

Standard Summary Project Fiche

Project number: TR 05 02.08

1. BASIC INFORMATION

1.2 CRIS Number

1.3 Title

Small Enterprises Loan Programme, 2nd Phase (SELP II)

1.4 Sector

1.5 Location

Turkey – 49 provinces as indicated in Law on Encouragement of Investments and Employment No: 5084 and the draft enactment. The branch network of the participating private commercial banks, still to be selected, shall determine the provinces (out of 49) where the Programme to be implemented. In addition, up to fifteen growth points with a relatively better developed business potential might be considered [for information only: SELP I Locations are Gaziantep, İzmir and Kocaeli].

1.6 Duration

7 years after signing the Funding Agreement (4th Quarter 2005 - 4th Quarter 2012)

2. OBJECTIVES

2.1 Overall Objective

The overall objective is to make a contribution to the economic development and employment creation by expanding and strengthening the financial sector and to contribute to the reduction of the regional disparities in Turkey.

2.2 Project Purpose

The purpose of SELP II is to make available to the target group permanent access to loans (particularly long-term loans) to be provided by private commercial banks at close to market conditions in the project locations.

2.3 Accession Partnership and NPAA priority

The revised Accession Partnership¹ 2003 sets out the principles, priorities, intermediate objectives and conditions decided by the European Council and Turkey. According to the AP (short term priorities), Turkey should develop and implement a national SME strategy in line with the European Charter for small enterprises and the multi-annual programme for enterprise and entrepreneurship. This should include the improvement of the business environment for SMEs, particularly where **access to finance** is concerned.

¹ Council Decision of 19 May 2003 on the principles, priorities, intermediate objectives and conditions contained in the Accession Partnership with the Republic of Turkey (OJ L 145, page 49) and Accession Partnership AP 2003

The 2004 Regular Report on Turkey's Progress Towards Accession² states that some progress has been made with regard to the promotion of small and medium sized enterprises (SMEs), e.g. an SME strategy and action plan has been adopted by the Turkish government, the business environment has been improved and simplified and the SME's access to finance have been improved. These developments are based on the improvement of macroeconomic conditions as well as due to the support of EU, World Bank, EIB and other bilateral and multilateral donors. Nevertheless, it states, "still high interest rates and short maturities remain serious constraints for SME in their access to credit". Further efforts and full private sector participation is needed in order to lift these constraints.

Regarding the participation of private banks in SME lending it is stated, that private commercial banks in general have started to consider SMEs as clients, due to reduced activities in trading government bonds after the considerable decrease in interest rates.

This assessment is confirmed by the experiences obtained in SELP I, which have shown that private banks are willing to lend to the smaller SME segment and to even invest their own resources in this segment. Still regional differences between Eastern and Western Turkey have only been addressed partially by SELP I with activities restricted to three project locations with relatively well developed business potential (Gaziantep, Kocaeli and Izmir). Nevertheless, the outreach of the programme into further Eastern regions shall be achieved with SELP II that is being addressed in this fiche.

Turkish national programme for the adoption of the Aquis (NPAA)

The Turkish national programme for the adoption of the Aquis³ outlines the necessity to promote SMEs at first priority with following necessary investments:

- Increasing the capacity in the field of SME Financing, including the establishment of new types of financing institutions;
- Establish a Market Maker Institution, which will create a network of service centres for technology transfer on national level, and support SMEs in the fields of technology transfer and industrial problem- solving (GEBZE –Technology support project for SMEs);
- Support to SMEs in terms of harmonization with technical legislation and developing for the adoption of the new approach of Directives and the use of CE marking.

The investment matters outlined above are first priority in the short term. In the medium term the "Industrial Strategy" and the other comprehensive measures should be considered⁴. The NPAA envisages around EUR 50 Million for capacity building measures and around EUR 3 billion of credits.

SELP II supports the achievement of the goals set out in the Accession Partnership and the NPAA. It contributes to the goal of capacity building in the field of SME Financing and it aims at minimising regional differences and enhances private sector involvement in the SME segment. Therefore it is in line with the above-mentioned programmes.

2.4 Contribution to the National Development Plan and the SME Strategy and Action Plan

² 2004 Regular Report on Turkey's progress towards accession, chapter 22, page 132, 6.10.2004

³ Turkish National Programme for the Adoption of the Aquis (NPAA), Chapters 4.17 page 369f. and 6.1.9 page 517f.

⁴ see NPAA, Chapter 4.17, page 373

Preliminary National Development Plan (pNDP)

Turkey's first pNDP is prepared to form the basis for using the financial assistance being provided by the EU within the framework of Turkey-EU relations towards economic and social cohesion. It is aimed that during the pNDP period (2004-2006), pre-accession financial assistance shall be used in an effective way. Moreover, the necessary infrastructure shall be initiated for the utilization of structural funds after the accession period. In the pNDP⁵ weaknesses of SMEs are defined in terms of insufficient financing means and their challenges to access financing.

The 8th Five Year Development Plan

The 8th Five Year Development Plan, which is running from 2001 to 2005⁶, outlines in chapter V.3 the necessity to - inter alia:

- Improve the productivity of SMEs;
- Increase the share of SME within the overall credit volume (so far 5% of overall credit volume)⁷;
- Back up SMEs with modern financing instruments and institutions within an environment which is in harmony with the capital and financial markets. The utilisation of financing facilities such as credit guarantee funds, risk capital, financing investment partnerships, asset investment partnerships shall be made prevalent;
- Support the enhancement of current technology levels of SMEs.

Furthermore, in chapter 7⁸ it is stressed that Turkey is on the way to combat regional differences. It states that almost all envisaged project regions of SELP II are below the Turkish average in terms of socio-economic development. The economic share of those regions is relatively low and they face various challenges such as low education levels, high migration as well as insufficient public goods due to population growth and low entrepreneurial capacities.

The plan aims at increasing income and welfare to overcome these disparities. This shall take place – inter alia – via supporting industrial activities, capacity building in the enterprise sector and via enhancing entrepreneurship. SMEs that are growing inevitably need financing. By increasing the outreach, SELP II will support the needed improvements.

SME Strategy and Action Plan

The SME Strategy and Action Plan published by SPO were adopted following the decision of the High Planning Council on 10 November 2003. Implementation of this document, which was prepared within the framework of the pre-accession period, is one of the priorities of the Small and Medium Size Enterprises Chapter of the 2003 Turkish NPAA. As mentioned in Chapter 16.2 of the NPAA, the SME Strategy and Action Plan is considered to be the main document for determining related activities of SMEs to be funded under the Pre-accession Financial Cooperation Programme in the next programming period. The plan is prepared to determine the essential strategies for SMEs and carry out activities in order to provide the scope of existing policies and programmes in detailed way, as well as the activities within this

⁵ Preliminary National Development Plan page 102-103

⁶ 8th Five Year Development Plan, 2001-2005, Chapter 8, V.3 page 137f.

⁷ Turkish national programme for the adoption of the Aquis (NPAA), Chapter 4.17, page 369

⁸ Five Year Development Plan, 2001-2005, Chapter 7, page 64 ff.

scope; to express clearly the responsibilities of public and private organisations on the way to the desired objectives; and to formulate the sum of required actions and projects.⁹

The plan analysed the sector and concluded that “Due to shortage of institutional capacity available for SMEs in the financial sector, it is not possible to make use of the money and capital markets of the EU to ease credit bottleneck for SMEs. There have been problems regarding the transfer of already available funds for Turkey to the SMEs. Halkbank, which has traditionally rendered financial services to SMEs, has now become dysfunctional and privatisation of the bank has been planned. In Turkey, financing instruments such as credit guarantees for SMEs, venture capital investment partnerships, real estate investment partnerships, SME finance companies, factoring and leasing companies for SMEs, an SME stock exchange enabling SMEs to make use of equity markets have either remained as mere theory or have only had symbolic value”¹⁰. The Plan recommends – inter alia – encouraging Banks to give SME credits, to simplify tax legislations to SME and to develop approaches to solve SMEs’ problems with banks.

The SELP II is taking into account the principles and guidelines laid out in the 8th Five Year Development Plan and the ‘SME Strategy and Action Plan’ and is therefore fully in line with the developmental strategies of Turkey regarding SME development.

2.5 Cross Border Impact

Not applicable.

3. DESCRIPTION

3.1 Background and justification

Problem

Small and medium-sized enterprises¹¹ represent a substantial component of the Turkish economy and have a good potential for growth. More than 99.3 % of all Turkish companies belong to the category of SMEs and have a considerable impact on Turkish economy. They generate a significant percentage of the GNP (approx. 25%) and account for around 77% of all jobs. Compared to European SMEs, they have lower administrative and technology levels and are subject to severe financing problems. They represent around 5% of the overall lending volume in Turkey.¹² Investments into SMEs generate expansion and thus:

- *Increased employment* (contiguous with *reduced poverty* and less demand for social services);
- *Improved competitiveness* (contiguous with increased productivity, export growth and increased ability to serve national demand);
- *Increased public revenue* through income/ profit tax and contiguous with more resources for social expenditures.

⁹see:<http://www.euturkey.org.tr/abportal/content.asp?CID=6020&VisitID={A82F51B1-41A8-4094-B37E-C04FF815CDE9}&Time=5845> (last insight: 29.11.2004)

¹⁰ National SME Strategy and Action Plan, page 36f.

¹¹ According to a common definition in Turkey enterprises with up to 150 employees and assets of up to US\$ 5 Mio.

¹² Compare Turkish national programme for the adoption of the Aquis (NPAA), Chapter 4.17, page 369ff

The existence of a dynamic and strong SME sector is thus a major element of balanced economic growth, but also a necessary condition for social and political stability¹³.

However, SMEs have found the necessary capital and financial services in very short supply. Commercial banks tend to be primarily specialized in large business and they have reservations against financing the SME sector. Their development is hampered by several technical and financial factors: the classical credit analysis currently applied is based on balance-sheet interpretation. The SMEs, however, prepare balance sheets principally for the tax authorities, which make them difficult to analyse under banking criteria. Moreover, high fixed costs and relatively small loan sizes for SMEs result in high unit costs for a credit. This makes SME finance relatively unattractive for profit-driven banks. Because of the lack of information about individual SMEs and the market (e.g. credit and payment history, average credit-failure in the market), loans to SMEs are considered very risky. Insufficient guarantees or their insufficient enforcement makes it difficult to properly secure their loan. Perceived as disproportionately costly and risky, leading banks tend to concentrate on larger loans to larger companies, which are thought to generate a higher fee and interest income. Additionally, Turkish banks have traditionally been active in investing in government bonds. The state-owned banks, Halkbank, Ziraat Bankasi, and TKB supply financial services to SMEs only to a very limited extent compared to the huge demand in Turkey.

In particular, the lower segment of the SMEs (having up to 50 employees with a maximum asset size of EUR 1 Million) have difficulties to access long-term finance. Due to the national importance of this sector, insufficient access to long-term funds and equity is a serious obstacle for growth and development.

SELP II addresses these shortcomings in the SME Finance market and promotes the extension of financing to smaller SMEs. It therefore contributes to the promotion of income generation in all project regions and will foster economic development.

Government strategy

The economic and social cohesion policies of the European Union (EU) place substantial importance on the development of industry and small and medium sized enterprises.

As indicated in the 8th Five Year Development Plan, the basic targets of SME related policies are to increase the productivity of the sector, its share in total value added and its international competitiveness.

The government strategy aims to address all these shortcomings. As stated before it is targeted to: Improve the productivity of SMEs; to increase the share of SME loans within the overall credit volume (so far 5% of overall credit volume)¹⁴ and to provide SMEs with modern financing instruments and institutions.

Composition of the sector

After hitting by the most severe crisis of its recent history in 2000-2001, the Turkish economy bounced back and is now among the fastest growing economies of OECD member countries (OECD Policy Brief, October 2004). Significant progress has also been made in stabilising and modernising the Turkish banking sector. Market capitalisation is at a high level and the quality of assets is improving. Banks have achieved a healthier asset – liability structure and more free capital than during 2003. Significant progress has been made with regard to non-performing

¹³ World Bank, 2003 – Proceedings from the World Bank Conference on New Technologies for Small and Medium-sized Enterprise Finance – Financial Sector Learning Programme, Discussion Abstract No. 3.

