Report Number: ICRR0022053

1. Project Data

Project ID	Project Name
P157691	MSME & LESCF Project
Country	**Practice Area(Lead)**
Turkey	Finance, Competitiveness and Innovation

L/C/TF Number(s)	Closing Date (Original)	Total Project Cost (USD)
IBRD-85690	01-Jul-2019	200,000,000.00
Bank Approval Date	**Closing Date (Actual)**	
22-Dec-2015	01-Jul-2019	

	IBRD/IDA (USD)	Grants (USD)
Original Commitment	200,000,000.00	0.00
Revised Commitment	200,000,000.00	0.00
Actual	200,000,000.00	0.00

Prepared by	Reviewed by	ICR Review Coordinator	Group
Antonio M. Ollero	John R. Eriksson	Christopher David Nelson	IEGFP (Unit 3)

2. Project Objectives and Components

a. Objectives

According to the Loan Agreement (page 5), the project development objective of the Turkey Micro, Small and Medium Enterprise (MSME) and Large Enterprise Supply Chain Finance (LESCF) Project was "to improve access to finance for micro, small and medium enterprises, and longer-term finance for large enterprises involved in domestic supply chains."

b. Were the project objectives/key associated outcome targets revised during implementation?
No

c. Will a split evaluation be undertaken?
No

d. Components
The project had two components.

Improving Access to Finance for MSMEs provided for the creation and operation of a credit facility at Turkiye Halk Bankasi A.S. (Halkbank) for the provision of sub-loans to MSMEs (maximum US$3.5 million for each sub-loan, extended at market terms, and maximum US$5 million for each MSME) for the carrying out of MSME sub-projects. Sub-loans to MSMES (firms employing less than 250 workers) were to be made to finance short-term working capital as well as longer-term investment. It was expected that at least 60 percent of the project funds would be used to fund MSME sub-loans. Moreover, although micro enterprises were supported by the project, it was expected that the majority of MSME sub-loans would be made to small and medium enterprises.

Improving Access to Long-Term Finance to Large Enterprises Involved in Domestic Supply Chains provided for the creation and operation of a credit facility at Halkbank for the provision of sub-loans to large enterprises in domestic supply chains (maximum US$6 million for each sub-loan, extended at market terms, and maximum US$10 million for each large enterprise) for the carrying out of large enterprise sub-projects. Sub-loans to large enterprises (firms employing 250 to less than 1,000 workers) were to be made to finance only longer-term investment (this requirement was relaxed at project restructuring) and only if the large enterprises were involved in domestic supply chains with MSMEs: (a) the large enterprises bought inputs from MSMEs and had payables to MSMEs of at least 25 percent of their annual purchases, or (b) the large enterprises distributed outputs through MSMEs and had receivables from MSMEs of at least 25 percent of their annual sales.

e. Comments on Project Cost, Financing, Borrower Contribution, and Dates
Project Cost: The project cost was estimated at US$200 million at appraisal.

Financing: The project was financed with a US$200 million IBRD loan to Turkiye Halk Bankasi A.S. (Halkbank), majority-owned by the state, as the borrower, with the loan guaranteed by the Republic of Turkey. The loan was fully disbursed.

Borrower Contribution: Neither borrower nor the guarantor contributed any financing to the project.

Dates: The project was approved on December 22, 2015, and became effective on January 21, 2016. The project underwent a Level II restructuring in April 2019, with US$170.3 million of the US$200 million loan amount disbursed, which: (a) allowed the provision of working capital sub-loans to large enterprises, by changing the definition of "working capital sub-projects" in the Loan Agreement, and (b) dropped the requirement that 15 percent of the loan amount allocated to MSMEs be made for sub-loans financing sub-projects located in "priority regions" of the country (defined in the Council of Ministers Decree Number 2015/8190), or for sub-loans financing working capital sub-projects wherein the goods and services financed are used in the priority regions, after the requirement proved impractical following the currency crisis in 2018. The project closed as scheduled on July 1, 2019.

3. Relevance of Objectives

Rationale

The project objective was highly relevant to the problems of, and development strategies for, the MSME finance and the supply-chain enterprise finance sectors, both at project appraisal and closing.

