
Project Proposal

Energy Sector Management Assistance Programme

ACCELERATE THE ENGAGEMENT OF THE PRIVATE SECTOR IN THE PROVISION OF ENERGY SERVICES IN IDA COUNTRIES

1 SUMMARY

The objective of this proposal is to seek DFID's support to ESMAP to undertake a major effort to accelerate the engagement of the private sector in the provision of energy services in IDA countries.

ESMAP is a global technical assistance program that promotes the role of energy services in poverty reduction and economic growth in an environmentally and socially responsible manner. DFID has been a major supporter of ESMAP's work both through core funding and project-specific support.

Private investment and management and public-private partnerships in the provision of energy services are critical for developing countries. The involvement and flow of private investments to the energy sector of developing countries, especially for power, has declined rapidly over recent years: investments in power projects with private participation in 2002 were only a tenth of 1997 levels, widening the already huge financing gap between sector investment needs and private sector financing and thereby contributing to increase unmet demand for energy services in developing countries. The situation is even more acute in IDA countries, as most of them present higher risks to investors while the demand is increasing rapidly not only to meet the needs of growing economies and increasing urban growth, but also to catch up with the lag in rural services. Governments increasingly recognize that utilities' self financing capacity, fiscal resources and public sector borrowings will not suffice to meet investment financing needs, and that they urgently need to develop more effective partnerships with the private sector and create an environment that will attract private sector financing, investors, and operators.

The project aims to capitalize on the work done in a number of IDA countries through efforts supported by DFID, PPIAF, PIDG, GVEP, ESMAP, Shell Foundation, the World Bank, the Regional Banks and other bilaterals, in order to accelerate the engagement of the private sector in the provision of energy services in IDA countries. While the generic reasons for the slow participation of the private sector in the delivery of energy services are well known, it is well-recognized that solutions have to be adopted at the country level. The project will

therefore focus on selective countries (components 2 through 5) and will cover the following interlinked components:

- (1) Identify obstacles to the private sector in the provision of energy services,
- (2) Improve the investment climate in the energy sector,
- (3) Improve the fiscal framework applicable to private investment in energy,
- (4) Leverage financing, including risk mitigation instruments,
- (5) Harness local entrepreneurship when available,
- (6) Knowledge management and dissemination, and
- (7) Impact Monitoring and evaluation in terms of inflow of private investment and lending in the energy sector.

The success of the project will be assessed by both the increase in private sector participation in the provision of energy services, and in the increase in sustainable access to these services by households, in particular the poor, by communities, and by enterprises in the selected countries (see Annex 1 on country selection).

Funds will be managed through ESMAP. The activities will be implemented by ESMAP and Regional Energy Staff of the World Bank in coordination with other donors and GVEP members. It will leverage policy dialogue and lending programs of the World Bank group and other donors. This project supports the goals of the WSSD Johannesburg Conference and Bank's initiative to scale up energy services, including those based on renewable energy, in order to achieve the Millennium Development Goals.

Narrative Summary	Output	Implementation Arrangement	Impact Indicators
<p>Objective: To increase access to modern energy services in selected IDA countries through the increased engagement of the private sector in the provision of these services.</p>			<p>1. % of poor people, communities and enterprises in each country with sustainable access to modern energy services. 2. % of energy investments in each country with private participation 3. # of private energy service providers</p>
<p>Component 1: Identify obstacles to the private sector in the provision of energy services in IDA countries</p>	<p>Clear methodology for reviewing framework for private sector</p>	<p>ESMAP will commission staff and consultants to establish a common</p>	<p>1. Adoption of the platform for country case studies.</p>

