Project Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 16-Jun-2020 | Report No: PIDA29423

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Turkey	P174112	Emergency Firm Support Project	
Region	**Estimated Appraisal Date**	**Estimated Board Date**	**Practice Area (Lead)**
EUROPE AND CENTRAL ASIA	16-Jun-2020	14-Jul-2020	Finance, Competitiveness and Innovation
Financing Instrument	**Borrower(s)**	**Implementing Agency**	
Investment Project Financing	Türkiye Kalkınma ve Yatırım Bankası A.Ş. (TKYB) Bank, Türkiye Vakıflar Bankası T.A.O. (VakıfBank)	Türkiye Vakıflar Bankası T.A.O. (VakıfBank), Türkiye Kalkınma ve Yatırım Bankası A.Ş. (TKYB) Bank	

Proposed Development Objective(s)

The Project Development Objective is to ensure access to finance for private SMEs affected by or adapting to the economic impact of COVID-19

Components

Liquidity support to COVID-19 affected SMEs through VakifBank
Liquidity support to COVID-19 affected SMEs through TKYB

The processing of this project is applying the policy requirements exceptions for situations of urgent need of assistance or capacity constraints that are outlined in OP 10.00, paragraph 12.
Yes

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Project Cost	500.00
Total Financing	500.00
of which IBRD/IDA	500.00
Financing Gap	0.00

DETAILS

World Bank Group Financing

International Bank for Reconstruction and Development (IBRD)	500.00

Environmental and Social Risk Classification

Moderate

Decision

The review did authorize the team to appraise and negotiate

B. Introduction and Context

Country Context

Turkey is a large, upper-middle-income country with a strong record of inclusive growth, but recent shocks are risking the economic gains made since the early 2000s. Turkey achieved rapid economic and social development in the 2000s, with poverty incidence more than halving and real Gross Domestic Product (GDP) increasing by 50 percent by 2008. Since the Global Financial Crisis (GFC), rapid growth continued but was increasingly associated with stagnant productivity, a rising current account deficit and growing foreign exchange-denominated debt stock. Turkey then experienced a sharp external adjustment in mid-2018 as the Turkish Lira (TL) depreciated more than 60 percent against the US dollar between January and September that year. Over the course of late 2018 and 2019, the economy went through significant adjustments, supported by some agile policy measures from the authorities. Current account imbalances declined sharply, banks and corporates reduced their exposure to foreign currency debt, private sector credit growth returned, and demand had started to recover. By the end of 2019, economic activity was rebounding with strong growth in the fourth quarter, and GDP growth was projected to rebound to 3 percent in 2020. With the onset of the COVID-19 pandemic, the outlook for 2020 has sharply deteriorated.

Turkey is being severely impacted by COVID-19, both in terms of the health impact and economic losses. Turkey recorded its first confirmed COVID-19 case on March 11, and over the following 20 days, the number of cases increased to 38,000, one of the fastest growth rates of the epidemic seen so far. The authorities have responded rapidly. Testing scaled up quickly, the authorities implemented targeted curfews (ongoing for the elderly and young people, and for everyone on non-working days), closures of education facilities and other service providers that entail close contact, and restrictions on the activity of other in-person and transportation services. Large swathes of firms are severely affected as they face the combined shocks of lower demand, activity restrictions, and supply chain disruption. The impact on firms comes immediately following the recession, which already hit many firms hard. Small and medium-sized- enterprises (SMEs) and other segments that have credit constraints even in normal times (women-owned firms, young firms, and firms in less developed regions), are less likely to be able to access finance for much-needed liquidity, raising the risk of widespread layoffs and bankruptcies. There is also a risk of a second wave of community transmission, depending on the effectiveness of virus control measures, which may then necessitate even more restrictive measures over a longer period.