- Banks, which dominated Turkey's financial system (itself lacking depth, with total assets at 180 percent of GDP in 2014 compared to an average 195 percent or all emerging markets), had run into performance headwinds in recent years. Banks continued to suffer maturity mismatches and negative liquidity gaps, highly dependent on short-term deposits, principally under-three months, backing more than half of loans, more than three-fourths of which were over three months in maturity. Other funding sources had not made sufficient difference in closing the maturity mismatch: balance sheet liquidity and wholesale funding from abroad barely breached three-year maturity; foreign securitization and foreign subordinated debt comprised only 15 percent of long-term funding; and, domestic bonds had tenors of six to 18 months only. Overall, bank credit growth had slowed nine percentage points lower than in the past to 18.5 percent in 2014.
- MSMEs were most affected by the financing pressures. In 2014, the IFC (Global Enterprise Finance Gap Database) estimated the credit gap at Turkey's SMEs at more than US$72 billion. In 2016, the European Union (Survey on Access to Finance for Enterprises) estimated that more than 40 percent of Turkey's MSMEs did not receive the funding they applied for, more than twice the average for the E.U. countries. In 2017, the government estimated the share of MSMEs of total credit at just about 27 percent. Yet, MSMEs were vital to the national economy, accounting for 99 percent of all enterprises, 76 percent of employment, 60 percent of exports, 54 percent of investments, and 55 percent of total value-added. Medium and large enterprises were particularly constrained by the lack of long-term finance for their capital investment plans, in turn adversely affecting the MSMEs that were integrated into their local supply chains.
- At the time of the project appraisal in 2015 and project closing in 2018, the government's "Tenth Development Plan, 2014-2018" and "SME Strategy and Action Plan for 2015-2018" continued to emphasize long-term finance and MSME access to finance as key focus areas for the state's national development efforts.

The project objective was aligned with the Bank Group strategy in Turkey at the time of project appraisal and project closing.

- The “Country Partnership Strategy for the Republic of Turkey for the Period 2012-2015” (CPS) focused on three strategic objectives --- to enhance competitiveness and employment, to improve equity and public services, and to deepen sustainable development. The project objective was aligned with one of several outcomes targeted by the first CPS strategic objective --- a “deepened and broadened access to finance.”
- At the time of project appraisal, Bank support for MSME finance in Turkey had begun more than a decade earlier and delivered some US$14 billion in commitments over 11 credit line

operations. The PAD (page 5) noted that the project was a "natural continuation of the SME series of projects" in Turkey, beginning with the First Access to Finance for SMEs Project, approved in 2006, and continuing with the Inclusive Access to Finance Project, approved in 2018 as this project closed. The PAD (page 4) also qualified that lines of credit act as a "bridge" until financial infrastructure constraints are lifted and alternative sources of long-term finance are in place, which however can be a long-term process.

- The project objective remained aligned with the Bank Group strategy in Turkey at the time of project closing. The “Country Partnership Framework for the Republic of Turkey for the Period FY18-FY21” (CPF) focused on three areas of engagement --- growth, inclusion, and sustainability. The project objective was aligned with the first focus area, which aimed to: (a) increase fiscal space; (b) “increase access to finance for under-served markets”; and, (c) enhance competitiveness and employment. The CPF objective to “increase access to finance for under-served areas” would be evidenced by the number of persons, SMEs, and exporters provided with financial services.
- Considering that the IFC had estimated the credit gap at Turkey's SMEs to be US$72 billion in 2014, this US$200 million project would cover only a tiny fraction of that gap --- three-fourths of one percent during the first round of lending and some multiple of that percentage if principal repayments on sub-loans were plowed back by Halkbank into additional rounds of lending. But, the project was also part of a longer series of Bank Group lending to Turkey for SMEs, including future projects. And, as the PAD argued, the project and similar credit line operations would only serve as a "bridge" until the banking system mobilized more resources for SME lending and the financial system developed longer-term sources and instruments of credit to enterprises.

Rating
High

4. Achievement of Objectives (Efficacy)

OBJECTIVE 1

Objective
To improve access to finance for micro, small and medium enterprises.

Rationale
Theory of Change: Providing long-term funds to a bank for a credit facility for MSMEs improves the access by MSMEs to finance. Access to long-term bank credit enables MSMEs to reduce their exposure to rollover and interest-rate risks and to undertake long-term fixed investment that allows them to remain competitive, to explore new markets, and to better integrate into local supply chains. At the same time, long-term fund sources allow banks to address negative liquidity gap problems and maturity mismatch risks arising from their dependence on short-term deposits, mostly of a maturity under three months, to fund lending, mostly concentrated above three months.