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<p>There is a growing interests amongst lower income country governments to find solutions to accelerate the delivery of energy services, including those based on decentralized and renewable energy resources. There is also a interest in building-up public-private partnerships as a means to accelerate the flow of investments and the effective delivery of the services. However, there are still a number of institutional, financial, and other barriers impeding private investment. This component will review and identify with the collaboration of potential investors, lenders, manufacturers, and representatives of selected IDA country governments these barriers. The main areas to be reviewed will include:</p> <ul style="list-style-type: none"> • The analysis of the legislations and regulatory regimes applicable to private decentralized/renewable energy projects to supply isolated areas and/or to access the power grid; • The constraints in the financial support mechanisms (such as banking sector regulations or others) to meet the needs of private investors; • The incentive framework, tax regime, financing opportunities (CDMs, GEF, Carbon Finance and others), and other components; • The analysis of the risk profile of different types of the private investments and engagement, including for decentralized or renewable energy projects. 	<p>participation, including barriers to entry of private investors, lenders and operators in the provision of energy services in the selected IDA countries. The approach should clarify sub-sectoral differences, e.g. between grid and off-grid electricity, hydrocarbon- and biomass-based products. It will propose a minimum regulatory and institutional platform for the provision of energy services involving private partners.</p>	<p>methodology and conduct the reviews. Starting with a literature review, in particular of the Country Framework Reports developed by PPIAF and the Country Business Climate studies of Bank’s PSI department, it will proceed in developing a minimum regulatory and institutional platform for the provision of energy services, which will be tested with several stakeholders in one or two pilot countries.</p>	<p>2. Adoption of the platform by country governments and others in their sector analysis for Private Sector Participation</p>
<p>Component 2: Improve the legal, regulatory and policy framework in selected countries</p> <p>This component will include four tasks as follows. Each task contains in-depth study and pilot activities. This component will provide TA services to a few selected IDA countries to assist the government in improving their regulatory and policy framework for private sector investment in the energy sector.</p> <ul style="list-style-type: none"> • <u>Business climate</u>: this task will develop a “code of conduct” to be followed by the World Bank Group and its development partners in support of electric utility Public Private Partnership (PPP) initiatives for IDA countries. In particular, this task will aim to define minimum 	<ul style="list-style-type: none"> • Successful PPP case studies developed. • Minimum standard or requirement for public, regulatory, and corporate governance for PPP in pilot countries • Improved investment climate & stronger sector institutions in 	<p>A project team will be established in each country case, consisting of Bank Staff, representatives of key donors, Government and Regulatory staff, private sector representatives, and consultants as needed.</p>	<ul style="list-style-type: none"> • Increased private financing in energy sector in a few selected countries • Increased private financing & private provision of services in rural electrification – grid or off-grid, including

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<p>standards for governance of electric utility PPPs –in terms of corporate governance (utility ownership/service provision functions) and regulatory governance (technical and economic regulation functions), alongside overall public sector governance (e.g., policy making, law making/enforcement, tax assessment and collection, etc.). The task will conduct several case studies in selected countries to explore and delineate “critical success factors” underlying good governance practices for electricity utility PPPs.</p> <ul style="list-style-type: none"> • <u>Rural electrification incentive policies</u>: this task will analyze how to use subsidies and other incentives to attract private investors and operators in rural electrification projects. • <u>Renewable energy policy</u>: this task will examine how the government can provide financial incentive mechanisms to attract the private investment in renewable energy. • <u>Hydrocarbon-& biomass-products</u>: this task will examine the regulatory framework to allow for fair pricing through competitive production, procurement & distribution. 	<p>the selected countries</p> <ul style="list-style-type: none"> • TA services provided in a few selected countries in improving investment climate & institutions • A report on rural electrification incentives policies & instruments • A report on financial incentives & instruments for renewable energy • In the selected countries, improved regulatory and policy framework for private investment in rural electrification and renewable energy 		<p>renewables</p> <ul style="list-style-type: none"> • Greater availability of hydrocarbon and biomass biased products
<p>Component 3: Improve the fiscal framework</p> <p>This task will review the subsidization and taxation regime applicable to investments and incomes over the life of the energy project from private investors’ & entrepreneurs’ perspectives. It will include a review of possible sources of distortion, such as (i) fuel tax exemptions granted to hydrocarbon-based power generation, (ii) accounting for social benefits associated to the provision of energy services in remote areas, (iii) accounting for environmental benefits from clean energy, (iv) the adequacy of asset depreciation rules for fiscal purposes in relation to the asset financing instrument maturity. It will propose fiscal strategies which will improve the</p>	<ul style="list-style-type: none"> • An analysis and recommendations on fiscal framework in a few selected countries 	<p>Same as for Task 2</p>	<ul style="list-style-type: none"> • Improved fiscal framework in selected countries