¹⁴ Turkish national programme for the adoption of the Acquis (NPAA), Chapter 4.17, page 369

loans, and those remaining in the banks' books have been better provisioned for. The level of short forex positions in the banking sector has been decreased significantly. On the other hand, major challenges are the relatively large share of government securities in total banks' assets and the sharp decline in the yield of these securities. The drop in the general level of interest rates cuts further into the earning potential of banks. Thus, profitability will be the main issue in the near future and in the medium term.

General economic conditions – especially inflation – have significantly improved, but the BB- (S&P) and BB- (Fitch) rating of Turkish government foreign currency debt is three respectively four steps below investment grade, leading to relatively high refinancing costs for banks.

During the period between January and September 2004, the number of banks in the banking system decreased from 50 to 49 due to the fact that Turkey's branch of Credit Lyonnais was transferred to Credit Agricole Indosuez Türk Bank. Thus, the Turkish banking sector developed as follows:

In September 2004, the total number of branches rose to 6,031, thus increasing by 82 as compared to December 2003. The number of branches increased in privately owned commercial banks to 3,692, by 98 compared to December 2003. On the other hand, the number of branches in state-owned commercial banks decreased by 14. The number of employees reached 126,970 as of September 2004, increasing by 3,721.

Table 1: Number of Banks and Branches in the System*

	December 2003		September 2004	
	Banks	Branches	Banks	Branches
Commercial Banks	36	5,949	35	6,031
- State-owned banks	3	1,971	3	1,957
- Privately owned banks	18	3,594	18	3,692
- Foreign Banks	13	209	12	208
- Banks in the Fund*	2	175	2	174
Non depository banks	14	17	14	19
Total	50	5,966	49	6,050

*Banks under the deposit insurance fund

Source: TBB

In 2003, the asset size of the banking sector increased by 17.4% (3% in real terms) and reached TL 249.7 quadrillion. In USD terms, the asset size of USD 130.1 billion as of end-2002 increased by 37.5% to USD 178,9 billion along the appreciation of TL against foreign currencies (BRSA, 2004).

During 2003, bank assets were mostly concentrated in securities and loans while the share of liquid assets declined. Deposits are still the most important funding source of the sector and the share of own-funds in total liabilities increased with the improvement in profitability.

Although the share of state banks in the banking sector has shown a decreasing trend throughout years, it was still at a high level with 36.3% as of 2003. Despite the liberalisation-oriented policies of the last 25 years, the government is still a major player in the banking sector. Halkbank and Ziraat Bank have always been among the top 6 banks. An IMF-led restructuring plan for the state banks was launched in April 2001.

The asset structure of the banking sector changed in 2003 and during 2004 in favour of loans and securities, whilst the share of liquid assets decreased.

The increase in loan demand related to the recovery of economic activity and decrease in interest rates as well as the restructuring of approximately 5 billion USD worth of loans under

the Istanbul Approach led, by end 2003, to an 18.7% increase in real terms in loans extended by the banking sector. As a result, the share of loans in total assets increased by 3.5 points to 26.5%. The securities portfolio increased by 8.9% in real terms and its share in total assets increased to 42.8%. The share of liquid assets decreased by 1.9 points to 11.6% when compared to end 2002

There has been a remarkable increase in the TL denominated loans extended by the banking sector in 2003. TL-denominated loans increased by 57.7% in real terms, while forex denominated loans increased by 22% on USD basis, with their share in total loans decreasing.

An analysis of loan sizes as of end 2003 shows that 60,6% of total loans exceed TL 500 billion (EUR 266k as of 10 November 2004) and benefited by only 11.697 clients. However, 28.8% of loans are less than TL 50 billion (EUR 27k).and benefited by a very large client base which of 18,647,204. This indicates the preference for larger loans by the Turkish banks, whilst Micro and Small to Medium sized enterprises are still underserved.

The number of customers with loans under TL 50 billion increased by 18.3% when compared to the previous year, while those which took loans exceeding TL 500 billion increased by 9.1%. The largest increase in numbers of loans has been in the range between TL 51-500 billion. However, by far the largest increase has taken place in consumer and private loans, whilst business loans saw only moderate growth.

This vindicates the efforts that have to be undertaken to promote the SME loan sector.

Table 2: Distribution of total credits by their size and number of customers *

Loan Size	December 2002		December 2003	
	Banks	Branches	Banks	Branches
	No. of customers	% Distribution	No. of customers	% Distribution
Loans exceeding TL 500 billion	10,711	0.07	11,697	0.06
Loans from TL 101 billion to TL 500 billion	12,042	0.08	20,288	0.11
Loans from TL 50 billion to TL 100 billion	15,085	0.10	27,673	0.15
Loans under TL 50 billion	15,755,582	99.75	18,647,204	99.68
Total	15,793,431	100.00	18,706,862	100.00

*Excluding Iller Bank, Source: BRSA

Involvement of Civil Society

SME Finance is an activity, where high skilled labour, adequate techniques and financial sound background of the operator is highly necessary. Usually banks, and in some countries non-bank financial institutions supervised by the bank regulator, fulfil this endeavour. It is therefore generally not an activity undertaken by an NGO. For Turkey it can be stated that there are almost no visible NGOs actively involved in the SME Finance Sector (exceptions are Maya Foundation and a microfinance scheme in Diyarbakır). Nevertheless, there are Civil Institutions in place dealing with Small and Medium Enterprises, such as the chambers of artisans, of trade and of industry. Every officially recognized SME is member of one of these chambers and therefore enabled to participate, via this vehicle, in civil society. As SELP II deals in first priority with the strengthening of the private productive capacity and the related effects, it is possible for these strengthened and growing enterprises to enhance their value and their

influence in these chambers.

3.2 Project Identification

3.2.1 Gap Analysis

Market Gaps were analysed in a feasibility study financed by the German government in autumn 2000 identifying several weaknesses of the financial environment for SMEs, which are mentioned in Chapter 3.1. The study identified the on-lending of a credit line via private banks as the best approach to solving the SME's financing problem.

To address the specific financial needs of Turkish SMEs the SELP I has been identified as the only possible option to create a system of incentives for the local commercial banks. Its concept has been agreed upon with the Undersecretariat of Treasury (Hazine) and was discussed with a number of private banks. The European Commission enlisted KfW in July 2002 to establish and manage the SELP I. The overall objective of the programme is to contribute to the economic development and employment creation and to support the expansion and strengthening of the financial sector.

The practical implementation of SELP I has successfully started in 2004. The EUR 20 Million Programme comprises of three components: a Revolving Fund, an Exchange Risk Cover Fund (ERCF) and Technical Assistance (TA). After some delays with the start of the programme, SELP I gained momentum in 2004 and is now developing rapidly. The three On-lending Banks (Disbank, Finansbank and TEB) have signed EUR 4.75 Million by the end of 2004. Given the short period of time considerable results could be achieved (see Annex 7). It is expected that the funds will be disbursed totally by mid-2005.

Given the so far modest lending results of the banks in terms of long-term SME loans, SELP I has proven to spur and promote SME lending and to be a significant, interesting new business line for the participating OLBs. SELP I therefore is a significant additional element in the overall SME banking strategy of the participating banks for a hitherto underserved, but important and growing market.

As stated before, there is a massive – nationwide – unmet demand by SMEs loans from commercial banks. The current endowment of the SELP I contributes to meet this demand only to a limited extent, as the project is restricted to three regions, which are relatively well developed (Kocaeli, Izmir and Gaziantep). The good results in these regions underline the attempt tapped by above mentioned feasibility study. An extension of the SELP approach under SELP II would – in close cooperation with other EC-funded programmes – allow the inclusion of less developed regions and/or cities, especially in the eastern part of the Country. Taking into account of the weight of the agricultural sector in the less developed regions of Turkey, lending to the agricultural sector would also be given a certain priority within the framework of the TA component. This will improve livelihoods and economic development of that region, being a precondition for social and political stability. A more comprehensive demand study is currently being conducted in the first quarter of 2005 to efficiently target the potential locations.

3.2.2 Legislative and Administrative Issues

The change of the business environment and banking regulations and supervisions is not subject of the programme addressed in this project fiche.

3.2.3 IT needs

The Project Implementation Unit (PIU) with the assistance of TA consultant shall establish a system for regular reporting by the OLBs and inform the EC accordingly. The Consultant will design, implement and manage this system according to its legal requirements, the reporting requirements of the EU and the capabilities of the OLBs. Within the framework of SELP I a reporting system was already established. The OLBs are sending regular reports on monthly and quarterly basis. This system is working efficiently and could also in principle be used for SELP II. However, further development of SELP II may require a Management Information System (MIS), for which high-skilled personnel would be brought-in to ensure an optimal long-term solution.

3.2.4 Sequencing

The sequencing of tasks will – to some extent – be determined by the selection and contracting of the On-lending Banks. This will only be possible after a full due diligence will have been carried out. After that, the funds of the EFT and ERCF, for which accounts will be established at the very beginning of the project, will be disbursed according to the OLB's demand.

The training measures will begin soon after selecting the OLBs. However, the respective consultant services will already be tendered by CFCU almost immediately after signing the respective funding agreement.

3.3 Results

3.3.1 Purpose

The purpose of SELP II is to make available to the target group permanent access to loans (particularly long-term loans) to be provided by private commercial banks at close to market conditions in the project locations.

The private commercial banks' ability to profitably and effectively serve the small enterprise segment with financing and particularly long-term financing shall be increased. Furthermore, the project aims at strengthening the ability of private banks to finally mobilise their own long-term refinancing resources. A special focus is set on the less developed regions in Eastern Turkey. Associated Indicators are:

- OLBs increase their share of SME Portfolio compared to total portfolio by the end of the programme.
- OLBs use more than 20% of their own resources to refinance SME loans in the project regions by the end of the programme.
- All Partner Banks develop a profitable SME Finance Business by the end of the programme.
- The EFT not only maintains its real value, but increases its volume by the end of the programme.

3.3.2 Results

By the end of the programme the participating banks of SELP II will be able to extend loans to SMEs in the project regions. The EFT will grow and increase its volume if the demand to EFT sources increases. The expansion of the fund will be possibly financed by SELP I funds and other international donors as well as most likely private investors. At the end of the programme, the EU grant in the EFT and the management of the fund will be transferred to the

Treasury and the TKB respectively (Component 1). Participating banks will use the Exchange Risk Cover Fund to cushion their currency risk and to extend TRL loans to SMEs (Component 2). Furthermore, the participating banks are capable to manage SME lending successfully through capable staff and lending technology. This corresponds directly to the purpose to make permanent access to loans available to the target group. In addition, the TKB will be able to manage the EFT by means of the TA (Component 3).

The Associated indicators comprise for:

Component 1:

- Credit volume to SME (Portfolio) is increased by at least for the amount refinanced.
- SME Portfolio at risk will be below 3% on average.
- All means of the fund will be disbursed within a period of at most 5 years after the signature of agreements.
- The total volume of the EFT at the end of the programme exceeds its initial value.
- A European Fund will be established

Component 2:

- Cash flow statements of ERCF.
- An average of at least 60% of the loans extended to SMEs is denominated in TL.

Component 3:

- Number of loans per loan officer is increased.
- SME related credit technology is used by all SME loan officers.
- Number of SME staff and efficiency is increasing.
- TKB is capable of administrating the European Fund for Turkey.

3.4 Activities

SELP II is designed in analogy to SELP I. The slight differences reflect the experiences and the lessons learnt of the OLBs in their day-to-day operations and the recommendations taken out of discussions with and the respective recommendations of the Treasury, the SPO and the EC Delegation.

SELP II will provide a revolving loan fund from which banks can draw down funds at close-to-market conditions for their on-lending to SMEs and technical assistance to train the banks' SME-staff in assisting the new target group. In order to cushion the commercial banks' Foreign Exchange Risk for Turkish Lira loans, an Exchange Risk Cover will be implemented.