Outcomes:

- The volume of Bank support to MSMEs was US$162.2 million by the project closing date, meeting the target that at least US$120 million of the project funds be utilized by MSMEs.
- The number of MSME beneficiaries financed under the project was 268 by the project closing date, exceeding the target of 240. Most of the 268 MSMEs were active in the basic metals, machinery and equipment, textiles, and trading industries.
- The ratio of the average maturity of MSME sub-loans under the project to the average maturity Halkbank's MSME loans that were not financed under the project rose from 1.0 in the baseline (January 2016) to 1.9 by the project closing date (June 2019), meeting the target that the ratio be greater than 1.0. According to the ICR (page 11), the average maturity (weighted average) of MSME sub-loans under the project was 4.66 years. In contrast, the average maturity of all loans made by Turkey's banks was less than one year by June 2019 (no breakdown of the data is available for loans to MSMEs and loans to large enterprises).

Core Indicators: The ICR also reported the results for some "core indicators", which were drawn from the Bank's "Results Platform - Core Sector Indicators" (the list of July 2013). For the MSME Finance sector, the Bank's "core indicators" cover: the volume of Bank funding for SME finance (6 indicators); outreach (9); portfolio quality (4); and, financial sustainability (3). The PAD (Annex 1, pages 12-16, and Annex 4, pages 33-35) listed seven "core indicators" for this project. No targets are associated with these "core indicators", as none are required and principally serve corporate reporting purposes (see Section 9.A). Nonetheless, all seven "core indicators" are cited here as being relevant to this objective.

- The outstanding MSME finance portfolio increased from US$16.6 billion in the baseline to US$19.1 billion by the project closing date.
- The number of active MSME finance accounts rose from 233,000 in the baseline to 358,377 by the project closing date.
- Halkbank's portfolio-at-risk (the ratio of the outstanding balance of all loans with arrears over 30 days plus all renegotiated or restructured loans to the outstanding gross loan portfolio) deteriorated slightly from 0 percent in the baseline to 0.6 percent by the project closing date, but remained below the overall NPL ratio of 4 percent for the bank's total loan portfolio.
- Halkbank's return on equity (the ratio of net income to shareholders' equity, an indicator of profitability) declined from 14.4 percent in the baseline to 4.2 percent by end-2018, but remained relatively sound.
- Halkbank's return on assets (the ratio of net income to total assets, another indicator of profitability) declined from 1.5 percent in the baseline to 0.3 percent by end-2018.
- As it had in the baseline, Halkbank maintained its compliance with prudential regulations in mid-2018.
- The percentage of MSMEs and large enterprises that considered sub-loans to have reflected their needs was 99.2 percent, according to a citizen engagement survey. Part of the project covenant, the survey was conducted by Halkbank in the first quarter of 2019 to cover 267 project beneficiaries, 173 or 72 percent of whom responded. Some 78.5 percent of respondents "strongly agreed", while 20.7 percent "agreed", that the sub-loans reflected their needs.
- Despite poorer values for three financial ratios at Halkbank --- portfolio-at-risk, return on assets, and return on equity --- over 2016-19, the numbers remained within accepted benchmarks. Moreover, the outturns were not entirely due to the project, but to Halkbank's total operations and the

macroeconomic and financial environment under which the bank operated (political crisis in 2016, currency and debt crisis in 2018, and recession in 2018-19).

Rating
Substantial

OBJECTIVE 2

Objective
To improve access to longer-term finance for large enterprises involved in domestic supply chains.

Rationale
Theory of Change: Providing long-term funds to a bank for a credit facility for large enterprises involved in domestic supply chains improves the access by large enterprises to finance. Access to long-term credit enables large enterprises to reduce their exposure to rollover and interest-rate risks and to undertake long-term fixed investment that allows them to remain competitive, to serve export orders, and to explore new markets. At the same time, long-term funds allows banks to address negative liquidity gap problems and maturity mismatch risks arising from their dependence on short-term deposits, mostly of a maturity under three months, to fund lending, mostly concentrated above three months.

Outcomes:

- The volume of support for large enterprises involved in domestic supply chains was US$37.8 million. Together with US$162.2 million in support of MSMEs, the total volume of support to all enterprises was US$200 million by the project closing date, meeting the target to raise the total volume of support to all enterprises by US$200 million.
- The number of large enterprise beneficiaries financed under the project was 26 by the project closing date, exceeding the target of 20. Most of the large enterprises were in the chemicals and textile industries. Most of the large enterprise borrowers had to provide evidence of the participation of MSMEs in their supply chains, affirming the dual objective of supporting large enterprises and MSMEs. According to the ICR (page 12), about 25 percent of total loans disbursed to large enterprises were utilized for supply chain finance to MSMEs.
- The ratio of the average maturity of large enterprise sub-loans under the project to the average maturity Halkbank's MSME loans that were not financed under the project rose from 1.0 in the baseline (January 2016) to 1.4 by the project closing date (June 2019), meeting the target that the ration be greater than 1.0. According to the ICR (page 11), the average maturity (weighted average) of sub-loans to large enterprises under the project was 4.15 years. In contrast, the average maturity of all loans made by Turkey's banks was less than one year by June 2019 (no breakdown of the data is available for loans to MSMEs and loans to large enterprises).

