfW's mandate since 1948
- Financial system development crucial for private sector development and sustainable economic growth
- SMEs – the potential backbone also of developing and transition countries' economies
- Development of adapted financial services and sound institutions

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KfW's Approach to Financial Sector Reform in Bosnia and Herzegovina (II)

- KfW's comprehensive financial sector approach
 - Fostering the financial sector as a whole
 - Competition between institutions and models
 - Policy dialogue, i.e. not mere "islands of stability"
- Complementary approaches
 - Micro Enterprise Bank Bosnia
 - European Fund for Bosnia and Herzegovina (Down-scaling)
 - Credit Guarantee Fund
 - Deposit insurance system

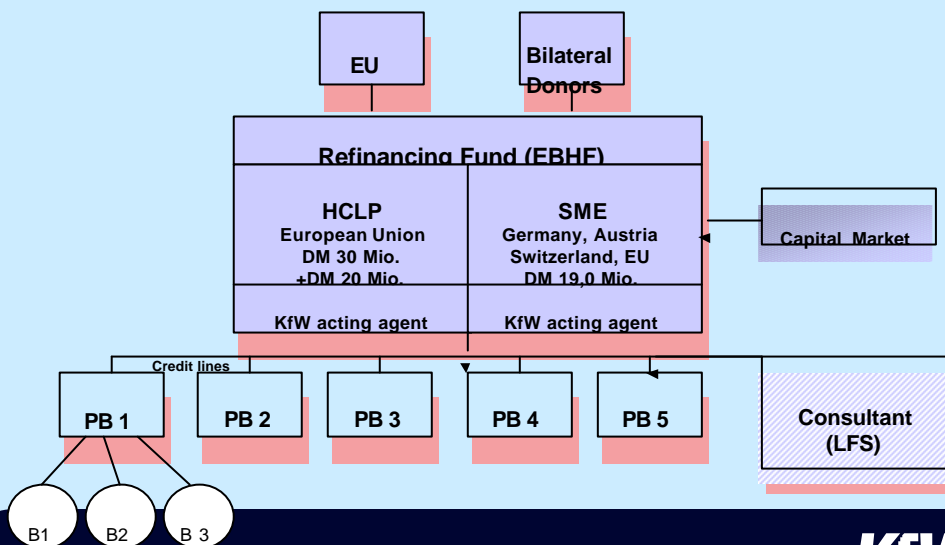
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Micro Enterprise Bank Bosnia

- Microbanks – a particularly successful approach
 - Institutional successes: rapid growth, sound portfolios, profitability
 - Demonstration effect
- KfW holds an equity stake also in the MEB Bosnia
 - Growth: outstanding loans: DM 28m; 7 branches
 - Sound portfolio: arrears 0.7% (portfolio at risk)
 - Profitability

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European Fund for Bosnia and Herzegovina



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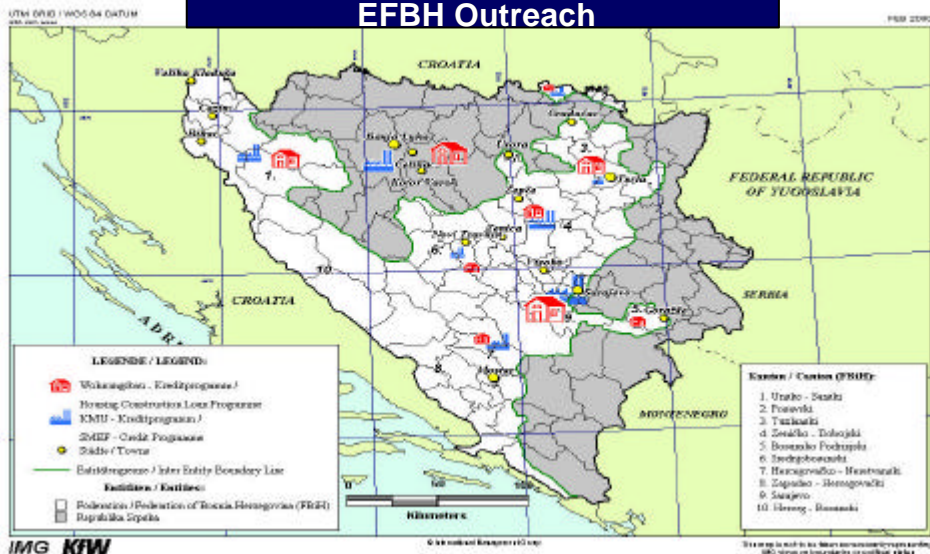
Objectives of the EFBH



- Effective donor co-ordination and pooling of financial resources
- Promotion of the target groups (SMEs and house owners)
- Fostering financial sector development by means of institutional strengthening of partner banks and competition in the financial sector
- Introduction of new products: housing and SME loans, soon also a rural SME line
- Outreach and excellent portfolio quality