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incentive framework for investors, entrepreneurs, and financiers.			
<p>Component 4: Leverage financing</p> <p>The financing mechanisms have to be fundamentally improved, from largely donor-based to market-oriented mechanisms that leverage private sector financing and operators, for a whole range of projects, both in terms of scale and technology. Domestic financing sources, particularly those from local financial institutions and private sector, can play an essential role. To leverage financing from local capital markets, outreach activities, capacity building, and risk-mitigation and credit-enhancement instruments are critical. In addition, establishing or developing financial intermediaries can be another effective approach to tap domestic liquidities for energy investments.</p> <p>This component will:</p> <ul style="list-style-type: none"> • Sponsor the organization of financiers meetings, (a) to bring all financing stakeholders to the same level of understanding on financing needs, available or needed risk mitigation instruments, and (b) to mobilize financing commitments for energy services programs.(see Annexe 2) • design innovative financing models to engage the domestic private sector and leverage domestic capital market for provision of energy services; • review and introduce risk mitigation instruments, to mitigate the risks for investors and financial institutions dealing with high risks/low returns activities such as decentralized energy services. • design consumer financing schemes to address affordability issues in rural and peri-urban areas for private sector provision of energy services • test a few pilot activities in the same selected IDA countries on the above identified innovative financing approaches. 	<ul style="list-style-type: none"> • Risks better identified in selected countries • A few innovative financing mechanisms designed, including deployment of innovative risk mitigation instruments • Consumer financing schemes designed • Pilot activities conducted • Lessons learned disseminated 	In addition to the basic country teams, private and public financiers will participate in both study groups and financing meetings.	<ul style="list-style-type: none"> • Substantial increase in financing from the domestic private sector and financial institutions leveraged in at least 2-4 countries per year.
<p>Component 5: Harness local entrepreneurship</p>	<ul style="list-style-type: none"> • Capacity building of SMEs 	In addition to the basic country team (see task 2), private	<ul style="list-style-type: none"> • SME capacity improved

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<p>In the same selected IDA countries, this component will:</p> <ul style="list-style-type: none"> • Build Capacities of SMEs for providing energy services • Engage existing large and medium private domestic alongside with international players in providing rural electrification, including renewable-based and other energy services. • Take advantage of existing marketing networks, including for other products or services (e.g. telecenters, general stores), to promote the development of energy services and appliances (e.g. SHSs) 	<p>conducted</p> <ul style="list-style-type: none"> • A number of existing private players invest in rural electrification and renewable energy • Successful demonstration of existing distribution network for renewable energy sales 	<p>entrepreneurs will be mobilized and trained.</p>	<ul style="list-style-type: none"> • Substantial increase in private operators and energy service providers • Demonstrated lower risks for private investment
<p>Component 6: Knowledge management and dissemination</p> <p>Project developers and industry have indicated that they would welcome the Bank taking a lead in preparing a “Business Handbook” that provides standardized approaches/documents related to decentralized energy services, including renewable energy and rural electrification contracting, feasibility studies, regulations, financing, etc. This task will develop such a Handbook/Toolkit to be operationally oriented and provide specific guidance and instructions on various design features of rural electrification and renewable energy projects. The Handbook will also include the case studies and best practice experience from the selected countries.</p>	<ul style="list-style-type: none"> • A business handbook and toolkit produced 	<p>ESMAP will take the lead in the preparation of the handbook, contracting consultants as needed</p>	<ul style="list-style-type: none"> • Experience and knowledge shared and disseminated
<p>Component 8: Monitoring and evaluation. This component will provide Impact M&E of activities and results achieved from this project, and disseminate the lessons learned.</p>	<ul style="list-style-type: none"> • Monitoring report for detailed activities • Impact evaluation report 		<p>Information will be generated to substantiate the indicators identified for the overall project goal</p>

2 PROJECT RATIONALE

2.1 Modern Energy Services and the Millennium Development Goals

Although the availability of reliable and least cost services is not one of the Millennium Development Goals, the World Summit on Sustainable Development confirmed the view that energy services are key to achieve the Millennium Development Goals. Modern energy services are indispensable to sustain the

development of economic activities, to create incomes and provide social services. Modern energy services are also indispensable to provide safe water, reduce maternal mortality, and promote environmental sustainability. While many governments have made substantial efforts to increase investments in energy sector development, it is clear that the energy-poverty gap between nations is increasing, with the lowest income countries unable to generate sufficient fiscal and operating incomes for the further development of services. Governments increasingly recognize that fiscal resources and public sector borrowings will not suffice to meet investment financing needs, and that they urgently need to develop more effective partnerships with the private sector and create an environment that will attract private sector financing, investors, and operators.

