2003 Georgia Benchmarking Report

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Background

Georgia was one of the first countries to gain formal independence after the collapse of Soviet Union; however, its development has been hampered by ethnic violence and a civil war, which has resulted in large segments of the population being displaced and/or otherwise negatively affected by the conflicts. More than ten years on, the ethnic conflicts are still not fully resolved. As a result, Georgia has yet to complete the transition to a modern market economy. The slowness of reforms and liberalization of the market has led to little increase in the economic prosperity of the population. In fact, the delays in the transitions led to high levels of unemployment, which in turn, left many Georgian citizens with few options other than to take up self-employment to generate income and make their livings. Over the years, the micro and small business sector has evolved and become very dynamic. This has fueled the demand for microfinance services giving rise to an emerging microfinance industry.

Microfinance in Georgia

Microcredit in Georgia began in the mid-nineties and is provided primarily by three types of organizations: non-profit MFIs registered as unions or foundations, commercial banks, and credit unions. This report focuses mainly on non-profit MFIs that serve over 70 percent of the borrowers currently being reached in the Georgian microfinance market.[2] Most of the non-profit MFIs started as humanitarian assistance projects with microcredit components. They provided group-guaranteed loans to micro-entrepreneurs affected by the political and economic turmoil, many of whom were refugees or internally displaced people. The majority of these institutions remain very small and reach limited numbers of borrowers. They focus on serving urban clients engaged mainly in small trade or services that require short-term working capital loans. These MFIs have a limited range of products and many offer only a single loan product. However, despite their small scale, these institutions generate significant revenues and on average have achieved financial self-sufficiency. Profitability is close within their grasp, but high general cost levels, including onerous revenue taxes, have kept most of them from achieving positive returns on assets. Low efficiency and staff productivity also hinder their growth.

A recent survey conducted by USAID & GMSE "Microfinance Demand Survey"[3] showed that as of June 2004, Georgian microfinance institutions, both non-bank financial institutions and commercial banks, currently reach less than one third of the potential clients and serve less than ten percent of the effective loan demand. Thus Georgian MFIs have only begun to scratch the surface of the microfinance market.

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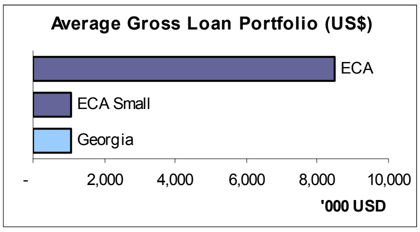
[2] 7 out of a total 11 non-profit MFIs were analyzed in this report.
[3] Summary Analysis and Report of the USAID\GMSE Microfinance Demand Survey, June 2004

Performance Analysis of Non-bank MFIs [4]

Institutional Size

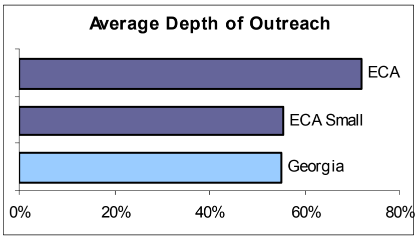


Georgian MFIs run much smaller operations than their ECA counterparts. Despite being on average five to six years old, Georgian MFIs exhibit many characteristics of start-up institutions, such as their small scale and limited infrastructures. The largest Georgian MFI has a total gross loan portfolio of under four million USD and is slightly less than half the size of the ECA average. The remaining MFIs are significantly smaller – five out of seven institutions do not exceed a half million USD in loan portfolio. The small scale of these MFIs is partially a result of the origins of microfinance in Georgia. Most of these programs had their beginnings as supplementary services to the humanitarian assistance towards war-affected populations and only recently have they established themselves as dedicated microfinance providers. Up until now, their status as supplemental service providers has severely limited their access to the funds for expansion. Georgian MFIs have limited infrastructure. With the exception of the largest MFI which has an extended network of branches covering most of the country, Georgian MFIs have on average only 3 offices, compared to the average of 6 offices for the ECA Small peer group. This further illustrates their limited scale.

		Georgian MFIs	MBB ECA Small	MBB All ECA	MBB ECA FSS	MBB All MFIs
Number of MFIs	Sample Size of Group	**7**	**27**	**49**	**29**	**231**
Age	Years Functioning as an MFI	**5**	**5**	**5**	**6**	**9**
Gross Loan Portfolio	Gross Loan Portfolio, adjusted for standardized write-offs	**1,068,872**	**1,072,041**	**8,510,944**	**12,276,427**	**19,214,376**
Offices	Number, including head office	**3***	**6**	**12**	**15**	**48**
Personnel	Total Number of employees	**30***	**33**	**83**	**103**	**376**

* for comparative reasons an outlier was taken out of the sample

Outreach



Georgian MFIs reach fewer borrowers than their ECA peers, but serve relatively lower income clients. With one notable exception, the majority of Georgian MFIs serve on average less than 2,000 active borrowers - well below the ECA average.