These instruments have been discussed recently in depth with two of the three OLBs participating SELP I. In comparison with SELP I the maximum maturity is extended from 36 months to 48 months, which is perfectly in line with the overall objective and the purposes of the project as long term financing is one of the major bottlenecks in the SME Segment. The maximum loan amount is increased from EUR 30,000 to EUR 50,000 (only for fixed capital investments). This is reasonable regarding the fact that these investments are mainly responsible for the creation and safeguarding of employment. A further amendment is related to the exit option to be fully in place seven years after signing the funding agreement. According to this exit strategy the beneficiary of SELP II will be the Turkish Treasury which will on-lend the funds as special assets to a Turkish financing institution – being proposed as TKB – capable of

administering the European Fund for Turkey. This fund is going to be managed by a professional management, to be integrated into the overall structure of this institution. Consequently, TKB will be in full charge of SELP II at the end of the programme..

Activities within the project will cover three major components:

3.4.1 Component 1: Establishment of the European Fund for Turkey

A tailor-made approach defining details of the establishment, structure and management of the fund will be developed by KfW with support of the TA-Consultant. Once the fund is established, EC Funds of EUR 15 million will be used as risk cushion (first loss piece) - following the model of the European Fund of Southeast Europe currently under implementation – in order to attract additional funds of other financial intermediaries like KfW, CEB and AFD. According to first estimations KfW and CEB will be able to procure up to EUR 40 Million to the EFT using above mentioned risk cushion. A total of up to EUR 55 Million will then be disbursed by private commercial banks (OLBs) to SMEs in the defined project regions. If the demand for the EFT resources continues, KfW will try to attract additional investors (mezzanine and private) to the EFT. In case the SELP I funds would be provided to the EFT at the end of SELP I, the EFT will expand its first loss piece. Consequently, it would be easier to attract further funds by lowering their interest rates. The beneficiaries are lower-end SMEs with up to 50 employees and a maximum of EUR 1 million in total assets.

The maximum loan size per individual borrower is limited. It is differentiated between working capital loans and fixed capital loans whereby working capital loans have a maximum amount of EUR 30,000 and fixed capital loans may amount up to EUR 50,000.

The participating banks are encouraged to on-lend with a maturity of comparatively long 48 months.

Activities under this component are summarized as follows:

- KfW will set up the European Fund for Turkey (EFT) to increase the Turkish capacity in the field of SME Financing by establishing a new sustainable type of institution, which can serve as a long-term individual institution to promote SME lending. This Fund will constitute the umbrella for the mentioned activities and will be available to refinance the windows for small loans (particularly long term loans) provided by commercial banks.
- Simultaneously KfW would search for additional funds of donors and private investors to increase the volume of the EFT. The fund will consist of SELP II funds and additional funds from other investors (CEB and KfW at beginning of the programme).
- The fund will thereafter serve as a platform to attract additional donor and commercial capital and simultaneously reduce the risks of the single investor. In case of the default of one of the banks the EU Funds and the Funds of other willing donors (e.g. KfW, CEB and other) would cushion the 1st and 2nd loss respectively in this scenario.
- The objective is not only to maintain the real value of the funds but also to increase its capital over time. This will be achieved by the interest payments made by the participating banks. The interest rates charged by the 'European Fund for Turkey' must be high enough to cover the cost of operations, the costs of funds as well as the risks entailed with lending to Turkish banks.
- Advantages are the provision of institutional preconditions for effective donor coordination and the pooling of limited financial resources. The flexibility of this instrument catering for a high leverage effect as additional international long term refinancing is more easier to attract and not as risky as in the case of direct refinancing for OLBs. It diversifies the risk of the single financier by providing the sector with a bigger amount of funds and thereby

effectively widening and deepening the financial system of Turkey. The knowledge that is being built up by SELP II would persist in Turkey.

- In the mean time Technical Assistance will be delivered by an experienced consultant to TKB.

3.4.2 Component 2: Establishment of the Exchange Risk Cover Fund

An Exchange Risk Cover Fund (ERCF) to mitigate the currency risks born by the participating banks through extending TRL-denominated loans to final borrowers. Given the positive reaction of the banks to the ERCF, the integration of this instrument into the SELP package can be seen as an additional incentive for Turkish banks not to discriminate the vast majority of SMEs without access to foreign currency earnings. As macroeconomic data and perspectives of the country are improving the OLBs indicate to use this fund but to a lesser extent. The relative size compared to the overall amount is therefore smaller than in SELP I.

3.4.3 Component 3: Technical Assistance (TA)

The TA package will cover various key areas:

- Necessary inputs during establishment and management of the EFT
- Strengthening the Credit Organisation and procedures of OLBs
- Training of bank staff on SME lending (if required also with regard to the agricultural sector).
- Loan Portfolio Monitoring and Development of an appropriate Management Information System (MIS).
- Exchange Risk Cover Fund monitoring.
- Visibility and further development.
- Support to OLBs to develop an incentive system for successful loan officers.
- Capacity building for TKB managing the EFT.

As part of the TA component a rather small budget will be reserved for general affairs, e.g. for joint marketing activities of the participating OLBs, to produce general information material for SMEs, organise conferences on SME best practices in Turkey and similar issues.

The consultant will have to design a tailor-made approach for each of the participating OLBs taking into account their specific weaknesses and needs and to adapt the offer accordingly. A similar approach will also apply in order to determine TKB's needs for reaching a capacity level enabling the bank to professionally administer the EFT (including a training programme). If required, an additional EC-financed TA programme might be proposed to further support TKB in that respect.

If appropriate, staff of the Credit Guarantee Fund and Ziraat Bank¹⁵ would be invited to training measures to enhance the capacity of the fund to support the SME Segment.¹⁶

¹⁵ Ziraat Bank is in the process of being privatized.

¹⁶ A support takes place through the reduction of collateral requirements for SME by the credit guarantee. This reduces risks of the financial intermediary and leads to a cheaper and more secure extension of loans.

3.5 Linked Activities

There are several linked activities in the development of SME and/or SME Financing. The most important ones are listed below with a focus on the complementarities between SELP II and relevant other activities.

3.5.1 SME Financing

1. **SME Finance Facility.** In this parallel project the EU contribution is used to finance an Exchange Risk Cover fund. KfW is providing the loan (EUR 21 Million) for the revolving fund to re-finance on-lending banks operating directly with SMEs. As already elaborated in this paper, the problem of scarcity of financial instruments affects in particular ‘small’ and ‘medium’ sized enterprises. Therefore, the EC has prepared the extension of the ‘SME Finance Facility’, which is already operating in most of the other candidate countries, also to Turkey. This ‘Facility’ mainly targets ‘medium’ sized enterprises with a maximum amount of 200,000 EUR and envisages the support to ‘medium-sized’ loans. Different from this project, the SELP II is especially addressed to bottom end SMEs and will support ‘small loans’ up to a maximum of EUR 50,000 for fixed capital.
2. **SELP I.** As described above SELP I loans are restricted to the regions of Kocaeli, Izmir and Gaziantep and are therefore of limited regional outreach. SELP II aims at effectively extending the regions to Eastern Turkey. Furthermore, enterprises will benefit from longer loan maturities.
3. **KfW** is in the process to grant a credit line of EUR 15 Million to Kocbank in order to provide credits to export oriented SMEs up to EUR 250,000. There is no regional restriction. These SMEs have to comply with the EU-SME definition. Furthermore, with very similar conditions KfW is presently negotiating a credit line of EUR 15 Million with another commercial Turkish Bank. A performance fee based incentive system is used to induce this bank to on-lend longer maturities and smaller credits thereby filling the gap between the upper segment and the maximum amounts possible with SELP II. There is no regional limitation leaving the investment decision to the bank.
4. Moreover the EIB recently approved an “**Industrial Sector IV Global Loan**” (of EUR 250 Million) to Halkbank, Ziraat Bankası, Vakıfbank, TSKB and TKB targeting export-oriented SMEs at the higher end of the SME market segment.
5. The **Credit Guarantee Fund** (Kredi Garanti Fonu - KGF) was established in 1991 to support SMEs. The KGF operates to find solutions to SME’s guarantee problems emerging when they try to use investment credits. KGF covers up to 80% of the guarantees required by the lending banks, the amount of guarantee for a single firm may not exceed Euro 400,000. The KGF shall be participating in the training and capacity building measure of SELP II. This will facilitate the transfer of knowledge to another financing institution and will provide a learning platform in the sector.
6. An international consortium of investors (IFC, OSI, KfW and possibly others) is intending to support the **microfinance sector**. It is envisaged to apply a downscaling approach to private commercial banks in Turkey. The total funding volume may be in the range of EUR 30 Million. This project will be complementary to SELP as micro enterprises (up to 10 personnel) face with difficulties to obtain credits. As the target group is not addressed by SELP I and II, the project will add to the further development of the financial sector and to the development of the productive activities of Microenterprises.

These examples quite clearly show that substantial efforts have been undertaken to enhance lending to SMEs and the recent report on Turkey's Progress towards Accession admits that some improvements have taken place in the last few years. Nevertheless, the stated data indicates that the provision of refinancing for SMEs lending presently sized very small. Furthermore, especially the upper segment of the SME Market is targeted thereby discriminating smaller enterprises, which are predominantly based in Eastern Turkey. The long-term loans extended under SELP II with a duration of up to 48 months and a loan amount of up to EUR 50,000 meet a strong demand by SMEs previously virtually excluded from refinancing services from private commercial banks. Demand studies carried out under SELP II highlight the large unmet demand for loans of this size. SELP II is a necessary complementary programme addressing the needs of the smaller SME segment and addressing the needs of the enterprises in less favourably regional conditions. This adds an important aspect to development of the small-scale private sector and to tackling of regional differences in Turkey.

3.5.2 SME Development

As stated, Small and Medium companies represent an essential segment of the Turkish industrial base and are a key target of the EU financial co-operation. Their development and increased competitiveness are a priority in the long-term development plans adopted by the Turkish Government. This is not only targeting SME finance but also other measures for the development of SMEs.

1. In this context, the European Commission has financed a project for the “**Development of European-Turkish Business Centres (ABIGEM)**” (DGIA-D/MEDTQ/01-98) through the provision of training and an enhanced access to market information. For training and monitoring purposes and in order to generate synergy effects with that Project SELP I also started in the respective project regions (Kocaeli, Izmir and Gaziantep). As there have been established successful linkages between SELP I and the Business Centres and the idea of linkage has been deepened successfully one could consider including new regions especially in Eastern Turkey to similar projects.
2. Moreover, the EU is funding the **South Eastern Anatolia Regional Development Programme** (TUR/01-2001), comprising a Small and Micro Enterprise Component. This programme aims at assisting start-ups and improving the entrepreneurial, operational and managerial capacities of existing entrepreneurs through upgraded GIDEM (Entrepreneur Support in Southeast) Services.
3. SME Component of the **Eastern Anatolia Development Programme** (DGELARG/MEDTQ/04-01) likewise aims at increasing employment and creating new jobs by supporting local SMEs.
4. **The Economic Development in Anatolia**, a project of Germany's Technical Cooperation (GTZ - Gesellschaft für Technische Zusammenarbeit) aims - inter alia - at enhancing the national and international competitiveness of Small and Medium Enterprises in Kahramanmaraş, Malatya and Ankara.
5. In addition to the above mentioned Business Centres project KOSGEB and TOBB are undertaking the following SME projects:
 - DGIA-D/MEDTQ/06-96 - **Support for Creation of an Industrial Zone for Small Subcontractors in the Automotive Sector** (KOSGEB)
 - DGIA-D/MEDTQ/08-96 - **EU Online Information Network** (KOSGEB)

The following projects might be good partners to reinforce the overall goal and to create synergies in the sectors:

Three **Regional Development Programmes** within the Framework of EU-Turkey Financial Cooperation:

These programmes are financed by EU Funds and presently cover Bitlis, Hakkari, Muş, Van (TRB2 Region Development Programme); Amasya, Çorum, Samsun, Tokat, Çankırı, Kastamonu, Sinop, Erzurum, Erzincan, Bayburt (TR82, TR83 and TRA1 Regions Development Programme); Ağrı, Ardahan, Bingöl, Elazığ, Iğdır, Karamanmaraş, Kars, Kayseri, Konya, Malatya, Sivas, Tunceli and Yozgat (TRA2, TR72, TR52 and TRB1 Level II Regions Development Programme), say 27 provinces in total. The wider objectives of these programmes are to reduce regional disparities and support sustainable development mainly by activities related to capacity building.