2.2 The Recent Trend of the Private Participation in the Energy Sector in Developing Countries

Private investments and public-private partnerships in the provision of energy services are critical for developing countries. Following the initial wave of private sector investments in the energy sector which began in the 1980s with the comprehensive privatization program in Chile, private sector investments grew rapidly in the 1990s and then reached a peak of US 46 billion in 1997 (about only 30% of sector investment needs). The economic crises which occurred in East Asia, South America, and Russia heightened perception of risk in developing countries from the international investment community has not recovered and the flow of private investments to the energy sectors of developing countries has declined rapidly. Investments in power projects with private participation in 2002 were only a tenth of 1997 levels and less than 5% of investment needs, widening the financing gap between investment needs and financing available and increasing un-met demand for energy services in developing countries. The situation is even more acute in IDA countries, as most of them present higher risks to investors while the demand is increasing rapidly not only to meet the needs of growing economies and increasing urban growth, but also to catch up with the lag in rural and peri-urban services.

2.3 Scaling up Energy Services, including decentralized and renewable-based services.

Many developing and industrialized countries have recently reaffirmed their commitment to find solutions to accelerate the availability of sustainable energy services and reduce the energy-poverty gap, and to take advantage of all least-cost technologies. In March 2003, the World Bank announced its ‘Scaling-up Initiative’, which it reconfirmed at the International Conference on Renewable Energies in Bonn in June 2004, adding that it was committing to a target of increasing its financing of both renewable energy and energy efficiency by at least 20 percent annually over the next five years. Other countries and development organizations announced commensurate commitments. This scaling-up will require substantial investments from both private and public sectors through effective partnerships.

The proposed project would demonstrate that by concentrating efforts in a few IDA countries --12-15 over the next three years – it is possible to achieve tangible results, in particular when this work capitalizes on institutional, analytical and partnership work already carried out or on-going. The expected outcomes from the project would be to demonstrate a substantial increase in private sector financing and participation in these countries, resulting in an acceleration in the availability of sustainable modern energy services.

2.4 ESMAP 2005-2007 Business Plan

The concept of ESMAP 2005-2007 business plan was presented at the March 2004 Consultative Group (CG) meeting and was well received by donors. This project will be an important component for ESMAP 2005-2007 work program. It fits with both ESMAP’s thematic strategy of helping countries improve their overall energy security by increasing access to energy services, relying on increased efficiency of energy markets and environmental sustainability of energy production and use. The project will also support ESMAP’s operational framework of providing cutting-edge analytical work, sharing knowledge, and leverage investment activities from the World Bank and other public and private financiers.

2.5 DFID policy framework

DFID’s PSI/CDC departmental policy focuses on three aspects of developing the private sector; namely:

- i. taking forward the implementation of substantial international and regional initiatives to mobilize private investment in infrastructure;
- ii. coordinating with other sources of finance (donor and private sector) with a view towards mobilizing private capital and joint funding of such initiatives; and
- iii. developing and implementing new international initiatives to mobilize private investment in infrastructure.

This proposal fits within this policy framework by focusing attention on the poorest countries and regions of the world where commitment to, and ownership of the MDGs is high. Activities have been selected to take advantage of the opportunities presented by existing multi-lateral initiatives, exhibiting strong client ownership and the potential to have significant impact on the ability of the domestic and small scale private sector to increase its scale and effectiveness both in financial and technical terms.

3 PROJECT PROPOSAL

3.1 Project Objective

The project goal is to increase access to modern energy services in selected IDA countries through the increased engagement of the private sector in the provision of energy services.

3.2 Project Activities

Please see Log-Framework for details.

4 IMPLEMENTATION

4.1 Management Arrangements for this Project

The overall project will be managed by ESMAP, which will contract as appropriate other World Bank staff and consultants. In each selected country, a joint team will be established with government representatives, key donors, civil society representatives, a Bank Task Manager and private sector participants. To provide overall coherence and a framework within which the lessons from these activities can be brought together and organized, ESMAP will nominate a Project Team Leader (PTL) from its senior staff. The PTL will liaise with all Task Managers, keep track of progress and provide a framework for coordinating all activities. The PTL will also take responsibility for the overall dissemination of findings from this Project.