Core Indicators: The ICR also reported the results for some "core indicators", which were drawn from the Bank's "Results Platform - Core Sector Indicators" (the list of July 2013). For the MSME Finance sector, the Bank's "core indicators" cover: the volume of Bank funding for SME finance (6 indicators); outreach (9); portfolio quality (4); and, financial sustainability (3). The PAD (Annex 1, pages 12-16, and Annex 4, pages 33-35) listed seven "core indicators" for this project. No targets are associated with these "core indicators", as none are required and principally serve corporate reporting purposes (see Section 9.A). Nonetheless, five of the seven "core indicators" are cited here as being relevant to this objective (these are identical to the last five of the seven "core indicators" reported under Objective 1).

- Halkbank's portfolio-at-risk (the ratio of the outstanding balance of all loans with arrears over 30 days plus all renegotiated or restructured loans to the outstanding gross loan portfolio) deteriorated slightly from 0 percent in the baseline to 0.6 percent by the project closing date, but remained below the overall NPL ratio of 4 percent for the bank's total loan portfolio.
- Halkbank's return on equity (the ratio of net income to shareholders' equity, an indicator of profitability) declined from 14.4 percent in the baseline to 4.2 percent by end-2018, but remained relatively sound.
- Halkbank's return on assets (the ratio of net income to total assets, another indicator of profitability) declined from 1.5 percent in the baseline to 0.3 percent by end-2018.
- As it had in the baseline, Halkbank maintained its compliance with prudential regulations in mid-2018.
- The percentage of MSMEs and large enterprises that considered sub-loans to have reflected their needs was 99.2 percent, according to a citizen engagement survey. Part of the project covenant, the survey was conducted by Halkbank in the first quarter of 2019 to cover 267 project beneficiaries, 173 or 72 percent of whom responded. Some 78.5 percent of respondents "strongly agreed", while 20.7 percent "agreed", that the sub-loans reflected their needs.
- Despite poorer values for three financial ratios at Halkbank --- portfolio-at-risk, return on assets, and return on equity --- over 2016-19, the numbers remained within accepted benchmarks. Moreover, the outturns were not entirely due to the project, but to Halkbank's total operations and the macroeconomic and financial environment under which the bank operated (political crisis in 2016, currency and debt crisis in 2018, and recession in 2018-19).

Rating
Substantial

OVERALL EFFICACY

Rationale
The degree of achievement of the project objectives is assessed as substantial. The project achieved all six outcome targets, meeting the target for the volume of funding support to MSMEs and large enterprises in domestic supply chains, exceeding the expected number of MSME and large enterprise beneficiaries, and lengthening the maturity of sub-loans supported by the project by 90 percent (over the maturity of loans not funded by the project) for MSMEs and 40 percent for large enterprises. The outcomes were achieved notwithstanding political and economic shocks that adversely affected the demand for credit from enterprises and the supply of credit by banks over much of the project implementation period: an attempted coup and a declaration of state emergency in mid-2016; an indictment by the U.S. of a former Halkbank officer in 2017 for evasion of U.S. sanctions against Iran (ICR, pages 17-19, 20, 24); and, a currency and debt crisis and the ensuing recession in the fourth quarter of 2018 to the first half of 2019.

Overall Efficacy Rating

Substantial

5. Efficiency

Economic Efficiency: The PAD did not conduct a traditional economic and financial analysis of the project at appraisal. According to the PAD (page 9), MSME and large enterprise sub-projects could not be pre-identified at appraisal, nor could the amount of sub-project loans be pre-estimated. However, the PAD argues, the project could have several economic benefits: (a) MSMEs accounted for 76 percent of employment in the country, so improving access to finance for MSME would have positive employment effects; (b) MSMEs accounted for 40 percent of exports; (c) lending to MSMEs and large enterprises located in priority regions of the country (where a large percentage of the bottom 40 percent of the population lived) or MSMEs and large enterprises owned or managed by women would have positive effects on the poor and on women.