All of these programmes envisage grant schemes for SMEs in the regions stated above. The target groups are small and micro enterprises active in agriculture, manufacturing and services sectors. Physical investments of the target group enterprises shall be encouraged by granting a maximum of € 100,000 per project. However, not more than 50% of the project cost shall be covered. In order to increase the management capacity of the target group, entrepreneurship activities shall be promoted via technical assistance covering topics such as enterprise management, consultancy services and access to business database.

If appropriate, SELP II and the Regional Development Programmes would collaborate as both have similar objectives such as supporting SMEs and reducing regional disparities. Since the Regional Development Programmes cover up to 50% of the project cost by means of grants, the remaining 50% of the project cost could be covered by SELP II loans, provided that such projects are bankable according to an assessment by one of the SELP II On-lending Banks.

These non-financial projects are targeted at Microenterprises and partly at promoting Small and Medium enterprises. Their approach is complementary to the provision of finance and through linkage of SELP II with these projects synergies might be created. Further ideas of corporation still need to be discussed in a later stage of the programme, when the programme locations as well as additional EU financed programmes are defined. A Partnership will be sought subsequently.

3.6 Lessons learned

3.6.1 Experiences of SELP I

There is a strong unmet loan demand from SMEs

The long-term loans extended under the SELP I with a duration up to 36 months and a loan amount of up to EUR 30,000 meet a strong demand by SMEs previously virtually excluded from refinancing services from private commercial banks. Demand studies carried out under SELP I highlight the large unmet demand for loans of this size

A rough calculation shows that given the institutional capacity of the OLBs each bank could allocate about EUR 300,000 per region, bank and month. This amount is likely to increase with the OLBs' increasing institutional know-how and experience in providing SME loans. By the end of 2004 and within four months EUR 4.75 Million were already disbursed (Annex 7 shows the currently outstanding loan numbers and amounts of the three OLBs in each of the pilot regions of SELP I).

Long-term loans to SMEs are a Novelty

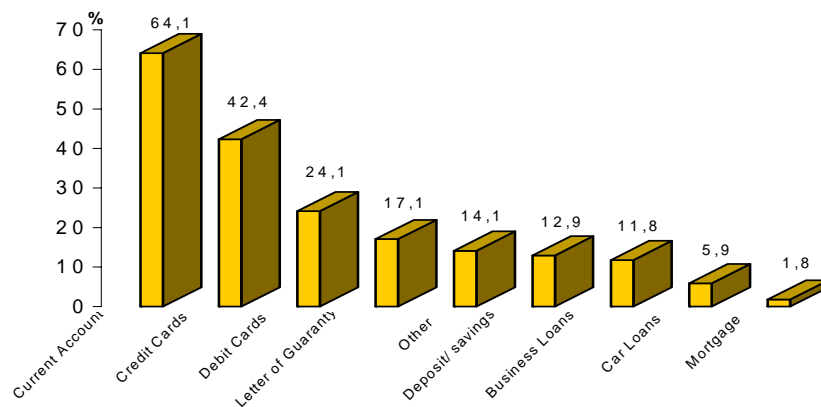
The huge unmet demand exists, because only a small number of SMEs have ever received a loan. The demand studies show that while 64% of the samples use banks' current accounts in the well developed regions, only 11.8% use business loans. The potential increase in SME loans is facilitated by the fact that the majority of entrepreneurs and companies have already established relations with banks by using current accounts, credit and debit cards and other financial services, as indicated by Chart 1.

Private mid-sized banks are particularly well suited for SME Lending

The thorough selection process of potential OLBs and the subsequent contract negotiations show that mid-sized banks are particularly well suited for SME lending. With the objective of SELP I to strengthen the role of private banks in financial services to the SME sector the choice mid-sized private banks may contribute to countering the high concentration of the Turkish banking market.

The Turkish republic has set up a number of specialised state owned banks designed to support the SME sector. While the role of these banks in supporting the SME sector is very important, they are not in a position to cover all regions and all segments of the market evenly and in a sustainable fashion.

Chart 1: Kind of Financial services used by SMEs



3.6.2 KfW's experiences in other European Countries

Experiences with SME Finance projects in other Southeast Europe and other countries have shown that several ingredients lead to a successful project, which is able to address the two important weaknesses observed in the Financial Market for SMEs. These are namely the lack of medium and long-term refinancing funds that fundamentally restrict the ability to banks to issue loans to SMEs and institutional weaknesses and unsuitable credit technologies that make it difficult for local banks to deal with the risk and administrative costs related to SME lending.

A tailored project design following the lessons learnt is therefore used in KfW's projects:

- Focus on private financial intermediaries, which have demonstrated their commitment to sound banking.
- In order not to create monopolies it is important to promote a variety of promising institutions simultaneously.
- Productive incentive mechanisms have to be established at all relevant levels in order to achieve sustainability.

- The principle of market orientation implies that funds be provided in conformity with market conditions. This refers to refinancing rates at which local banks draw on programme funds, which must be low enough to provide banks with an incentive to venture in the low-income market segment, and high enough to avoid causing market distortions.
- Experience shows that it is easier to serve urban areas first and then move to rural areas. In rural areas banks are benefiting most from assistance.

These experiences have been made in Kosovo, Serbia, Bosnia and Herzegovina, Montenegro and other neighbouring countries such as Bulgaria and the Caucasus. Additionally, KfW's experiences were collected in many other countries, especially in Latin America (e.g. Bolivia, Nicaragua, El Salvador and Peru) and Asia (e.g. Thailand). Altogether the most important conclusion that can be drawn is that sound banking with SMEs is possible even in an unstable economic and social environment.¹⁷

3.6.3 Experiences of other Phare Countries

International experience shows that private commercial banks are able to develop their lending to SMEs in order to advance economic growth, support employment and generate income to improve livelihoods even under less favourable conditions of businesses compared to high growth cities. This shall be proven valid especially in Turkey, where the prospect of EU accession and eventual membership will improve country risks, spur foreign direct investments into the banking sector and increase international refinancing to private commercial banks, thereby leading to sounder banks and improved SME lending.

Especially the national and multinational programmes that have been developed in co-operation with International Financial Institutions and are dealing with the promotion of small and medium-sized enterprises have proven to be useful for the development of the pre-accession partner countries. These SME facilities encourage intermediary banks to provide finance to SMEs in the partner countries. They are complementary to the support for SME development provided through the national programmes¹⁸.

3.6.4 Conclusion

SELP II is drawing conclusions on the lessons learnt and the respective improvements of SELP I and of other relevant projects in this segment. It may contribute to a diversification of the choice available for SMEs to tap into financial services provided by banks. The commercial banks, which have been contacted during the project identification, expressed their satisfaction with the present project and their appreciation of SELP II. They opted for higher loan volumes and longer maturities corresponding to the demand of bigger SMEs. The design of SELP II incorporates these indications and increased the maximum loan amount to EUR 50,000 (for fixed investment) and the maximum maturity to 48 months. It also adds a defined perspective on how to deal with the funds once the programme will be concluded.

Nevertheless, more precise data is needed to more efficiently target the relevant SME sectors. Therefore, a more comprehensive demand study in preparation of a new SELP II will be conducted in the 1st quarter of 2005.

¹⁷ See: The development of the Financial Sector in Southeast Europe (2004) and EU-Accession – Financial Sector Opportunities and Challenges for Southeast Europe (2005)

¹⁸ See: <http://europa.eu.int/comm/enlargement/pas/phare/programmes/index.htm>

4. INSTITUTIONAL FRAMEWORK

4.1 Steering and monitoring

A Steering Committee will be established for steering and monitoring of the project. The Committee will include representatives from Undersecretariat of Treasury, the CEB, KfW (PIU – Project Implementation Unit), Undersecretariat of State Planning Organization (SPO) and the Turkish Development Bank (TKB). The Central Finance and Contracts Unit (CFCU), the Secretariat General for EU Affairs, the TA consultant to be selected, and the European Commission Delegation and other investors that would participate in the EFT will participate in the Steering Committee as observers.

The Steering Committee will meet twice a year or more frequently, if needed. The Steering Committee meetings will be chaired and hosted by Undersecretariat of Treasury. The Steering Committee will provide strategic project direction and guidance to the PIU. It will act as the decision-making body of the project and take decisions on:

- issues related with the overall strategic approach of the programme, such as defining the amount of sub-loans (max EUR 50.000), changes in provinces designated as growth points (currently determined as 15 at maximum) and the early implementation of the exit strategy
- any other crucial issues related to the implementation of the project

The Steering Committee

- advises on selection criteria for locations
- advises on important implementation issues arising from progress report
- acts as conflict solving body for any disputes arising during implementation of the project

Steering Committee will take its decisions on the basis of majority voting rule.

The PIU will ensure that all activities to be provided under this project will be undertaken in line with the decisions of the Steering Committee. It will prepare regular reports regarding implementation of the project and submit to the Committee. The PIU will also inform the Steering Committee about the possibility of the potential investors (mezzanine, private investors, etc.) interested in investing to the EFT.

In case of inadequate absorption capacity in the programming regions due to the lack of demand, increased fund amount, or any other reason, the PIU may submit a recommendation to the Steering Committee to extend the coverage further than 15 growth points. The Steering Committee, upon the recommendation of the PIU, may propose to widen the coverage of the project to additional provinces or to the whole Turkey. Such a proposal could be approved by the unanimous decision of the EC, the Treasury, the SPO, and the EUSG, with the exchange of letters.

In the first month of the programme implementation, the respective institutions will determine their representatives taking a part in the Steering Committee and notify the Undersecretariat of Treasury as well as the PIU.

4.2 Implementation

The implementation of the project will be secured by the **Undersecretariat of Treasury** in

Turkey.

Due to the factors necessitates the presence of International Financial Institutions (IFI) and being a natural organ of the European Commission, an agreement will be signed between CFCU and the Council of Europe Development Bank (CEB). Since CEB does not have the required experience and manpower to establish and manage such an EFT, it will transfer the overall responsibility of the programme to KfW via a specific contract. The **KfW Project Implementation Unit (PIU)**, already established in Ankara, will together with the KfW-Head Office in Frankfurt administer this Project, manage the EFT as well as the Exchange Risk Cover Fund and monitor TA activities.

Contact details for the PIU are as follows:

KfW Office Ankara
And Sokak No:8/7
Çankaya 06700 Ankara – Turkey

Phone : +90-312-4288415
Facsimile: +90-312-4288416

The PIU operations will be regulated by a tri-lateral funding agreement to be signed among CFCU-CEB and KfW. The PIU will be directly responsible for the implementation of the Components 1 and 2 and will monitor the activities of the TA consultant (Component 3). The major responsibilities are as follows:

- Establishment and management of the European Fund for Turkey and Exchange Risk Cover Fund,
- Selection and monitoring of on-lending banks,
- Conclusion of loan agreements with the on-lending banks,
- Design of foreign exchange risk cover modalities,
- Establishment and adaptation of the necessary procedural steps for project implementation,
- Devising of a system for reporting and controlling to be used by the on-lending banks,
- Organizing the Official Launch of the programme.
- Assisting CFCU in selecting the TA Consultant (e.g. drafting the Terms of Reference).
- Supervision and co-ordination of the technical assistance for the participating (on-lending) banks,
- The periodic reporting to the stakeholders of the programme.
- Assisting the TA consultant for the capacity building activities for the TKB (stage, training, reporting etc.)
- Directing the TA consultant for the publicity campaigns and the awareness raising activities for the market.

The project execution will start with an “Inception Phase”, which will last no more than 12 months. During this phase the European Fund for Turkey (EFT) and the Exchange Risk Cover Fund will be created. KfW and CEB will transfer an amount up to EUR 40 Million to EFT. New Due Diligences will take place to select on-lending banks (OLBs). Moreover, negotiations for framework agreements will be concluded with the participating banks.

Simultaneously, the Terms of Reference for tendering the Technical Assistance (after an assessment of the OLBs’ needs) will be drafted. In addition, the procurement procedure (including pre-qualification) will be initiated and the contract will be awarded by the CFCU. The

Terms of Reference and the draft contract will have to be approved by the EC before the procurement procedure can be started.

After completion of the inception phase, the “Implementation Phase” will last until the end of 2012. During this phase the resources of the EFT and of the Exchange Risk Cover Fund will be disbursed to the participating banks. In addition, these participating banks as well as the Development Bank of Turkey (TKB) will receive training and technical assistance as specified in Chapter 3.2. point 3.