The ESMAP Manager will retain overall responsibility for the discharge of activities described within this proposal.

4.2 Timing

The timeframe for the whole project is from September 1st 2004 to August 31st 2007.

In order to assist in the defrayment of the costs of administration and other expenses incurred by the World Bank and ESMAP, the Bank will deduct an amount equal to 5% of the gross contribution in accordance with the MOU signed between DFID and the World Bank.

4.3 Contracting and Procurement

DFID resources would be un-tied as to the nationality of consultants or suppliers. All procurement of goods and services will be undertaken in accordance with World Bank Guidelines. The selection and recruitment of consultants financed from the DFID resources, and the administration and enforcement of any provisions of any agreement entered into between the Bank and the consultants and/or third parties, shall be the responsibility solely of the Bank and shall be carried out in accordance with its normal procedures.

4.4 Accounting

Annual financial reports of the overall contribution will be provided to DFID, within which will be included, but without specification, the use of DFID funds.

4.5 Reporting

Activities will all be incorporated into ESMAP annual work program. Reports describing progress against outputs will be provided to DFID every six months in ESMAP semi-annual and annual reports. The project progress will also be included in ESMAP Annual Report which will be available to the public. Other substantive reports and products will be shared with DFID as they become available.

On an annual basis the PTL will provide DFID with an overview of the progress of activities described in this proposal. ESMAP would welcome a regular (annual) review with concerned DFID staff to enable the program of activities described herein to benefit from the perspectives and insights of the key donor.

5 RISKS

The project may encounter the following identified key risks:

- Lack of political will or “buy in” from partners (including national governments, community organizations, private sector representatives, etc.).
- Difficult to apply lessons learned from country level to regional and global levels.
- Insufficient matching donor resources mobilized in time to fully fund initiatives.
- Lack of follow-up activities.

ANNEX 1: COUNTRY SELECTION

In order to identify the countries that will be selected for the project, ESMAP has undertaken a review of activities done with the support of a number of programs/organizations such as PPIAF, the Shell Foundation, GVEP and the World Bank. From this review, it seems that good candidate countries would be:

Africa:

Ethiopia (candidate for year 2 or 3):

The Government of Ethiopia hosted the first Energy-Poverty Reduction Workshop under the umbrella of the Global Village Energy Partnership. The Government is increasingly concerned with the lack of energy services to increase the productivity of agriculture from small irrigation, and to improve the quality of social services (health and education) in particular in the rural areas. The government is in the process of re-visiting its erstwhile conservative policy toward private sector involvement in the energy sector. The Project would be an opportunity a) to test the possibility of creating a large number of private or community-based energy service enterprises. Successful experience exists with women-owned enterprises for charcoal production; and b) to mobilize additional financing for the rural sector in particular.

Kenya (candidate for year 2 or 3):

The new Government has undertaken a major review of its energy sector policy, with a strong commitment to extend the delivery of energy services. PPIAF has already carried out some work on Power Sector Reform. Kenya is also one of the core GVEP countries, where the UNDP is taking the lead in assisting with the preparation of an Energy-Poverty Reduction Country Action Plan.

Ghana (candidate for year 1):

The Government has undertaken a complete review of its energy sector policies, with the objective of designing its operational strategy for the next 10 years. The World Bank has been providing support to the analytical work, and ESMAP has provided support for the Rural Electrification Strategy. Ghana is also one of the core GVEP countries, where the UNDP is taking the lead, with NREL, in assisting with the preparation of an Energy-Poverty Reduction Country Action Plan. The Government has asked KITE, a local NGO, to assist with the coordination of local stakeholders. The Project would be an excellent vehicle to facilitate the mobilization of the private sector for the implementation of the action plan.

Niger (candidate for year 1):

The Government is in the process of restructuring its power sector and is open to private sector investors, particularly in rural areas. In addition to a goal to increase the availability of energy services through decentralized models, including those based on renewables, it is keen to attract private sector investors in the delivery of

the services. The Project would be an opportunity to deepen the sector reform work and assist in the strengthening of the regulatory framework for decentralized services and private sector participation. It would complement the work initiated with support from the Global Village Energy Partnership and the European Union Energy Initiative (EUEI).