In contrast, the ICR completed an efficiency analysis of the project after closing, covering 250 MSME beneficiaries. According to the ICR (pages 13-14 and 37-39), MSMEs that received financing under the project in 2016-18 outperformed MSMEs that did not receive financing in 2016-18 but received financing in 2019 (the study's control group): (a) employment growth among the project beneficiaries rose from 19 percent before receipt of the sub-loans to 38 percent after; (b) employment growth at the control group was only 3 percent in 2016-18, suggesting that they could have posted higher employment growth figures had they had access to the sub-loans in 2016-18; (c) moreover, the employment growth among the project beneficiaries exceeded overall employment growth in the Turkish economy over the same period; (d) average sales growth among the project beneficiaries fell from 50 percent before the receipt of the sub-loans to 30 percent after; (e) average sales growth at the control group also fell (details are not provided); (f) in both cases, the drop-off is attributed to the economic downturn from mid-2016; (f) notably, overall turnover in the Turkish manufacturing sector declined 7 percent during the same period; (g) high underwriting standards adopted for the project --- cash-flow-based assessments, strict debt-to-equity ratios, and strict debt-service-coverage ratios --- ensured that only the most promising borrowers were financed; and, (h) overall, the project contributed to: the creation of more than 1,000 new jobs; an increase in turnover at MSMEs of 14 percent (in US$ terms); and, funding for 82 women-owned MSMEs and large enterprises.

Operational Efficiency: The projects funds were fully disbursed, albeit after adjustments were made allowing working capital sub-loans to large enterprises and scrapping the requirement that 15 percent of the project funds be allocated to sub-projects in priority regions of the country. The project closed as scheduled.

Efficiency Rating

Substantial

a. If available, enter the Economic Rate of Return (ERR) and/or Financial Rate of Return (FRR) at appraisal and the re-estimated value at evaluation:

	Rate Available?	Point value (%)	*Coverage/Scope (%)

Appraisal	0	0 ☐ Not Applicable
ICR Estimate	0	0 ☐ Not Applicable

* Refers to percent of total project cost for which ERR/FRR was calculated.

6. Outcome

The project development objective was highly relevant to development priorities in Turkey and to the Bank Group country strategy for Turkey. The project's efficacy in achieving the project development objective was substantial, with the project achieving all six outcome targets set at appraisal. The efficiency of the of the project was substantial, with employment growth higher at MSMEs receiving sub-loans, and sales declines (as a result of an economic downturn in Turkey from mid-2016 to mid-2019) less severe.

a. Outcome Rating

Satisfactory

7. Risk to Development Outcome

Macroeconomic risk. Concluding the 2019 Article IV Consultation with Turkey, the IMF reported in end-2019 that, although economic growth has resumed, buoyed by expansionary fiscal policy, rapid credit provision by state-owned banks, and more favorable external financing conditions, the Turkish economy remains susceptible to domestic and external risks. The fiscal deficit has increased and uncertainty over the possible scale of contingent liabilities and potential debt rollover pressures limits available fiscal space. Non-financial corporate and bank balance sheets have been stressed by currency depreciation, higher interest rates, and lower growth. Reserves are low and external financing needs are high. GDP growth is expected to average an annual 3.25 percent in 2021-24, but a far weaker outturn poses risks to both the business prospects for MSMEs and large enterprises and to the financial capacity of banks to expand lending to these enterprises.

Institutional capacity risk. The ability of Halkbank to operate a credit facility for MSMEs and large enterprises in domestic supply chains has been proven in this operation. The ICR (page 22) also reports that some US$16 million of reflows (amortization and interest payments) from sub-project loans in this operation had been tapped by the bank for a new round of lending by mid-2019. Considering its performance, Halkbank's institutional capacity to sustain the project outcomes should be considered strong. However, the ICR (pages 17-19,20, 24) reports on the indictment in 2017 and conviction in U.S. court in 2018 of a former Halkbank officer, one consequence of which had been a crimping of the bank's access to international funding.

8. Assessment of Bank Performance

a. Quality-at-Entry

The Bank designed the project as an integral part of a succession of operations, more than a decade long, promoting access to finance for MSMEs in Turkey. The First Access to Finance for SMEs Project, approved in 2006, the Second, approved in 2010, and the Third, approved in 2013, provided lines of credit targeting SMEs, intermediated by Turkish banks under wholesale (using an apex bank) or retail arrangements. The Project Appraisal Document (PAD) for this project (page 4) explained that credit lines were to be considered as "bridge" measures until financial infrastructure constraints were lifted and alternative sources for long-term finance were in place, which however can be a long-term process. In this regard, recent Bank operations supporting the development of long-term finance in Turkey, including of deeper, more competitive, and more transparent capital markets, are coherent and consistent with this strategy.

The Bank clearly defined: (a) the terms and conditions of the Bank loan to Halkbank; (b) the eligibility criteria for MSMEs and large enterprises involved in domestic supply chains; (c) the terms and conditions of sub-loans from Halkbank to MSMEs and large enterprises; and, (d) the eligibility criteria of MSME and large enterprise sub-projects. The details of these criteria, terms, and conditions were listed in the PAD (pages 16-18) and included as covenants in the Loan Agreement (pages 6-11) between the Bank and Halkbank. The Bank also specified implementation arrangements for the project (pages 28-35), including for financial management and monitoring and evaluation.