At the beginning of the 5th year of the programme, the steering committee will evaluate the present status of the exit strategy as well as TKB’s capacity to administer the proposed EFT. Technical Assistance (TA) Consultant will prepare an evaluation report addressing this issue. If the Steering Committee needs a further evaluation, then an external evaluator will be contracted through a Framework Contract. The PIU, in cooperation with the Technical Assistance (TA) Consultant, will assist the CFCU in the preparation of the Terms of Reference for this contract. Steering Committee will evaluate the result of these reports. In case the Steering Committee is satisfied with the results already achieved regarding the preparation of the exit strategy, KfW shall transfer the overall responsibility of the programme to TKB at the end of the 5th year of the programme. If the Steering Committee decides to further develop the capacity at the TKB, the programme will be implemented by the KfW for another year. In that case, at the beginning of the sixth implementation year, a final assessment will be done by Steering Committee, with the same conditions stated above.

Upon approval of the TKB’s capacity, the EU grant will be transferred to the beneficiary, the Turkish Treasury, which will on-lend the funds as special assets to Development Bank of Turkey (TKB). Simultaneously, KfW will transfer the administration of the EFT to TKB. Consequently, TKB will be in full charge of SELP II at the end of the programme.

Central Finance and Contracts Unit (CFCU) will be responsible for tendering and contracting the TA-consultant. KfW will support CFCU in this respect (e.g. drafting ToR, participating in the evaluation committee, monitoring the consultant).

TA consultant will be responsible for the implementation of Component 3.

4.3 Beneficiaries

SELP II will have a range of different beneficiaries, depending on the definition applied.

Institutional Beneficiary

The beneficiary of the project – and the official recipient of the EU grant – is the Undersecretariat of Treasury.

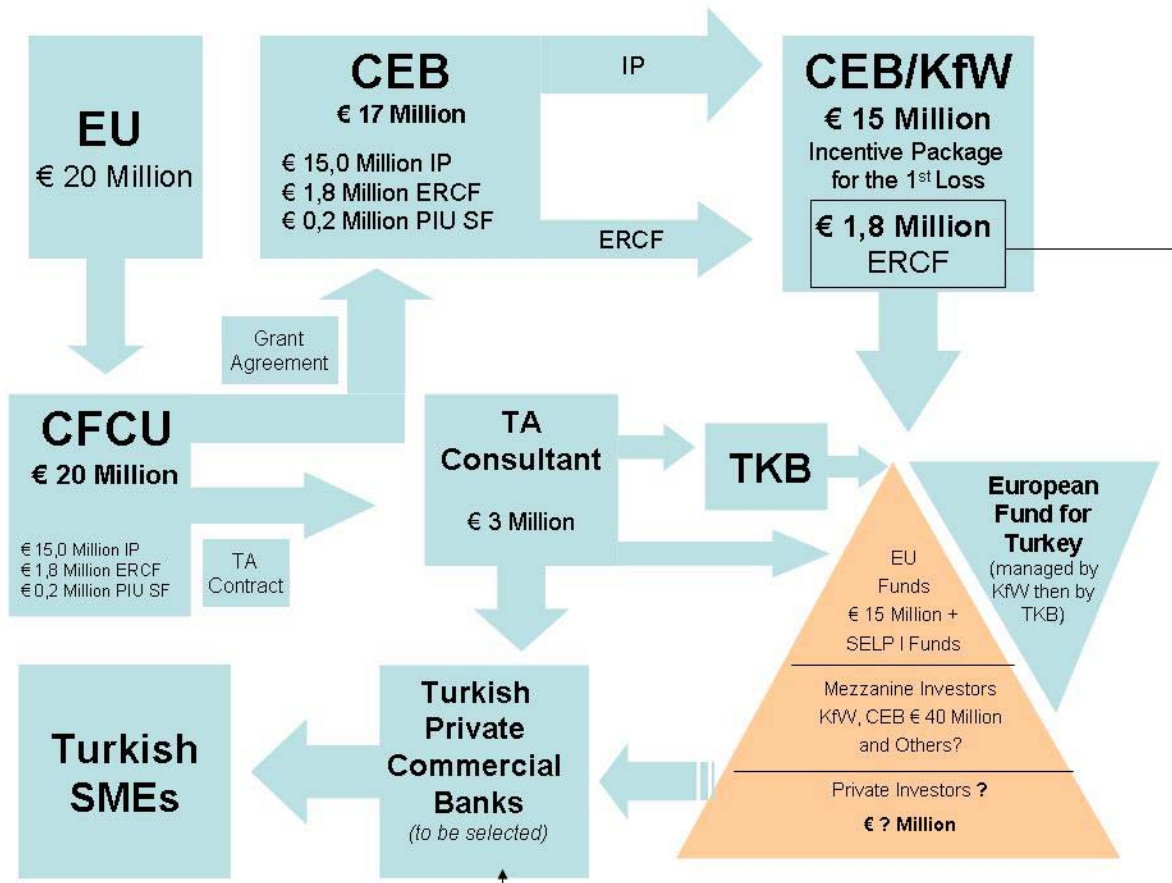
As the EU portion in the EFT will not diminish, an official Turkish institution will be needed at the end of the project to be the final beneficiary of these funds. Therefore, Treasury (Hazine), by definition, becomes the only alternative in order to receive SELP II funds. With regard to the exit strategy foreseen for SELP II, the Treasury is the only institution able to on-lend these financial means with a rather long maturity to a state-owned development bank. Türkiye Kalkınma Bankası (TKB) has been selected by Turkish authorities in order to administer the “European Fund for Turkey” still to be established. Sustainability of the exit strategy would be ensured since the privatization of TKB is not envisaged – in contrary to the other Turkish state banks. TKB being a state-owned development bank will gain substantial international

experience during the implementation of SELP II – by managing the “European Fund for Turkey” thereafter.

Target Group

The target group is represented by Turkish SMEs with fewer than 50 employees and assets of less than EUR 1 million each.

Below is an outline of the institutional structure of SELP II:



The **Institutions in Turkey**, the EC Delegation in Ankara and the EUSG will be responsible for the overall project supervision, whereas the CFCU for the tendering and contracting of the TA consultant.

The **participating (on-lending) banks** are responsible for granting sub-loans to SME in accordance with the on-lending contracts to be concluded with KfW. The on-lending banks shall assume the SME’s default risk. The participation in the SELP II will be open to all private commercial banks that fulfil a number of criteria, such as solvency, loan portfolio quality,

interest in the SME target group and willingness to introduce a new loan technology. The loans are to be used for the refinancing of sub-loans to SMEs for working capital and capital goods. The interest rates charged by the banks will cover refinancing costs and a risk and profit margin in order to stimulate their long-term involvement in the new market. Competition among the OLBs will be assured with the participation of minimum 2 banks in the programme. Based on the volume of the EFT, the banks' cash-flow projections and their offer to SMEs in the project regions of sub-loans with smaller amounts (max. EUR 30,000 working capital/max. 50,000 capital goods) and longer maturities (up to 48 months) the funds will be allocated to a maximum of up to 6 banks.

The respective loan agreements with the banks will consider an interest rate at close-to-market conditions (currently corresponding to EURIBOR + 1%). This interest rate shall be adjusted according to the market situation. The participating banks shall be supported in the extension or establishment of their SME business by financing technical advisory services for about two years (e.g.: training of loan officers in a new lending technology, lending and loan supervision, improvement of procedure). After suitable time additional services shall be provided selectively. At present, foreign exchange risk is to some extent still a concern of on-lending banks. SMEs without foreign currency income would generally prefer loans denominated in TL. In order to stimulate the banks' TL-lending an Exchange Risk Cover Fund will be created to cushion the respective risks.

The **Consultant** will provide OLBs with technical assistance and training on the development of a profitable SME lending business. The company will be selected following an open and international tender steered by CFCU. His activities will be monitored by KfW.

For the above mentioned PIU activities, and as in other cases, **KfW** would charge a fee of 1% of the total project volume for its services and pay from it the administrative costs (office, personnel etc.). Apart from first year's fees, KfW administration costs are to be covered from the fund's earnings corresponding to the EU portion.

5. DETAILED BUDGET

	Phare/P re- Accessio n Instrum ent support	Co-financing			Total Cost
		National Public Funds (*)	Other Sources (**)	Total Co- financing of Project	
€M					
Year 2005 - Investment support jointly co funded					
European Fund for Turkey	15.0	5.8***	40.0****	45.8	60.8
Exchange Risk Cover Fund	1.8	-	-	-	1.8
PIU Service Fee*****	0.2	-	-	-	0.2
Investment support –sub total	17.0	5.8	40.0	45.8	62.8
<i>% of total public funds</i>	<i>max 75 %</i>	<i>min 25 %</i>			

In case of *parallel* co-funding (per exception to the normal rule, see special condition as indicated below:

Year 2005 - Investment support co funded in parallel					
European Fund for Turkey	-	-	-	-	-
Exchange Risk Cover Fund	-	-	-	-	-
Investment support – sub-total	-	-	-	-	-
% of total public funds	<i>max 75 %</i>	<i>min 25 %</i>			

Year 2005 Institution Building (IB) support					
Technical Assistance	3.0	-	-	-	3.0
IB support	3.0				3.0

Total project 2005	20.0	5.8	40.0	45.8	65.8
---------------------------	------	-----	------	------	------

(*) contributions from National, Regional, Local, Municipal authorities, FIs loans to public entities, funds from public enterprises. For this particular project

(**) private funds, FIs loans to private entities

(***) the National Public co-financing will be provided by funds generated by the SELP I fund, once the exit strategy for this programme has been implemented. This provision is in line with the Commission Decision C(2002) 1080 approving the SELP-I project. At the end of the programme, the Revolving Fund would be transferred to a suitable Turkish institution to be agreed with the Commission (Commission Decision, page 6). Implementation deadline for SELP-I is 31 December 2008.

(****) estimated

(*****) for the first year of implementation

1. All investment sub-projects supported by the pre-accession fund must receive co-financing from national public funds. Minimum requirement for co-financing from national public funds is 25% of the combined PHARE and national contributions to the overall investment support.
2. Many Institution building projects will also have a degree of co-financing – this should be quantified and included wherever possible.
3. Expenditure related to equipment (regulatory infrastructure or ESC- related) and to Technical Assistance supporting investment (e.g. pre feasibility study / supervision of works / technical specifications) should be considered as Investment support in the project fiche.
4. All co-financing must be provided on a joint basis. Parallel co-financing will, in a principle, not be accepted. Exceptions to this rule have to be agreed with the Commission in advance.
5. All co-financing should be clearly quantified, also the degree of certainty of such co financing (i.e. for National Public Funds: is it already earmarked in local or national budget, for FIs Loans, private funds: are they already approved/ under appraisal, etc..).
6. **Where parallel co financing is accepted and justified per exception to the normal rule it should be provided in monetary form. If this is not possible there should be**

clear criteria set out for the valuation of any non-monetary contributions (that should be quantified in the table)

7. If twinning is involved, clearly state the expected budget of the twinning covenant
8. The financial engineering of the project should be closely monitored against actual delivery during implementation and against the objectives that were set in the project fiche so that corrective actions may be taken where required.

6. IMPLEMENTATION ARRANGEMENTS

Next Steps and Implementation Arrangements

A Demand Study will be carried out in the 1st Quarter of 2005 in order to identify project regions which are characterized by a high potential in terms of the project objectives.

6.1 Implementing Authority and Implementing Agency:

The Central Finance and Contracts Unit will be the implementing agency in terms of procedural aspects of the tendering process (TA Consultant), contracting matters (TA Consultant and KfW) and financial management regarding the TA Consultant and KfW.