Sectoral and Institutional Context

Impact of COVID-19 pandemic on the Turkish enterprise sector and underserved market segments

The onset of COVID-19 globally and in Turkey is a combination of both supply and demand shocks to firms, on a scale which has not been seen in recent history. The incidence of the virus, the behavioral changes it calls for, and required policy responses to slow its spread have disrupted supply and reduced demand for most parts of the economy. A multi-dimensional sectoral COVID-19 vulnerability index shows that certain sectors, such as accommodation and food services, transport and storage, construction, motor vehicles and the textiles, apparel and leather manufacturing sectors, are likely to be most severely affected, although most sectors will be adversely affected to some extent. First, businesses with direct restrictions on operation imposed by the authorities will be severely affected. Business operation restrictions aimed at limiting the spread of COVID-19 will severely affect in-person service sectors. Firms that can remain open are experiencing a number of supply shocks, such as increased absences of workers, disruptions in supply chains both nationally and internationally, including delays in shipments, increases in prices of scarce items or a lack of availability of certain inputs altogether. Lira depreciation will also be a further challenge through higher import prices for many goods, and costs of servicing of foreign currency (FX)-denominated or indexed debt. Consumer demand will be much lower for many goods and services, particularly in-person activities and those which cannot be provided remotely. The likely onset of a global recession will lower demand for exports, which amounted to over US$170bn in 2019, with Turkey especially exposed to the hard-hit EU market. Tourism, which generated US$35bn (equivalent to 5 percent of GDP) in direct expenditure over 2019, will be much lower in 2020. Second-round effects and reduced business demand mean these negative demand shocks will ripple through the economy, affecting a much wider range of firms.

These shocks will cause many firms to be in desperate need of liquidity to survive and adapt, and SMEs will be the least able to access it, with their financing requirement estimated to be around US$ 38 billion. Extended loss of revenue means that many firms will have to rely on working capital to survive until business operations have normalized. While firms in Turkey often maintain cash reserves to preserve against bouts of volatility, the duration and scale of this shock means these reserves will not be sufficient this time, and many will need access to working capital finance. SMEs have less access to finance even in normal times and are the most likely to be credit-constrained during an economic shock such as this one. The need for additional bank finance by SMEs, as a result of COVID-19, is estimated to be around US$ 38 billion as SMEs have difficulties accessing bank credit as well as trade finance. SME loans are perceived as riskier and tend to be amongst the first to decline when risk appetite lowers during a downturn. This is exacerbated by the fact that SMEs more frequently rely on collateral, often of lower quality, than large firms and as asset values fall during downturns, this collateral supports lower loan amounts. SMEs also tend to be less able to absorb shocks than large firms and are more exposed to refinancing and interest rate risks. Therefore, SME firms may be unable to raise the needed working capital over the COVID-19 crisis, and many could face a real risk of insolvency.

Access to finance conditions deteriorated for firms, and particularly SMEs, even prior to the COVID-19 crisis. According to the most recent Enterprise Survey (ES) 2019, access to finance was reported as the biggest obstacle to firm growth by 28.9 percent of respondents, up from 19.5 percent in the previous ES (2015). Small firms are most constrained financially, with perceived financing constraints – defined as those firms that consider access to finance as either a moderate, major or very severe obstacle to their business operations – even higher. SMEs in Turkey also rely more on internal funds for financing investments and working capital than peer countries in the ECA region and are more likely to have their loan applications rejected compared with large enterprises. This is a serious concern given that micro, small and medium-sized enterprises (MSMEs) account for 35, 21 and 18 percent of employment respectively, two-thirds of employment in the manufacturing sector, more than three-quarters in the services sector, and nearly 90 percent in construction. Data also show that, since the start of the recession in 2018, the share of SME loans in total loans declined by more than 4 percentage points to 23 percent. Certain categories of firms – women-inclusive firms, young firms, and firms operating in less developed regions – are expected to be impacted more severely by the tightening of credit conditions given that banks perceive them as higher-risk even in normal times.

Some firms may be more able to adapt to COVID-19 than others. While the business operation of many firms will be disrupted, some may be able to maintain business continuity by, for instance, implementing new systems or alterations to maintain social distancing in the workplace, implementing rigorous health and sanitation in the workplace, or moving to home-based and virtual working modalities. These adaptation measures will become even more relevant for firms' crisis preparedness and resilience going forward.