The Bank conducted a credible due diligence on Halkbank. Majority-owned (51 percent) by the government and the 7th largest bank (by assets) in the country, Halkbank served 1.2 million MSME customers in 2014 (more than half its non-retail client base) and concentrated on MSME lending (39 percent of its portfolio, compared to the industry average of 27 percent). The bank offered at least three notable MSME lending programs: an artisan and craftsman loan program, with guarantees provided by cooperatives; a credit line for MSME distributors of purchases from producers; and, a card program, allowing MSMEs to defer payments for materials and supplies used in their production lines. The Bank determined that Halkbank, like other Turkish banks, faced a significant maturity mismatch, but had a large and stable deposit base, a strong financial position based on its core MSME business, and a high score on corporate governance, according to the PAD (pages 24-27 and pages 37-38).

The Bank judged the risks to the project to be moderate, considering that the project's design had been tested under previous MSME credit line operations in Turkey and that intermediary bank performance and project outcomes had been rated either satisfactory or highly satisfactory in the earlier operations. Halkbank had been an MSME lender in an older Bank project and was familiar with the Bank operations, guidelines, and procedures. Nonetheless, to mitigate potential operational risks, Halkbank would be required to maintain adequate project records, prepare semi-annual financial reports, and be subject to an annual independent audit.

The Bank articulated a results framework for the project that was based on a coherent theory of change (see Section 4, Objective 1 and Objective 2) and included results indicators that were well defined and measurable and "core indicators" that were required for the Bank MSME Finance sector data series (see Section 9.A).

Quality-at-Entry Rating
Satisfactory

b. Quality of supervision

To supervise the project, the Bank employed a project Task Teal Leader (TTL) based in Washington, D.C. and a co-TTL based in Turkey. While the position of TTL changed twice over, that of co-TTL remained unchanged during the life of the project. The TLL and co-TTL interacted with the Halkbank PIU, the key staff of which served mostly unchanged during the life of the project.

The Bank conducted eight implementation support missions and filed eight Implementation Results and Status Reports (ISRs) over the three-and-a-half-year life of the project, about the two-per-year average for most Bank investment project financing operations. The last ISR of June 30, 2019, with the Bank loan fully disbursed, rated the development outcome as moderately satisfactory and the implementation performance as moderately satisfactory. In addition, the Bank held periodic meetings with the Ministry of Treasury and Finance and with the external auditor, Deloitte, and documented discussions with the two parties in project notes.

According to the ICR (page 22), the Bank was pro-active in responding to changing political and economic conditions which affected the project's performance. An aborted coup in Turkey in July 2016, six months after project effectiveness, raised political and economic risk in the country and slowed the pace of sub-lending to MSMEs and large enterprises in the remainder of 2016 and 2017. The Bank conferred with Halkbank to consider changing sub-loan and sub-project criteria, terms, and conditions in response to the slower-than-expected pace of disbursement in 2016-17, but both the Bank and the government dropped the proposal because looser project conditions would not necessarily accelerate disbursement in the face of the ongoing political and economic crisis in 2016-17 (see Section 9.C). A currency and debt crisis in 2018 dampened business activity --- the Turkish lira depreciated 20 percent from September to December 2018, CPI inflation rose from 10.2 percent in March to 25.2 percent in October 2018, the weighted average interest rate on commercial loans by banks spiked from 17.9 percent in March to 35.9 percent in September 2018, loan defaults rose, and the economy contracted 2.8 percent in the fourth quarter of 2018, 2.3 percent in the first quarter of 2019 and 1.6 percent in the second quarter. The Bank and Halkbank agreed to a restructuring of the project in April 2019, allowing sub-lending to large enterprises for working capital because working capital requirements had become critical with the worsened macroeconomic environment, according to the Restructuring Paper (page 3). Meanwhile, new restrictions (after the currency crisis) limiting foreign currency lending to foreign-currency-earning enterprises (mostly located in the developed regions) rendered the 15 percent quota on lending to priority regions impractical.

The ICR (page 22) also reports that the Bank conferred quickly with Halkbank to discuss the indictment by the U.S. in 2017 of a former Halkbank officer for participation in a scheme to evade U.S. sanctions on Iran. The Bank requested a broadening of the scope of audits of the project in 2018 and 2019 (see Section 10.B) to ensure that sub-loans and sub-projects were not connected to any of the firms and individuals cited in the indictment.