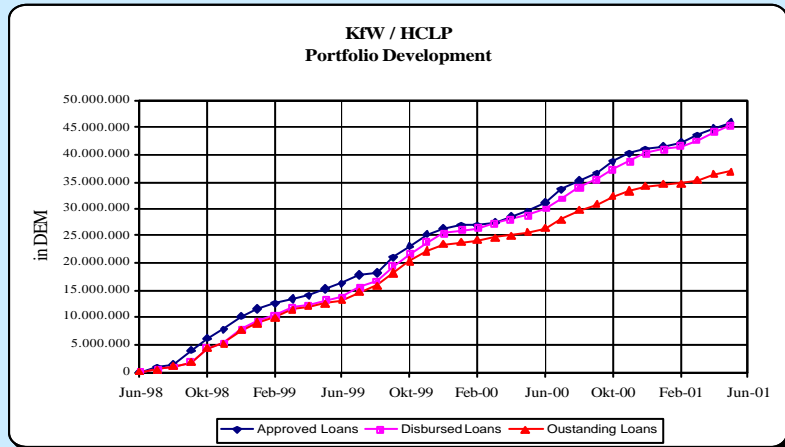
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EFBH Outreach



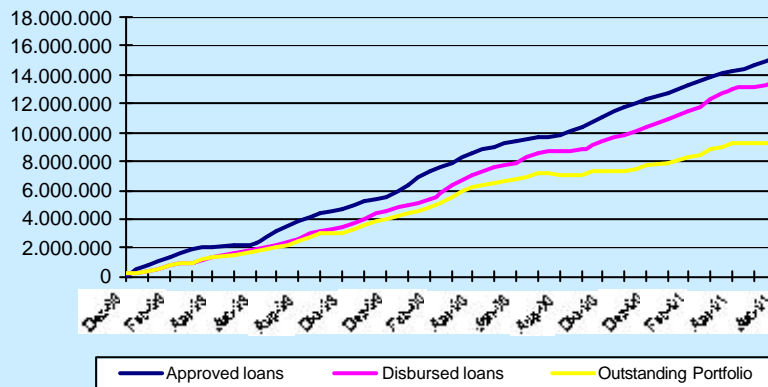
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EFBH – Housing Portfolio Development



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EFBH – SME Portfolio Development



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EFBH – Characteristics

- **Housing Portfolio**
 - 7 partner banks
 - 2.601 loans disbursed (DM 46.2 million); 2558 loans outstanding
 - Average loan size DM 17,800, portfolio at risk: 1.49%
- **SME Portfolio**
 - 6 partner banks
 - 217 loans disbursed; (DM 13.5 million); 187 loans outstanding
 - Average loan size DM 62,000, portfolio at risk: 4.0%
- **Phases**
 - Establishment
 - Consolidation

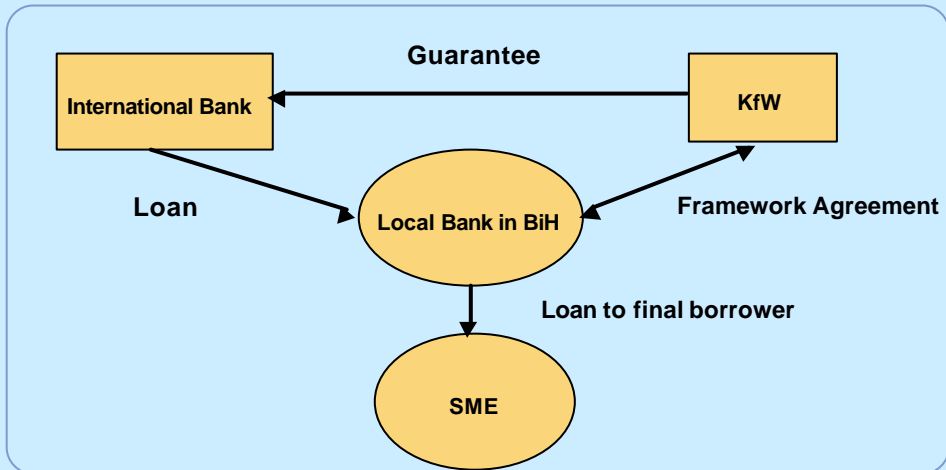
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Credit Guarantee Fund

- **Goals**
 - Access of local banks to international partners
 - Expansion of the refinancing volume for SME credits
- **Guarantee volume**
 - German Government DM 10 million
 - KfW subordinate guarantee DM 10 million
- **First guarantee under negotiation**
 - Commerzbank -> MEB Bosnia

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The Credit Guarantee Fund



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Federal Deposit Insurance Agency

- Objectives: Mobilisation of local resources
- High dependency of banking sector on external refinancing
- Insurance of deposits up to KM 5,000
- Co-capitalisation (DM 10 Mio) in 2001
- Need for institutional strengthening & adjustment of legal environment
- Acceleration of financial sector consolidation
- Dilemma: selection of winners vs. Risk averse insurance policy

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Lessons Learnt

- Comprehensive approach shows its merits
 - Improved access to financial services
 - Structural effects on financial sector at large
 - Increased competition
 - Effective in co-ordinating donor activities and in reaching economies of scale through pooling of resources
 - Allows KfW to offer tailor-made assistance and to graduate with the financial sectors in Southeast Europe
- Financial sector development is possible in an unstable, high risk environment

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Challenges Ahead

- MEB - strengthening of strategic position as specialised SME bank
- EFBH - institutionalisation & diversification
- CGF - additionality
- FDIA - institutionalisation at state-level
- Progress depends on BiH's overall political and economic development

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