Beneficiary

The Undersecretariat of Treasury
Eskisehir Yolu No:36
06510 ANKARA

Contact Person at the Beneficiary

Mr. Sedat Çal
Head of Department
Undersecretariat of Treasury, General Directorate of Foreign Economic Relations
Eskişehir Yolu No: 36, 15th Floor
Emek 06510 Ankara - Turkey
Phone: +90-312-2127784
Fax: +90-312-2128550
e-mail: sedat.cal@hazine.gov.tr

Contact Person at the Central Finance and Contracts Unit (CFCU)

Mr. N. Ercan Tortop
Ehlibeyt Mahallesi, 6. Sokak No16/8
Ekşioğlu İş Merkezi
Balgat 06520 Ankara - Turkey
Phone: +90-312-2852002
Fax: +90-312-2859624
e-mail: ercan.tortop@cfcu.gov.tr

Contact Person at the EUSG

Dr. İnci Ataç-Rösch
Head of Economic and Financial Department
Secretariat General for EU Affairs
Eskişehir Yolu 9. Km. 06520

Ankara- Turkey
Phone: +90-312-2857720
Fax: +90-312-2856377
e-mail: iatac@abgs.gov.tr

Contact Person at the SPO

Mr. Ahmet Yücel
Head of Department
General Directorate of European Affairs
Undersecretariat of State Planning Organization
Necatibey Caddesi 108, Yüce-tepe, 06100
Ankara- Turkey
Phone: +90-312-2945716
Fax: +90-312-2945770
e-mail: ayucel@dpt.gov.tr

Contact Person at the EC Delegation

Mr. Güray Vural
Delegation of the EC to Turkey
Uğur Mumcu Caddesi No:88, 4th Floor
G.O.P. 06700 Ankara - Turkey
Phone: +90-312-4598700
Fax: +90-312-4361093
e-mail: guray.vural@cec.eu.int

Contact Person at the TKB

Ms. Selcan Şahinkaya
Funding Director
Development Bank of Turkey
İzmir Caddesi No: 35
Kızılay 06440 Ankara - Turkey
Phone: +90-312-4250205
Fax: +90-312-4170146
e-mail: selcan-s@tkb.com.tr

Contact Person at KfW (PIU)

Mr. Melih Çadircı
KfW Office Ankara
And Sokak No:8/7
Çankaya 06700 Ankara – Turkey
Phone : +90-312-4288415
Fax: +90-312-4288416
e-mail: mcadirci@kfwankara.com

Contact Person at Council of Europe Development Bank (CEB)

Ms. Elif Timur
Council of Europe Development Bank
55, Avenue Kleber, F-75116
Paris - France

Phone: +33-1-47-55-37-79
Fax: +33-1-47-55-37-52
e-mail: elif.timur@coebank.org

6.2 Twinning

Not applicable

6.3 Non-Standard Aspects

An agreement will be signed between CFCU and Council of Europe Development Bank (CEB) to channel EFT- and ERCF-funds as well as the PIU management fee (total of EUR 17 Million). Thereafter, a funding agreement will be signed among CFCU, KfW and CEB for establishment and management of the EFT. In order to frame up the exit strategy, a Memorandum of Understanding will be signed among EC, KfW, the Treasury and TKB. Since the project envisages extending loans with a 48 months maturity, the project duration is longer than the one of standard projects. Therefore, standard disbursement rules and related time frames will not be applicable for this particular project. In addition, KfW will be responsible for the selection of on-lending banks according to KfW's guidelines and procedures taking into account the Commission's relevant eligibility and publicity rules.

Council of Europe Development Bank (CEB) and Turkey

Set up in 1956, the CEB (Council of Europe Development Bank) has 36 member states since 18 December 2003, when Bosnia and Herzegovina joined the institution. 15 Central and Eastern European countries are listed among the member states.

As a major instrument of the policy of solidarity implemented by the Council of Europe, the Bank finances social projects by making available to them resources raised in conditions reflecting the quality of its rating (AAA with Standard & Poor's, Fitch Ratings and Moody's). It thus grants loans to its member states, to financial institutions and to local authorities for the financing of projects in the social sector, in accordance with its Articles of Agreement.

Turkey is the founding member of CEB with a share of 7.007 % (as of 30.11.2004). Since its establishment in 1956, the CEB has approved nearly EUR 5 billion in favour of more than 150 Turkish projects mainly in the sectors of rural modernisation, natural disaster, health and education. A Framework Loan Agreement between Turkey and the CEB for an amount of EUR 200 million in favour of bigger Turkish SMEs was signed on April 4, 2004. The CEB loan proceeds will be channelled through five Turkish banks to finance investments in infrastructure and equipment undertaken by medium-sized private enterprises in the manufacturing, renewable energy, tourism sectors and related services. The participating banks include Turkish state banks such as the Industrial Development Bank of Turkey (TSKB), Halkbank, Vakıfbank, the Development Bank of Turkey (TKB) and Ziraat Bank. This loan facility, which is complementary to SELP II, will contribute to facilitate access of bigger Turkish SMEs' to medium to long term financial resources.

KfW and the European Commission Cooperation

KfW works closely together with the EU Commission and contributes its special know-how – both in the professional dialogue and in joint financings. In numerous countries and sectors several member states and the EU are active simultaneously. In order to increase the effectiveness of the European assistance on the whole it is important, for the benefit of the partner country, that the donors and the partner country seek agreement on the terms and

conditions and the objectives of the assistance provided and try to make the various measures compatible.

The cooperation of KfW with the European Commission is many and varied: It ranges from an intensive expert dialogue in site in the partner country to the cooperation of experts from KfW in EU working groups in Brussels and to a number of co-financing activities. In appropriate cases KfW also cooperates with the EU Commission in the form of a “delegated cooperation”.

In this context KfW becomes active in projects of common interest where it has special sector know-how, like the financial sector in Eastern Europe and Turkey. It assumes tasks in the area of technical management and the financial handling and administration of the financial contribution provided by the EU and at the same time ensures that the European regulations are being observed and that the European contribution becomes visible. Up to now the cooperation in this area was altogether very gratifying. As of November 1, 2004, KfW administers and controls 17 projects on behalf of the European Commission for a total amount of EUR 140 million in the priority regions of the Balkans, Turkey, Sub-Saharan Africa and Afghanistan. This cooperation is a good example of the stronger donor harmonization and of better coordination and complementarity of the European assistance, which is the objective of both the individual member states and the EU Commission.

KfW's Role in SME Lending

Any economy is strengthened through the promotion of efficient financial systems. KfW for many years helps the financial institutions in partner countries with introducing payment transaction systems, setting up new loan and savings programmes and – in particular – financing small and medium sized enterprises as well as providing microfinance to micro-enterprises. Improved access to financial services makes it possible for small and micro enterprises to increase their turnover, create jobs and raise their profits. On behalf of the German Federal Ministry for Economic Cooperation and Development (BMZ) and on an assignment from the European Union, KfW provides approximately EUR 400 million just to support the build-up of microfinance institutions in 36 countries with 82 projects. Given a financing volume, KfW is one of the leading banks worldwide in the field of financing SMEs and microfinance. Roughly one quarter of the funds are provided at KfW's own risk.

As an example to KfW activities, by mid-2004 the eleven micro-banks with which KfW cooperates in Eastern Europe had a loan portfolio of more than EUR 645 million. Given an average loan amount of EUR 3,640 this makes 177,000 borrowers plus their children, family members and employees and their families. As KfW will grant new loans in the amount of EUR 20 to 30 million every month, it is expected that the total number of borrowers to rise to over 200,000 by early 2005.

Within the context of SELP II KfW will fulfil any of the criteria relevant to a successful implementation for such a programme. In particular, KfW is well experienced in managing similar programmes – sustainable – in Turkey as well as in Eastern Europe, the Balkan and Caucasian Countries. This implies that KfW also gained substantial in-depth knowledge e.g. in drafting and negotiating the required agreements with OLBs, tendering and monitoring financial consulting services, setting up of specialized legal and transaction departments, etc.. Moreover, KfW with its own office in Ankara is for years very closely following developments of the Turkish financial sector and is – also with various other products – in a constant dialogue with almost all private commercial banks in Turkey.

KfW Experience in European Funds

European Fund for Bosnia and Herzegovina

In Bosnia and Herzegovina (BiH) KfW set up the European Fund for BiH in the context of a delegated cooperation with several other donors. The fund administered by KfW extends credit lines to local financial institutions for housing and SME loans. Besides funds from German Financial Cooperation, financial contributions from the European Union, Austria, Switzerland, the Netherlands and the Council of Europe Bank (CEB) are used for the fund (total volume of the fund: approximately EUR 60 million). The European Fund for BiH is still regarded as an example of successful coordination of different donors in financial sector promotion.

European Fund for Kosovo

In 2000 the EAR (European Agency for Reconstruction) and KfW established the European Fund for Kosovo, which serves as a pool for credit lines to qualified banks and non-bank financial institutions which on-lend the Fund's money to their clients in the SME sector. The EAR with funding from the European Union and KfW is helping to create an environment in which SMEs can flourish through the provision of credit and a comprehensive range of information, advisory and training services for the local financial institutions.

European Fund for Serbia (EFS)

KfW established the European Fund for Serbia, which commenced operations in July 2002. There are three partners in the Fund: KfW (EUR 18.4 million), EU through the European Agency for Reconstruction (EUR 5 million) and the Swiss Government through Swiss Agency for Development and Cooperation (EUR 2.4 million). KfW manages the Fund

European Fund for Montenegro (EFM)

In order to facilitate access to financial resources for SMEs in Montenegro, the European Fund for Montenegro (EFM) has been established by foreign donors (European Union, KfW, the Swiss Government and the Government of the Republic of Montenegro) with a capital of EUR 15 million. The project is implemented by KfW enabling the design of a more efficient model of financing, as well as transfer of knowledge to the institutions that issue loans and that provide the resources.

6.4 Contracts and Covenants

Component 1 and 2: Establishment of the European Fund for Turkey and Exchange Risk Cover Fund

Direct agreement: 16,800,000 EUR

Component 3: Consultancy and training services

Service contract: 3,000,000 EUR

Service fee : 200,000 EUR

Following contracts will be signed among the parties:

Related	Type of Contract	Purpose	of	the	Parties	of	the
----------------	-------------------------	----------------	-----------	------------	----------------	-----------	------------

Programme Component		Contract	Contract
Component 1-2	Direct Agreement	Legal Document for transferring funds for EFT and ERCF	CFCU-CEB-EC
Component 1-2	On-lending Agreement	Legal Document for transferring the management of the programme to KfW and stipulating responsibilities of the PIU	CFCU-CEB-KfW
Component 1	Framework Agreement	To stipulate the general lending conditions between KfW and the OLBs	KfW-OLBs
Component 1	Individual Loan Agreement	To stipulate the terms of drawings from the EFT	KfW-OLBs
Component 2	ERCF Agreement	To stipulate the terms of the ERCF	KfW-OLBs
Component 2	Option Agreement	To stipulate the terms of particular option buying and selling transaction	KfW-OLBs
Component 3	Service Contract	TA Activities	CFCU– TA Consultant

Component 3	Consultancy Memorandum of Understanding	To stipulate the terms of cooperation between TA Consultant and the OLBs	TA Consultant-KfW-OLBs
Component 1-2	Memorandum of Understanding	Legal Document for transferring SELP Funds to Undersecretariat of Treasury as the institutional beneficiary of the programme and thereafter to TKB as special asset.	EC-KfW- Treasury-TKB

7. IMPLEMENTATION SCHEDULE

7.1 Start of tendering/call for proposals

Immediately after signing the Funding Agreement a due diligence for the participating banks and the tender process for the TA-consultant will be initiated. The ToR and the required project documents will be ready by that time which most likely in the first quarter of 2006.

7.2 Start of project activity

1st Quarter of 2006

7.3 Project completion

7 years after signing the Funding Agreement (possibly 4th Quarter of 2012)

IMPLEMENTATION SCHEDULE			
	Start of Tendering/ Call for Proposals	Start of Project Activity	Project Completion
Component 1-2	Direct Agreement	2006/I	2012/IV
Component 3	2006/I	2006/IV	2008/IV

8. EQUAL OPPORTUNITY

Equal opportunity principles and practices in ensuring equitable gender participation in the programme will be guaranteed, particularly as regards to the final sub-borrowers. The programme will be open to both man and woman entrepreneurs as well as legal commercial entities.

9. ENVIRONMENT

In accordance with the environmental policy of the EC, the PIU shall examine or at least be assured that the SMEs financed under the project comply with national environmental and employee's health laws and regulations and that major investment projects have undergone an environmental impact assessment as required by the Turkish law. Resulting from the relatively small investment amounts, no relevant environmental impact can be expected.

10. RATES OF RETURN

Not applicable.

As this project is not a classical physical investment project but acts as a financial Apex Institution in the SME Finance Sector, the *Commission's Guide to Cost-Benefit Analysis of Major Projects*¹⁹ does not apply.