The Banking Sector's response to the Increased Demand for Liquidity

Commercial banks are reluctant to expand their lending activity due to an increase in risk aversion, the banking sector's financing structure, and asset quality concerns. Private commercial banks have been cautious in intensifying their lending activity. Measures designed to support credit growth, such as additional capital provided to the Credit Guarantee Fund for risk sharing and the Central Bank's and authorities' liquidity measures, including swap lines to stimulate credit growth and the introduction of an asset ratio, have had only limited effect. Increased uncertainty due to the crisis combined with a negative economic outlook means that banks adopt a more conservative approach, leading to severely rationed credit to the riskiest segments, i.e. SMEs and other underserved groups. Commercial bank's reluctance to lend is amplified by large maturity mismatches between short-term liabilities and medium to long term assets, which widened in the last two years. Depreciation of the Lira has also increased pressures on bank balance sheets exposed to FX mismatches. The downturn that began in 2018 saw an increase in distressed assets, with NPLs up from 2.8 percent in mid-2018 to 5.2 percent in February 2020.

In this context, tightening liquidity conditions could be a drag on new credit activity. The banking sector is adequately capitalized, following a period of deleveraging and ensuring ample FX liquidity since August 2018. While banks have continued to be able to refinance FX debt when needed, external financing has become more difficult and costly, and private banks have maintained a rollover ratio for external liabilities below 100 percent, standing below 80 percent as of February 2020. Banks continue to maintain liquid FX assets sufficient to cover long and short-term external debt requirements maturing in the next 12 months. However, refinancing risks have increased, particularly given the chronic shortage of long-term funding and widening maturity mismatches on bank balance sheets. Rapidly expanding domestic financing of the government budget deficit may further crowd out credit to the private sector. These trends could lead to lower or even negative credit growth in the absence of public intervention, as seen in previous credit cycles in Turkey.

While public banks have been the predominant source of credit growth both before and since the onset of COVID-19, credit provided still falls far short of total demand.[1] Public banks increased external borrowing over the last year, and have continued to expand credit during the crisis. In Q2 2020, public bank credit expanded by TL 178 billion (US$ 26 billion) while private bank credit expanded by only TL 54 billion (US$ 8 billion) (Figure 9). Especially more vulnerable segments such as SMEs depend on countercyclical support through public banks (Figure 10). Over 60 percent of public bank lending in Q2 2020 went to SMEs – TL 116 billion (US$ 17 billion) –, whereas only 7 percent of credit from private banks, or TL 4 billion, went to SMEs. While credit provided through public banks has been substantial, it still falls well short of the estimated US$ 38 billion needed to respond to SMEs urgent liquidity needs to cope with the impact of the COVID-19 crisis, see above, leaving a finance gap of around US$ 20 billion.

[1] Banks' share in total SME cash-loans were 48 percent for state banks, 29 percent for domestic private banks and 23 percent for foreign banks as of April 2020.

At the same time, public banks' balance sheets and capital are becoming increasingly strained due to the uptick in lending, requiring them to ration their credit provision. It is to be expected that public banks, similar to private banks, will therefore seek to target the least risky firms first, which will adversely affect the most vulnerable segments. Therefore, making additional financing available through public banks is expected to be met with large demand, particularly from underserved segments.

Government Policies to Mitigate the Economic Impact of COVID-19

Supporting otherwise profitable SMEs and other underserved segments with liquidity over this challenging period will be critical to contain the fallout from the COVID-19 crisis while preparing for the recovery. SMEs in Turkey risk being caught in a vicious cycle of a supply shock, demand shock, decline in working capital, and an increase in insolvencies. At the same time, tightened credit conditions affect their ability to access liquidity, setting in motion a downward spiral that can significantly impair the backbone of the economy and employment. The direct impacts of the COVID-19 shocks are bad enough. However, if firms begin to go bankrupt in large numbers and employment losses ensue, the negative impacts will be magnified via the knock-on effects of lower demand, debt defaults, and much elevated unemployment levels. The short-term support measures announced by the authorities will be necessary to help firms minimize financial obligations between March and June, but unless further measures are announced, the need for working capital will increase in the third quarter of 2020. The needs will be greatest for SMEs and other underserved groups as those will be most affected by credit rationing, as mentioned above. In that respect, a credit line through public banks that specifically supports otherwise viable SMEs and other underserved firms (i.e., women-inclusive and young firms and those located in less developed regions) that have at the same time been highly affected by the crisis would be an appropriate mechanism to provide targeted support that ensures additionality.