Uganda (candidate for year 1 or 2)

The country has developed a long-term Energy for Rural Transformation Plan. It has established a Rural Electrification Plan which has received some funding from the World Bank and institutions to support Rural Electrification. The World Bank funds are used to finance projects presented by private developers under private-public partnership schemes. In addition, PPIAF supported the preparation of a Country Framework Report, and the Shell Foundation has initiated some innovative financing to support new decentralized energy enterprises through commercial banks. Uganda is also one of the GVEP focus countries, where the UNDP is leading a number of activities, including some innovative credit facility for SMEs and consumers. The Government has expressed an interest in bringing public and private financing partners in order to raise additional resources for the Rural Electrification Fund in particular. The Project would be an excellent opportunity to assess the progress made with the implementation of public-private partnership under the Energy for Rural Transformation Plan, to identify remaining bottlenecks, and to mobilize additional commitments.

Zambia (candidate for year 1)

The Government is presently preparing a major investment program to be financed by the World Bank for the expansion of rural electrification. In addition, it has received assistance from USAID to review market based mechanisms for rural electrification. The Energy Ministry has also set up some working groups that include private sector investors, NGOs, and other partners with the objective of preparing an Energy-Poverty Action Plan. The Project would be most instrumental in helping mobilize investment financing and to train entrepreneurs for the implementation of the Energy-Poverty Action Plan.

Asia

Bangladesh (candidate for year 1):

Bangladesh has had increasing success with its energy services program. In the most recent World Bank financed Rural Electrification and Renewable Energy Development project, the off-grid component of the project has been very successful. The project involves a rural electrification fund for off-grid regions of Bangladesh. The fund is administered by IDCOL, which is a financing institution that was created to assist private sector development in Bangladesh. The fund is managed by a specific unit within IDCOL, and is technology neutral, in that all forms of off-grid electrification can be funded under the project. The approach of the project is that entities such as NGOs, communities or the private sector can submit proposals for

off-grid electrification in Bangladesh. The unit within IDCOL managing the fund evaluates the proposals and qualifies the firms to participate in the program. For renewable energy project, there is a GEF grant subsidy component under the project for offgrid electrification involving renewable energy. At present, 20,000 PV systems have been approved for funding under the project, mostly involving micro-finance institutions. There are also several community-wide systems being considered.

It now seems evident that the project will reach its investment financing goal in about 3 rather than 5 years.

India (candidate for year 1)

The States of Gujarat and Andhra Pradesh have requested assistance from the World Bank to develop rural electrification. Workshops are to be conducted to learn from experience, including from other states and neighboring countries, on how effective public-private partnerships can be set up both for service provision and revenue collection. The Project would assist the respective states in the pre-investment phase, strengthen their legal and regulatory framework, in particular for decentralized energy services, and help design an incentive framework that will facilitate private sector participation during the implementation phase of the program.

Laos, Cambodia and Vietnam (candidates for Year 2 or 3)

PPIAF has prepared Country Framework reports for Cambodia and Vietnam, and conducted workshops in Laos and Cambodia on power sector reform and the role of the private sector. These three countries are also going to participate in the Asia GVEP workshop that ESMAP will be leading with ASTAE in early 2005. In Cambodia, the E7 have developed very successful public-private partnership projects. The Project would be an opportunity (a) to further the analytical work necessary to improve the investment climate, and (b) to mobilize private sector financing and train entrepreneurs.

LAC

Honduras and Nicaragua (candidates for year 2 or 3)

PPIAF has conducted work on the investment climate in these two countries. Honduras is a GVEP focus country for which ESMAP has provided funding to initiate some GVEP activities on sector policy for the provision of decentralized energy services and a few pilot activities. Nicaragua participated in the GVEP Regional Workshop and expressed, as a result, an interest in developing an energy-poverty reduction action plan which would assist in scaling up the rural energy services program of which the World Bank is financing a first phase. The Project would in both countries assist with (a) the provision of technical assistance to strengthen local institutions, (b) assist with resource mobilization from the private sector, and (c) help training local enterprises and financial institutions.