11. INVESTMENT CRITERIA

11.1 Catalytic effect

Effective promotion of Small and Medium Enterprises is necessary to uplift the sector as a whole, to create sustainable employment and economic development not only in the buzzing cities but also particularly in the weaker regions of Turkey.

It is necessary that private banks engage in financing Small and Medium Enterprises and with an envisaged amount of EUR 300 billion additional funding. Turkey needs to effectively coordinate and manage the successful projects and to find a way to leverage the funds with means of International Finance Institutions (IFI), bilateral donors and national sources for funding.

11.2 Co-financing

KfW and CEB will channel funds up to EUR 40 Million (up to EUR 20 Million each) to the EFT.

The OLBs contribution to the project will cover provision of adequate office space, organisational costs of trainings, seminars and workshops (rental fees for training and seminar venues, interpretation equipment, catering as well as (international) travel of trainees in the framework of study visits and traineeships) and other costs non-eligible for pre-accession funding.

11.3 Additionality

As is seen in Chapter 3.5 (Linked activities) SELP II will fulfil its purpose in a - so far - unattended market niche. For the time being little funding has been available, that means that the EU grant will not displace other sources of funding. Especially in the European Fund for Turkey, the EU grant will lead to a leverage effect by efficiently multiplying EU Funds with funds from IFIs and commercial investors. SELP II is therefore fully complementary.

¹⁹ http://europa.eu.int/comm/regional_policy/sources/docgener/guides/cost/guide02_en.pdf, plus annex http://europa.eu.int/comm/regional_policy/sources/docgener/guides/cost/addendum_corrige.pdf

Leverage additional funds

The EC funds of SELP II will be transferred to the „European Fund for Turkey“. The EC Funds will be used as risk cushion (first loss piece) - following the model of the European Fund of Southeast Europe currently under implementation – in order to attract additional funds of other financial intermediaries like KfW or CEB and others. The additional funds of the financial intermediaries will be subordinated to the EC Funds in the sense that they would represent a different risk category (Mezzanine Loss Trench). In case that one or more partner banks default (no receivables from amortization and/or interest) the second loss investors would be not affected by losses until the First Loss Trench is completely exhausted. Accordingly international long term refinancing from multilateral or bilateral financial intermediaries is easier to attract, cheaper than and not as risky as in the case of direct lending to the partner banks.

As the demand for refinancing increases, it is foreseen to establish another risk category, the so called Senior Loss Trench. As the Mezzanine Trench would have second-rank liability for losses, this risk trench would be less risky than the other two Trenches and therefore even attractive for commercial investors. The Senior Trench would not become relevant – as in a waterfall - until the upper stages of First Loss and Mezzanine Trench are already fully depleted. So by graduating the risk there shall be an increasing flow of resources.

KfW and CEB have declared their willingness to invest in this Fund and – if demand increases – approach potential investors in the future.

11.4 Project readiness and size

As successor of SELP I the overall structure for SELP II is already in place. Therefore, an almost immediate start of the Programme is possible.

The project execution will start with an “Inception Phase” which will last up to 12 months. During this phase the European Fund for Turkey (EFT) and the Exchange Risk Cover Fund will be created and, in close collaboration with the European Commission and the Turkish authorities the additional project regions will be defined. A new due diligences will take place and negotiations of the respective loan agreements will be effected and –most likely- finalized with the participating banks.

The Terms of Reference for tendering of the Technical Assistance will be drafted. In addition the CFCU procurement procedure will be followed and the respective contract will be awarded. The Terms of Reference and the draft contract will have to be approved by the EC before initiating the procurement procedure.

After completion of the inception phase, the “Implementation Phase” will last for almost 6 years. However, after 4 years, TKB will be gradually involved in the administration of funds. During this phase the resources of the EFT and of the Exchange Risk Cover Fund will be disbursed to the participating banks. In addition, the latter will receive training and technical assistance as specified in Chapter 3.2. point 3.

During the project implementation phase the PIU will:

- Establish and manage the European Fund for Turkey and the Exchange Risk Cover Fund, reporting to the Commission and respective Turkish Authorities on their utilisation and performance.
- Supervise and carry out a due diligence to select the private commercial banks.

- Supervise and co-ordinate the technical assistance provided to the participating banks.
- Ensure the overall project co-ordination and the internal monitoring, promptly informing the EC on any relevant issue concerning the project execution.
- Elaborate in detail the final transfer of the Funds to TKB through Treasury (Hazine).

11.5 Sustainability

The experiences with SELP I Partner Banks show that the provision of loans to SMEs is a profitable and interesting business line in the banks loan portfolio.

SME Banking is sustainable, because costs of operations can be covered: Market near interest rates charged by the banks will cover refinancing costs, a risk and profit margin is providing for sustainable rates of return.

The technical assistance package builds up in-house knowledge of the banks. The SELP I partner banks have shown their willingness to invest their own resources to a limited extent, even though cautiously. There is still some time needed to induce them to entirely use their own resources. Given the continuing interest of the partner banks and on going favourable macroeconomic environment, the programme shall be sustainable.

A professionally managed European Fund model is a long lasting tool for financing SMEs in Turkey. During the management by KfW, the Development Bank of Turkey will receive training for building up capacity to handle such a fund after the exit of KfW. Therefore the sustainability of the programme is ensured.

11.6 Compliance with state aids provisions

Not applicable

12. CONDITIONALITY AND SEQUENCING

Signing of the on-lending agreement among CEB, KfW and CFCU is a pre-condition for starting the activities within the framework of component 1 and 2 as well as for initiating tendering process for the service contract. Transferring the full amount of the respective funds to KfW is a precondition for establishing the European Fund for Turkey and Exchange Risk Cover Fund at KfW.

After the funding agreement is signed, KfW will start the due diligence and select the participating banks. With approval of the EC, KfW will start negotiation process with selected OLBs and will conclude the respective Framework Agreements. On the other hand, conclusion of the service contract and the selection of on-lending banks are pre-conditions for the signature of MoU between the TA Consultant, KfW and the On-lending banks.

Completion of the conditions precedent documents by participating banks is the pre-condition for signing Individual Loan Agreements. Likewise signing the ERCF agreement is a precondition to OLBs to buy options.

Sequencing

The programme is designed with two phases:

1. Inception Phase: Probably 1st Quarter 2006 – 4th Quarter 2006
2. Implementation Phase: 1st Quarter 2007 – 4th Quarter 2012

In the Inception Phase following activities will take place:

Activity	Anticipated Year/Quarter
Signing the On-lending Agreement among CEB, KfW and CFCU	2006/I
Signing the MoU among EC, KfW, Treasury and TKB	2006/I
Establishment of the EFT and respective accounts	2006/I
Transfer of SELP II Funds to EFT	2006/I
Transfer of CEB and KfW contributions to EFT	2006/I
Prequalification and launching of the tender for the TA Consultancy services and completion of the selection of the TA consultant	2006/I-III
Due Diligence for selection of OLBs	2006/I-II
Selection of OLBs	2006/II-III
Negotiation and Signing the Framework Agreements with OLBs	2006/IV
Negotiation and Signing the ERCF Agreements with OLBs	2006/IV
Negotiation and Signing the TA Cooperation Agreements with OLBs	2006/IV
Completion of Conditions Precedent Documents by OLBs	2006/IV

In the Implementation Phase following activities will take place:

Activity	Anticipated Year/Quarter
Establishment of the “European Fund for Turkey”	2006/IV- 2012/IV
TA Activities	2006/IV- 2008/III
Signing ILAs with OLBs	2006/IV- 2011/IV
Disbursement of loans to SMEs	2006/IV- 2012/II
ERCF Transactions	2006/IV- 2012/IV

ANNEXES TO PROJECT FICHE

1. Logical framework matrix in standard format (compulsory)
2. Detailed implementation chart (compulsory)
3. Contracting and disbursement schedule by quarter for full duration of programme (including disbursement period) (compulsory)
4. Reference list of related sector and feasibility studies
5. Reference list of relevant laws and regulations
6. Reference list of relevant strategic plans and studies
7. Overview of recent developments of SELP I
8. Restriction for SELP II Loans
9. Map of Turkey

Annex 1 – Logframe Matrix

LOGFRAME PLANNING MATRIX FOR Small Enterprises Loan Programme, 2nd Phase (SELP II)		Date of Drafting: 22.02.2005	
		Contracting period expires: 30 November 2006 (Components 1, 2 and 3) Disbursement period expires: 30 November 2012 (Components 1, 2)	
		Total budget: 20 m EUR	
Overall objective	Objectively verifiable indicators	Sources of Verification	Assumptions and Risk
To make a contribution to economic development and creation of employment opportunities, to support the expansion and strengthening of the financial sector, and to promote the alleviation of regional disparities in Turkey.	Number of jobs created or secured per € 1.000.000 of loan extended is more than 500 More than 30% of SELP Loans are provided to new SME clients OLBs SME portfolio increases by 30% p.a.	OLBs progress report (monthly, quarterly) KfW bi-annual and annual supervision reports Monthly and quarterly credit statistics KfW final evaluation (Impact Study)	Macroeconomic situation in Turkey remains stable with reasonable inflation rates
Project purpose	Objectively verifiable indicators	Sources of Verification	Assumptions and Risk
Improved access to long-term loans to be provided by commercial banks for the target group at market conditions.	Average loan size is less than € 25,000 at the end of each calendar year 60% of the loans have a maturity of more than 12 months at the end of each calendar year	OLBs progress report (monthly, quarterly) Monthly and quarterly credit statistics KfW bi-annual and annual supervision reports	<ul style="list-style-type: none"> • Macroeconomic situation in Turkey remains stable with reasonable inflation rates. • Financial sector reforms

	Portfolio at Risk / SME repayments is less than 3% at the end of each year	KfW final evaluation (Impact Study)	<p>continue.</p> <ul style="list-style-type: none"> • OLBs continue their engagement in the SME Sector. • Business potential in project regions not deteriorating • No partner bank defaults
--	--	-------------------------------------	---

Results	Objectively verifiable indicators	Sources of Verification	Assumptions and Risk
1.1. European Fund for Turkey (EFT) for SME financing was established	On-lending Agreement among CEB, KfW and CFCU	On-lending Agreement among CEB, KfW and CFCU	<ul style="list-style-type: none"> • Macroeconomic situation in Turkey remains stable with reasonable inflation rates. • OLBs continue their engagement in the SME Sector. • International Financial Institutions and Private Investors are interested in investing in EFT.
1.2. On-lending banks extended loans to SEs.	Total allocated budget for the EFT disbursed within a period of 5 years after the signature of the Funding Agreement.	EFT Account Statements Monthly and quarterly credit statistics	
1.3. The EFT grew and increased its volume	The total volume of the EFT exceeded its initial value by 10 %	KfW bi-annual and annual supervision reports KfW final evaluation (Impact Study)	
2.1. ECRF facility made available throughout the project duration	More than 70% of the loan portfolio is denominated in TL ERCF Agreements has been signed Options were sold to OLBs	KfW bi-annual and annual supervision reports ERCF Account Statements ERCF Agreements Options signed	
			<ul style="list-style-type: none"> • Residual risk acceptable to OLBs. • OLBs willing to extend loans in local currency. • OLBs willing to sign options.