Quality of Supervision Rating
Satisfactory

Overall Bank Performance Rating

Satisfactory

9. M&E Design, Implementation, & Utilization

a. M&E Design

The M&E plan called for Halkbank, as loan borrower and project implementing agency, to conduct the M&E for the project. Halkbank's Project Implementation Unit, created under the Loan Agreement between the Bank and Halkbank, would be responsible for the borrower's M&E function.

The PAD defined six outcome indicators (see Section 4) to measure the achievement of the project objectives. These results indicators were well-defined and measurable. Halkbank was also to monitor and report on progress with seven other indicators drawn from the Bank's list of "core indicators" for the MSME Finance sector. Although the PAD (pages 12-15) labeled these as "intermediate results indicators", there were no targets associated with these indicators and were instead intended to track the cumulative progress of Bank operations in the sector, up to and including the results of this project. According to the Bank's "Results Framework and M&E Guidance Note" (2013), a "core indicator is an outcome or output indicator that can be measured and monitored at the project level, and can be aggregated across projects and countries for corporate reporting. Core sector indicators only cover some of the most recurrent results of Bank operations."

Halkbank was to submit to the Bank periodic Project Reports, including progress with the implementation of the Environmental Policy Framework, each covering a calendar semester. According to the Loan Agreement (page 11), the reports would have to list each sub-project approved for financing under the project, including the nature, location, and the start and completion dates of each sub-project.

b. M&E Implementation

According to the ICR (page 19), Halkbank performed its M&E responsibilities as planned. In addition, the PIU conducted a biannual compliance review of at least 15 percent of all sub-loans approved in each reporting period. Reports of the results of these compliance reviews were submitted to the Bank.

Details of sub-loans and sub-projects had become particularly important not only for M&E purposes but also for the financial management and audit of the project, after the U.S. indicted in 2017 a former Halkbank officer for participation in a scheme to evade U.S. sanctions on Iran (see Section 10.B).

c. M&E Utilization

According to the ICR (page 19) data on sub-loans to MSMEs and large enterprises were highly relevant to understanding the slow rate of project fund utilization in 2016 and 2017. In both years, the slow rate of sub-lending by Halkbank was associated with political and economic uncertainties prevailing in Turkey during the period, following an attempted coup in July 2016. These findings were discussed at length between the Bank and Halkbank, and resulted in an consensus that sub-loan and sub-project criteria, terms, and conditions did not have to be altered to stimulate sub-lending by Halkbank. Looser project conditions would not necessarily accelerate disbursement in the face of the ongoing political and economic crisis in 2016-17.

Because the project had a well-defined M&E design that was implemented according to plan, and for which the M&E data were useful to understanding issues with project implementation and informing actions by the Bank and the government, the quality of the M&E for this project is assessed as substantial.

M&E Quality Rating

Substantial

10. Other Issues

a. Safeguards

Environmental Safeguards: The project was classified as an environmental category FI (Financial Intermediary) at appraisal. According to the PAD (pages 10-11): (a) the project would not have any large-scale, significant, or irreversible environmental impacts because the credit facility would finance only small-scale construction works and purchases or replacement of equipment; (b) the credit facility would not finance any sub-project that would have impacts on natural habitats; (c) the credit facility would not finance any sub-project that polluted or otherwise affected the quantity or quality of water in international waterways; (d) Halkbank had prepared an environmental review framework document, that was consistent with the Bank's Operational Policy 4.01 and with the government's environmental assessment requirements, and which was disclosed at the government's website and in the Bank's InfoShop in October 2015; (e) under the framework, sub-loan applicants would be required to conduct environmental screening, due-diligence, and assessment of sub-projects following Bank guidelines and Halkbank would be responsible for quality assurance of environmental documents and monitoring of sub-projects; and, (f) Halkbank would maintain staff responsible for environmental safeguards compliance and continue to receive related Bank safeguards guidelines. The rating for compliance with environmental safeguards was satisfactory during project implementation.

Social Safeguards: According to the PAD (page 10), the project was not expected to have any negative social effects. Rather, (a) sub-loans to MSMEs and to large enterprises involved in domestic supply chains would have positive effects on employment; (b) the sub-loans would also have positive effects on MSMEs and large enterprises owned by women; and, (c) the credit facility would not finance any sub-project involving involuntary land acquisition or involuntary resettlement. The rating for compliance with overall safeguards was satisfactory during project implementation.

b. Fiduciary Compliance

Procurement: The PAD (page 10) reported that the nature of the project precluded a determination of the procurement requirements of sub-projects to be financed by the credit facility. Hence, Halkbank could not be expected to develop a procurement plan for the project. However, sub-projects would follow Bank procurement guidelines and Halkbank would be responsible for ensuring that procurement rules for sub-projects specified in the PAD and in the project Operations Manual would be followed. The rating for procurement was satisfactory during project implementation.

