Background
Job creation and enterprise development are at the heart of the Government's development strategy. Within this, microcredit is recognized as an important tool to help support the entrepreneurial poor develop self-employment activities and micro and small enterprises. Supporting the smallest businesses is probably the fastest and most immediate way to create jobs, particularly for those with low incomes.

Objectives
The overall development goal of the project is to address the urgent need to raise incomes, develop businesses and create jobs in Bosnia and Herzegovina, through provision of credit and other financial services to low-income people. Specifically, the project will:

- Finance the growth and institutional development of high-performing microfinance institutions that have the capacity to provide sustainable financial services to significant numbers of low-income clients considered as "unbankable" by mainstream commercial banks, given their low-incomes and limited assets; and
- Support the transition of the microfinance sector towards sustainable sources of financing.

Project Description
This Second Local Initiatives Project is designed to build on the achievements of LIP I and increase the scale, financial viability and social impact of microfinance services in BH. LIP II has continued to foster entrepreneurship and promote active employment by providing access to financial services to low-income entrepreneurs who currently have limited access to services from the commercial banking sector. It also supports the development of new products and services and encourages a greater focus on the needs of low-income clients to broaden and deepen financial service delivery to the poor.

As under the LIP I, the project continues to take a strategic approach of developing a strong sustainable microfinance industry at a nationwide level. The project has the following main components:

1. Microfinance Fund (US$ 23.28 million) - market-driven financing is provided to selected, high-performing microfinance institutions (MFIs) so as to increase their outreach and quality of services to low-income clients.

The project has taken an institutional approach, lending funds to MFIs that have demonstrated the capacity to be institutionally and financially viable over the long-term and that have the capacity to reach large numbers of low-income clients. Qualifying MFIs receive long-term, Euro-denominated loans so as to enable them to build-up a capital base and to assist them leverage commercial financing.

2. MFI Legal and Regulatory Reform (US$ 0.9 million) - the objective of this component is to support further development of the legal and regulatory framework for microfinance, so as to enable Micro Credit Organizations (currently the only legal form of MFI other than commercial banks) to expand their sources of capital and the types of services they can provide.

3. Microfinance Sector Capacity Building Support (US$1.42 million) - the objective of this component is to further strengthen the institutional and financial capacity and performance of MFIs in BH. This component will provide financing for training and technical consulting services and other capacity building activities for MFIs and the Microfinance Units of the Foundations responsible for on-lending funds to MFIs, and monitoring MFI performance.

4. Impact Assessment/Research and Development (US$ 0.32 million) - under this component a longitudinal impact assessment is carried out. The objectives of this assessment are: (i) to document the impacts of a sustainable microfinance sector in BH; (ii) to provide client-level information to MFIs for use in management decisions; (iii) to build interest and understanding among MFIs on the use of client-level information for documenting program impacts, improving program management, and developing new products and services; and (iv) to build local research capacity in this field.

5. Project Management/Operating Costs (US$ 1.14 million) - the operating costs of the Microfinance Units of the Foundations responsible for project implementation.

These costs represent no more than 4 percent of the overall project costs, and less than 2 percent of the outstanding loan portfolio and are fully funded by the MFUs' own interest income which is counted as government counterpart contribution to the project.

Implementation Arrangements
The proposed Credit is a single operation with two parts, one in each Entity – the Republika Srpska and the Federation of BH.

Project implementation is the responsibility of the two government-created foundations, one in the Federation and one in Republika Srpska. In Republika Srpska, the Development and Employment Foundation (FSD). Each Foundation has a specialized unit – Microfinance Units (MFUs) – that have day-to-day management responsibility for project implementation. The MFUs play the role of microfinance apex institutions with the following responsibilities: (i) on-lend funds to eligible MFIs and assess their institutional and financial performance; (ii) help MFIs identify their institutional development needs and provide technical services to support their development as independent, sustainable institutions; (iii) support further development of an appropriate legal and regulatory framework for microfinance; and (iv) document and assess the impact of microfinance support technical services and encourage the use of client-level information.

Project Status
Financing provided to 9 partner organizations has significantly increased the scope of microcredit activities in Bosnia and Herzegovina. The following cumulative results have been achieved as of June 30, 2003:

- 201,421 loans disbursed for the total amount of over KM 656 million;
- monthly disbursement has been increased to about 5-6,000 loans;
- about 51,000 active clients and the outstanding portfolio of over KM 119 million.

Status sheets completed and submitted to the World Bank.
microenterprises provide employment to a total of about 100,000 people.
- MCOs are making a significant shift toward extending their outreach to entrepreneurs in rural and remote areas. Over the last months, portion of loans provided in the sector of agriculture and small farming has increased to 39% of the total number of loans disbursed.

The project performance in terms of achieving the overall objective of providing credit to significant number of low-income people in order to raise incomes, develop businesses and create jobs is assessed as highly-satisfactory.

Partner MCOs continue to perform well as measured by an agreed set of performance indicators. Repayment rate remains impressively high with portfolio at risk (over 30 days past due) at 0.37%.

Project financing has helped partner MCOs to leverage additional commercial financing. 5 out of 8 partner MCOs have raised commercial debt financing in the total amount of KM 6.7 million. This provides reasonable assurance that the second project objective of supporting the transition of the sector towards sustainable sources of financing will be met.

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