C. Proposed Development Objective(s)

Development Objective(s) (From PAD)

The Project Development Objective is to ensure access to finance for SMEs affected by or adapting to the economic impact of COVID-19

Key Results

The key results expected for the proposed Project will be measured by four PDO indicators: (i) Number of SMEs financed under the Project; (ii) Volume of credit line disbursed under the Project; (iii) Employment multiplier: Ratio of weighted average change in employment of the SMEs financed under the Project, over the average change of employment in their respective sector; and (iv) Operating results multiplier: Ratio of weighted average change in operating results [EBITDA] of the SMEs financed under the Project, over the average change of operating results [EBITDA] in their respective sector.

D. Project Description

The Project will provide US$500 million for the establishment and operation of credit line facilities to extend sub-loans to SMEs and underserved SME market segments affected by the economic impact of COVID-19. Compared to a total loan book of TL 3.15 trillion (US$443.5 billion) of the Turkish banking sector as of May 8, 2020 and the stimulus measures announced by the authorities, including an additional TL 25 billion support from the Ministry of Treasury and Finance (MoTF) for the CGF, a US$500 million credit line in isolation can only make an impact if it is targeted on segments that would otherwise struggle to obtain sufficient financing. The Project will therefore focus on SMEs and other underserved segments that are credit constrained even in normal times and support them as part of the immediate crisis response as well as the recovery phase. Component 1 will be a US$250 million line of credit to VakifBank, to be directly on-lent to eligible SMEs. Component 2 will consist of a US$250 million line of credit to the Turkey Development and Investment Bank (TKYB), which will be on-lent to private commercial banks, leasing companies, and factoring companies (PFIs) under a wholesale structure. PFIs will be expected to provide co-financing of at least 20 percent of each investment sub-project approved under the Project. In addition, TKYB and VakifBank will commit to channel all repayments from sub-borrowers and PFIs to new sub-projects consistent the original PDO and eligibility criteria.

The Project targets SMEs that were severely affected by the COVID-19 crisis but that remain financially viable and are likely to survive the crisis if provided financing to meet temporary liquidity needs and firms that want to adapt to the new operating environment. The proposed Project design seeks to address, on the one hand, the need to have flexible and broad eligibility criteria for the use of funds to respond to the urgent liquidity needs of vulnerable enterprises, and, on the other hand, the need to make scarce WB financing available to enterprises that have been most affected by the COVID-19 crisis and that are credit constrained even in normal times. The primary focus of the Project will be to support viable businesses that face temporary cash flow disruptions due to decreased demand to their products and supply chain problems, as well as businesses that had to shut down to follow social distancing guidelines. Furthermore, the Project will only support businesses that were in sound financial condition before the pandemic (defined as the end of 2019), and that are expected to survive the crisis, based on financial intermediary's credit appraisal process and evidenced by detailed financial criteria defined in the Project Operations Manuel (POM). The WB financing provided under the Project, mostly in the form of working capital sub-loans, will help keep these businesses afloat and maintain their employment during the current acute phase of the crisis and support their recovery when the health situation improves and the economy re-opens. In addition, the Project will support companies' working capital and investment expenditures to adapt to the new operating environment. Key target groups to be financed are defined as follows:

- **Target Group 1** – Highly Impacted SMEs: SMEs that experienced at least a 20 percent drop in gross sales in Q2 2020 compared to Q2 2019.
- **Target Group 2** – Highly Impacted Underserved SMEs: High-risk perception towards certain categories of enterprises including women-inclusive enterprises, young enterprises, and enterprises in less developed regions results in higher credit rationing to these groups even in normal times and compared to other SMEs.
- **Target Group 3** – SMEs seeking to proactively adapt to the COVID-19 environment by (i) introducing crisis management and resilience measures (i.e., workplace sanitation and health monitoring arrangements, refurbishments to improve social distancing); and (ii) introducing new products and services, new marketing channels, and new business solutions.