<p>3.1. Technical assistance provided to OLBs to improve their SE lending capabilities</p>	<p>Number of bankers trained in seminars.</p> <p>Feedback from seminars is more than 75% positive.</p> <p>OLBs meet reporting requirements.</p>	<p>KfW bi-annual and annual supervision reports</p> <p>Reports by the TA Consultant</p>	<p>OLBs willing to accept consultant's training and advisory input.</p>
<p>3.2. Fund management responsibilities and capabilities transferred to TKB.</p>	<p>Number of staff trained in TKB</p> <p>TKB capable of administering the EFT.</p>	<p>MoU signed among EC, Treasury, TKB and KfW</p> <p>Assessment by External Evaluation and decision by the Steering Committee</p>	<p>TKB willing to accept consultant's training and advisory input.</p> <p>TKB will be committed to the objectives of the project.</p>

Activities	Means	Cost	Assumptions and Risk
Component 1: Establishment and operation of European Fund for Turkey (EFT)	1. Direct Agreement: Loan Agreement for Establishment and Management of the European Fund for Turkey (EFT) and the Exchange Risk Cover Fund <ul style="list-style-type: none"> • KfW Project Implementation Unit (PIU) in Ankara 	Contract 1 Service contract 15.000.000 EUR	Direct agreement signed between the CEB and the CFCU
1.1.1 Signing the On-lending Agreement among CEB, KfW and CFCU 1.1.2 Signing the Memorandum of Understanding among KfW, Treasury and TKB 1.1.3 Establishment of EFT and			

Activities	Means	Cost	Assumptions and Risk
<p>respective accounts</p> <p>1.1.4 Transfer of SELP Funds to KfW through CEB</p> <p>1.1.5 Transfer of CEB and KfW contributions to EFT</p> <p>1.2.1 Due Diligence for selection of OLBs</p> <p>1.2.2 Selection of OLBs</p> <p>1.2.3 Negotiation and signing the Framework Agreements with OLBs</p> <p>1.2.1 Start of disbursements from EFT to OLBs</p> <p>1.2.2 Start of disbursements of sub-loans from OLBs to SMEs</p> <p>1.3.1 Regular reporting to the stakeholders of the project</p> <p>1.3.2 Transfer of the EU contribution and fund management to Treasury and TKB respectively</p>			
<p>Component 2: Establishment and operation of Exchange Risk Cover Fund</p>	<p>1. Direct Agreement: Loan Agreement for Establishment and Management of the European Fund for Turkey</p>	<p>Contract 1 Service contract 1.800.000 EUR</p>	<p>Direct agreement signed between the CEB and the CFCU</p>

Activities	Means	Cost	Assumptions and Risk
2.1.1 Transfer of SELP II Funds to CEB/KfW 2.1.2 Establishment of the ERCF account 2.1.3 Negotiation and signing the ERCF Agreements with OLBs 2.1.4 Signing of options 2.1.5 Regular reporting to the stakeholders of the project	(EFT) and the Exchange Risk Cover Fund KfW Project Implementation Unit (PIU) in Ankara		
Component 3: Technical Assistance	2.Service contract for technical assistance <ul style="list-style-type: none"> • Long and short term experts • Training seminars • Study tours 	Budget for service contract 3.000.000 EUR	

<p>3.1.1 Determining the training needs of the OLBs</p> <p>3.1.2 Developing training curricula for the OLBs</p> <p>3.1.3 Provision of training to OLBs</p> <p>3.1.4 Study tour to Financial Institutions in EU Countries</p> <p>3.1.5 Seminars and workshops for loan officers</p> <p>3.1.6 SME Conference</p> <p>3.1.7 Loan Portfolio Monitoring</p> <p>3.1.8 Developing a Loan Reporting tool or MIS</p> <p>3.1.9 Impact assessment of SELP II</p> <p>3.1.10 Necessary inputs for establishment and management of EFT</p> <p>3.1.11 Developing publicity and awareness campaigns for the OLBs</p> <p>3.1.12 Regular reporting to the stakeholders of the project</p> <p>3.2.1 Determining the training needs of the TKB</p> <p>3.2.2 Developing training curricula for the TKB</p> <p>3.2.3 Provision of training to TKB</p>	<ul style="list-style-type: none"> • Conferences 		
			Preconditions

None

Annex 2: Detailed implementation chart

	2005			2006									2007									2008																			
	O	N	D	J	F	M	A	M	J	J	A	S	O	N	D	J	F	M	A	M	J	J	A	S	O	N	D	J	F	M	A	M	J	J	A	S	O	N			
	<i>4th Quarter</i>			<i>1st Quarter</i>			<i>2nd Quarter</i>			<i>3rd Quarter</i>			<i>4th Quarter</i>			<i>1st Quarter</i>			<i>2nd Quarter</i>			<i>3rd Quarter</i>			<i>4th Quarter</i>			<i>1st Quarter</i>			<i>2nd Quarter</i>			<i>3rd Quarter</i>			<i>4th Quarter</i>				
Direct Agreement	N	N	N	N	N	N	N	N	N	N	N	N	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I
Technical Assistance 1	T & C	T & C	T & C	T & C	T & C	T & C	T & C	T & C	T & C	T & C	T & C	T & C	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I

	2009-2012			
	2009	2010	2011	2012
Direct Agreement	I	I	I	I
Technical Assistance 1	I	I	I	I

N	Negotiation of the Contract
T&C	Tendering and Contracting
I	Implementation and Payments
I	TKB Capacity Building

		2006				2007				2008				2009-2012			
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2009	2010	2011	2012
1	Signing the Grant Agreement between CFCU and CEB																
2	Signing the MoU among KfW, Treasury and TKB																
3	Establishment of EFT, ERCF and respective accounts																
4	Transfer of SELP Funds to EFT through CEB																
5	Transfer of KfW and CEB funds to EFT																
6	Prequalification and launching of the tender for the TA Consultancy services and completion of the selection of the TA consultant																
7	Due Diligence for selection of OLBs																
8	Selection of OLBs																
9	Negotiation and Signing the Framework Agreements with OLBs																
10	Negotiation and Signing the ERCF Agreements with OLBs																
11	Negotiation and Signing the TA Cooperation Agreements with OLBs																
12	Completion of Conditions Precedent Documents by OLBs																
13	TA Activities to OLBs																

		2006				2007				2008				2009-2012			
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2009	2010	2011	2012
1 4	TA Activities to TKB																
1 5	Signing the ILAs with OLBs																
1 6	Disbursement of loans by OLBs to sub-borrowers																
1 7	ERCF Transactions																
1 8	Assessment of TKB capability																

Annex 3: Contracting and Anticipated Disbursement Schedule (Quarterly – in Thousands Euro)

Contracted	I/2006	II/2006	III/2006	IV/2006	I/2007	II/2007	III/2007	IV/2007	I/2008	II/2008	III/2008	IV/2008	2009-2012	Check
Technical Assistance			3.000											3.000
EFT	15.000													15.000
ERCF	1.800													1.800
Management Fee	200													200
Cumulated	17.000		3.000											20.000
Disbursed*	I/2006	II/2006	III/2006	IV/2006	I/2007	II/2007	III/2007	IV/2007	I/2008	II/2008	III/2008	IV/2008	2009-2012	Check
Technical Assistance				350	350	350	350	350	350	350	350	200		3.000
EFT	15.000													15.000
ERCF	1.800													1.800
Management Fee**	200													200
Cumulated	17.000			350	350	350	350	350	350	350	350	200		20.000

* As KfW will be in charge of disbursing funds to OLBs, the entire means will be credited to an interest bearing EFT and ERCF-Account soon after the signing the Funding Agreement.

** For first year only; apart from first year's fees, KfW's fee of 1% of the project volume would be covered from the fund's earnings.

Annex 4: Reference list of related sector and feasibility studies

- KfW, market research on the current situation of the SME Finance Segment
- Data on Experience gained in SELP I
- Demand Study by BAI
- IFC-KfW-BDDK: Microfinance, Global Experience and Prospects for Turkey
- SPO: SME Strategy and Action Plan
- IKED (International Organization For Knowledge Economy and Enterprise Development): Strengthening Innovation and Technology Policies for SME Development in Turkey
- OECD: SME – Enterprise Development and Finance Project (SME Report on Turkey)
- OECD: Small and Medium Sized Enterprises in Turkey
- 2004 Regular Report on Turkey's progress towards accession
- Turkish National Programme for the Adoption of the Aquis (NPAA)
- 8th Five Year Development Plan, 2001-2005
- World Bank, 2003 – Proceedings from the World Bank Conference on New Technologies for Small- and Medium-sized Enterprise Finance. Financial Sector Learning Programme, Discussion Abstract No. 3
- KfW 2004, The development of the Financial Sector in Southeast Europe
- KfW 2005, EU-Accession – Financial Sector Opportunities and Challenges for Southeast Europe

Annex 5: Reference list of relevant laws and regulations

a) Turkish legislation

- Chambers of Commerce and Industry and Commercial Exchanges Law No. 5590.
- Decree on State Aids 2002/4367 for the Investments of Small and Medium sized Investments
- Decree for State Aids in Investment of SMEs 2000/1822
- Law on Encouragement of Investments and Employment No: 5084
- Law No.3624 on the Establishment of Small and Medium Industry Development Organisation
- Turkish Commercial Code Law No: 6762 including communiqués and decrees
- Law on the Establishment and Operations of Banks (Banking Law) No: 4389 and amendments including communiqués and decrees.

b) EU Legislation

- Council Decision No. 84/383/EEC
- Council Decision No. 87/182/EEC
- Council Decision No. 94/217/EC

Annex 6: Reference list of relevant strategic plans and studies

- IFC-KfW-BDDK: Microfinance, Global Experience and Prospects for Turkey
- SPO: SME Strategy and Action Plan.
- World Bank, Country Assistance Strategy
- IKED (International Organization For Knowledge Economy and Enterprise Development): Strengthening Innovation and Technology Policies for SME Development in Turkey.
- OECD: SME – Enterprise Development and Finance Project (SME Report on Turkey).
- OECD: Small and Medium Sized Enterprises in Turkey.
- 2004 Regular Report on Turkey’s progress towards accession.
- Turkish National Programme for the Adoption of the Aquis (NPAA).
- 8th Five Year Development Plan, 2001-2005.
- World Bank, 2003 – Proceedings from the World Bank Conference on New Technologies for Small - and Medium-sized Enterprise Finance. Financial Sector Learning Programme. Discussion Abstract No. 3.
- The development of the Financial Sector in Southeast Europe (2004) and EU-Accession – Financial Sector Opportunities and Challenges for Southeast Europe (2005).

Annex 7: Overview of recent developments of SELP I

Highlights of regions and pilot branches of SELP I by end of December 2004

	Izmir			Kocaeli			Gaziantep		
	<i>Dışbank</i>	<i>TEB</i>	<i>Finans</i>	<i>Dışbank</i>	<i>TEB</i>	<i>Finans</i>	<i>Dışbank</i>	<i>TEB</i>	<i>Finans</i>
Number of SELP loans outstanding	33	28	26	9	28	7	0	3	
Volume of SELP loans outstanding (in EUR)	523.993,57	296.642,56	568.907,93	151.272,42	373.019,97	149.510,14	0,00	26.983,50	541.221,

Total Loans: 165

Total Amount: EUR 2.791.503

Annex 8: Restrictions for SELP II Loans

Sub-Loans shall not finance enterprises involved in the following activities:

- Any activity which involves harmful or exploitative forms of child labour or forced labour;
- Any activity which is illegal under the laws or regulations of the Republic of Turkey or under international law;
- Production of/ or trade in weapons and munitions;
- Production of/ or trade in alcoholic beverages (other than beer and wine);
- Production of/ or trade in tobacco;
- Gambling, casinos and equivalent activities;
- Real estate activities (other than a Sub-Borrower's own operating purpose);
- Speculation in currencies; and
- Investment in securities of any kind.

Sub-Loans shall be granted in compliance with the environmental requirements for small and micro loans by which international financial institutions are bound. The following are excluded activities which can not be financed by Sub-Loans:

1. Trade in wildlife or wildlife products regulated under the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES);
2. Production of/ or trade in radioactive materials (other than the purchase of medical equipment, quality control or measurement equipment and any equipment where the radioactive source is trivial and/ or adequately shielded);
3. Production of, trade in or use of unbounded asbestos fibres (other than bonded asbestos cement sheeting where the asbestos content is less than twenty per cent (20%));
4. Production of/ or trade in products containing polychlorinated biphenyl (PCBs), likely to be found in products such as oil-filled electrical transformers, capacitors and switchgear dating from 1950-1985;
5. Production of/ or trade in pharmaceuticals subject to international phase-outs or bans;
6. Production of/ or trade in ozone-depleting chemical compounds (so-called Ozone Depleting Substances or ODSs) subject to international phase-out, such as aerosols, refrigerants, foam blowing agents, solvents and fire protection agents regulated under the Montreal Protocol;
7. Drift net fishing in the marine environment using nets in excess of 2.5 kilometres in length; and
8. Production or activities that impinge on the lands owned or claimed under adjudication, by indigenous peoples, without full documented consent of such peoples.

Discussion Draft

- Dashed lines indicate new provinces (13 provinces) to be included to the SELP II by the enactment of the Law on Encouragement of Investments and Employment No: 5084.