Financial Management: The PAD (pages 9-10) stated that financial management system at Halkbank were satisfactory. Nonetheless, Halkbank would be required to maintain adequate project records, prepare semi-annual financial reports, and be subject to an annual independent audit. The rating for financial management was satisfactory during project implementation.

Audits: According to the ICR (page 21), external audits of the project were conducted annually and reviewed by the Bank. No exceptions of significance were noted. The scope of the annual audit was broadened in 2018 and 2019, at the request of the Bank, to review the list of project beneficiaries and check for any overlap with the list of companies and individuals cited in the indictment by the U.S. of a former Halkbank officer for a scheme to evade U.S. sanctions on Iran, according to the ICR (pages 17-19, 20, 24). The audits did not find overlaps between the lists.

c. Unintended impacts (Positive or Negative)

---

d. Other

---

11. Ratings

Ratings	ICR	IEG	Reason for Disagreements/Comment
Outcome	Satisfactory	Satisfactory	
Bank Performance	Satisfactory	Satisfactory	
Quality of M&E	Substantial	Substantial	
Quality of ICR	---	Substantial	

12. Lessons

This ICR Review draws the following lessons from this project.

Having well-defined sub-loan and sub-project criteria, terms, and conditions facilitates the implementation of credit line operations. In this project, the eligibility criteria for MSME and large enterprise borrowers, the eligibility criteria for sub-projects, the terms and conditions of sub-loans to MSMEs and large enterprises, and the approval procedures for sub-loans to MSMEs and large enterprises were clearly defined in the PAD, incorporated as covenants in the Loan Agreement, and included in the project Operations Manual. According to the ICR (pages 16-17), the project benefitted from having well-defined operational parameters that were agreed upon during preparation. Moreover, the clear design of the project "enabled the utilization of future reflows," helping sustain the project outcome.

It is important for the Bank and a borrower to be highly responsive to the effects of political and economic shocks on the implementation of an operation. In this project, the coup attempt in 2016, the indictment by the U.S. of a former Halkbank officer in 2017, and the currency and debt crisis of 2018, required, at the very least, a discussion between the Bank and Halkbank of the possibility of adjusting the project parameters to address changed conditions in the credit markets. In response to the indictment of the former Halkbank officer, the Bank broadened the scope of project audits. And in response to the currency crisis, the Bank allowed working capital loans to large enterprises and waived the requirement to confine 15 percent of sub-lending to sub-projects in priority regions of the country.

Credit line operations need to be placed in the larger context of banking, non-bank, and capital market development in the long run. In this project, the PAD explicitly recognized that the Turkey Micro, Small and Medium Enterprise (MSME) and Large Enterprise Supply Chain Finance Project, like other MSME credit line operations in the country, was a "bridge" measure that was both necessary and beneficial until Turkey made greater strides developing long-term sources of finance for MSMEs in its banking system, non-bank sectors, and capital markets. In this regard, concurrent efforts by the government and the private sector to reform the country's collateral regime, improve the credit information system, revise the bankruptcy law, as well as deepen the capital markets (including by introducing securitization, project bonds, and long-term Sukuks) are treated as complementary initiatives to MSME credit line operations.

13. Assessment Recommended?

No

14. Comments on Quality of ICR

The ICR articulated a theory of change for the project, which, it drew from the results framework table included as Annex 1 of the PAD. The ICR statement of the underlying results chain for the project was sound and logical (see Section 4).

The ICR (pages 17-18) was candid with its assessment of the outcome of the project, placing the results within the larger context of political and economic disturbances in Turkey in 2016-18 that affected overall economic activity in the country and demand and supply conditions in the credit markets.

There were minor deficiencies with the document however.

- There appears to be misunderstanding of what is required in Section IV.D on risks to the sustainability of the development outcome of the project (page 22). The first paragraph discusses risks during the implementation of the project --- "domestic challenges", "global uncertainty", "retrenchment of emerging market risk appetite". The second paragraph discusses risks to the future performance of Halkbank and sub-borrowers. The latter is relevant, but the former is not.
- Similarly, there appears to be a lack of understanding on what is required in Section V on lessons learned from the project (pages 22-23). The first paragraph mentions lessons learned from previous Bank operations, and their relevance to this project. The next three paragraphs purport to list "lessons drawn from this project", but lack clarity on what precisely the lessons were that are relevant for future operations.

a. Quality of ICR Rating

Substantial