The Project's design combines different features to maximize additionality, outreach and rapid response to the COVID-19 crisis. To ensure additionality of WB funds, the Project will focus on SMEs and other underserved market segments that would otherwise struggle to obtain financing. Project flexibly allows for both working capital and investment loans, but it is expected that the majority of loan demand will be for financing enterprises' urgent liquidity needs and working capital expenditures (wages, raw material, utility bills, rent etc.). Direct lending especially by VakifBank together with retroactive financing will allow for fast disbursements to crisis-affected and vulnerable firms. On the other hand, Project funds will be available to finance investment needs of SMEs, especially in support of firms that want to proactively adapt and respond to the new operating environment (Target Group 3) and for the investment needs of enterprises in the recovery phase. Including leasing and factoring companies as PFIs will allow SMEs access to income-producing assets without a significant base of collateral and can play a critical role in their inclusion in the formal financial system. Focusing on different target groups and the need to respond quickly given the crisis situation calls for a combination of intermediary institutions and models that complement each other. The Project's dual lending modality, using both direct and wholesale lending, will allow for this complementary and will facilitate outreach to all targeted segments, in support of the Project's PDO.

VakifBank and PFIs will be able to provide loans to beneficiary enterprises in local currency. While it is expected that the IBRD loan will be provided in FX, the Borrowers have the option of converting the loan into local currency through the currency conversion options embedded in the loan, subject to the availability of a liquid swap market in TRY at the time of disbursement. If the loan is provided in FX, the banks will manage the currency risk in their balance sheet or make use of the country's well-developed currency swap market. VakifBank, TKYB and PFIs will provide loans in accordance with the Council of Minister's Decree Number 32 which regulates the foreign exchange lending provisions.

Legal Operational Policies

	Triggered?
Projects on International Waterways OP 7.50	No
Projects in Disputed Areas OP 7.60	No

Summary of Assessment of Environmental and Social Risks and Impacts

The environmental and social risks are assessed as Moderate. Overall, the Project will have positive social impact by addressing the economic impacts of the COVID-19 pandemic in Turkey, helping firms stay afloat and reducing the potential layoffs of workers as a consequence of reduced economic activity. The credit line shall mainly address working capital needs such as salary payments and fixed costs, and a small portion for investment expenditures for adapting to the new operating environment, therefore the environmental risks are considered minimal. The main environmental and social risks of the Project are related to labor and working conditions, occupational health and safety, dust, noise, energy use and waste management at the sub-project level. These are expected to be site specific, temporary and can be readily addressed through standard mitigation measures and compliance with national laws. The overall portfolio risk is thus considered moderate.

E. Implementation

Institutional and Implementation Arrangements

The Borrowers and Project Implementing Agencies for the project will be VakifBank (Component 1) and TKYB (Component 2). The IBRD will enter into a Loan Agreement with each bank. The Government of Turkey, represented by MOTF, will guarantee the obligation of each Borrower in respect to the Loan Agreement. For implementation of Component 2, TKYB will enter into Subsidiary Financing Agreements with eligible PFIs, which will on-lend the IBRD loan proceeds to eligible enterprises through sub-loan agreements.

VakifBank and TKYB were selected based on their strong track record in supporting the enterprise sector, including under WB projects. VakifBank is a state-controlled bank with a loan portfolio of TL 282.2 billion (US$ 47.4 billion) at end-2019. VakifBank is Turkey's third-largest bank in terms of loan book and has extensive experience in offering direct credit to SMEs and midcap companies through its extensive branch network. TKYB is a state-owned development bank with a loan portfolio of TL 15.0 billion (US$ 2.5 billion) at end-2019, with the mandate to address financing gaps both though direct lending to mid-caps, as well as channeling wholesale funding to banks, leasing companies, and factoring companies for on-lending to SMEs. Additional criteria for selecting these two banks include their sound financial position, adequate governance structure, and satisfactory performance as Borrowers in past line of credit operations financed by the WB.

Both banks have established Project Implementation Units (PIUs) and will maintain them throughout project implementation. The PIU will be fully funded and staffed by each bank and will operate under the overall supervision of a Deputy General Manager. The PIU responsibilities will include: (i) ensuring that the IBRD loan proceed are on-lent to final beneficiaries in accordance with the terms and conditions recorded in the Loan Agreements and Project Operations Manuals for the respective components; (ii) responsibility for adherence to all fiduciary and safeguard requirements of the World Bank; and (iii) monitoring and evaluation based on the agreed results indicators. TKYB's PIU will also be responsible for the selection of and on-lending to PFIs and for monitoring of PFIs to ensure compliance with Project criteria.

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