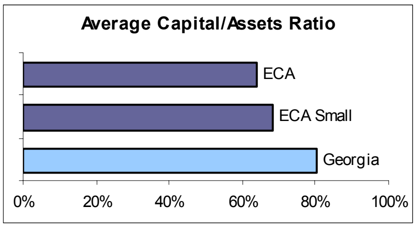
Perhaps the largest obstacle to increasing their outreach is the general ambiguity regarding the legal status of these institutions. This limits possibilities for institutional development and reduces their willingness to explore new markets, which may require developing innovative products to reach new client groups. As is typical for small NGO-type institutions, Georgian MFIs reach deeper than the average ECA MFI. They are very diversified in that respect. A few reach the poorest clients in ECA with average loan balances below 25 percent GNI per capita, while others serve better-off entrepreneurs. The smallest loans are given predominantly to unregistered businesses, often run by women involved in petty trade. Georgian MFIs primarily focus on densely populated urban areas with the largest concentration of microentrepreneurs enabling them to work towards maximizing the numbers of clients without large investments in office infrastructure. Thus, despite their success in reaching poor clients, there are still presumably large sections of the rural population that have little or no access to microfinance services.

OUTREACH INDICATORS		Georgian MFIs	MBB ECA Small	MBB All ECA	MBB ECA FSS	MBB All MFIs
Number of Active Borrowers	Number of borrowers with loans outstanding, adjusted for standardized write-offs	**1,990***	**2,368**	**5,840**	**7,882**	**47,688**
Percent of Women Borrowers	Number of active women borrowers/ Adjusted Number of Active Borrowers	**62.4%**	**66.8%**	**65.6%**	**67.8%**	**60.2%**
Average Loan Balance per Borrower	Adjusted Gross Loan Portfolio/ Adjusted Number of Active Borrowers	**482**	**805**	**1,263**	**1,071**	**689**
Average Loan Balance per Borrower/ GNP per Capita	Adjusted Average Loan Balance per Borrower/ GNP per Capita	**58.1%**	**57.2%**	**73.0%**	**71.3%**	**74.7%**

* for comparative reasons an outlier was taken out of the sample

[4] The analysis is based on the information provided by seven non-bank MFIs that participated in MicroBanking Bulletin #11: BBK Financial Group, Business Assistance Initiative, Constanta Foundation, Crystal Fund, FINCA Georgia, Small Business Development Foundation, VF Credo (WVI Georgia).

Financial Structure



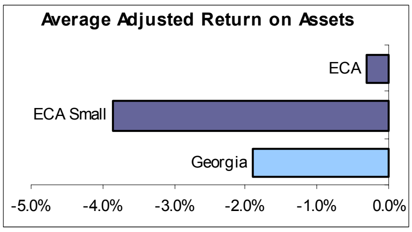
Georgian MFIs are predominantly donor-funded and have had little success in accessing commercial funds. As evidenced by their lack of leverage, which is many times lower than the ECA average, Georgian MFIs do not mobilize savings and have yet to attract significant funds from commercial sources. This is typical for many small-scale institutions.

Several factors relating to the operating environment shed light on why this is the case. Under Georgian law, savings collection by non-bank MFIs is not permitted. What's more, the earlier mentioned demand study[5] revealed that there is apparently very little demand for savings services among microentrepreneurs, which consequently reduces the incentives for MFIs to transform into banks in the hopes of using savings to fund portfolio growth. Because of unclear legal regulations international investors are cautious to enter the Georgian market and many local commercial financial institutions are hesitant to lend to MFIs. Hence, the majority of Georgian MFIs do not yet access borrowed funds, and if they do, these funds are not used for on-lending. However, the recent introduction of legal amendments to Georgian law regulating MFI operations[6] will likely dispel some of the uncertainty and increase MFI access to commercial funds. And most importantly, the majority of Georgian MFIs are not sustainable enough to bear the full price of commercial loans, so few of them choose to seek out loans from local banks. Georgian MFIs are nevertheless managing their assets well and dedicate a very high percentage of their resources to the loan portfolio – the main income-generating asset.

FINANCING STRUCTURE		Georgian MFIs	MBB ECA Small	MBB All ECA	MBB ECA FSS	MBB All MFIs
Capital/ Asset Ratio	Adjusted Total Equity/ Adjusted Total Assets	**80%**	**68.3%**	**64.0%**	**63.2%**	**44.1%**
Commercial Funding Liabilities Ratio	All liabilities with "market" price/ Adjusted Gross Loan Portfolio	**2.0%**	**15.9%**	**21.8%**	**23.4%**	**63.2%**
Debt/ Equity Ratio	Adjusted Total Liabilities/ Adjusted Total Equity	**0.1***	**1.0**	**1.3**	**1.5**	**2.2**
Gross Loan Portfolio/ Total Assets	Adjusted Gross Loan Portfolio/ Adjusted Total Assets	**80.9%**	**77.1%**	**79.6%**	**83.1%**	**70.5%**

* for comparative reasons an outlier was taken out of the sample

Financial Performance



Georgian MFIs have reached operational self-sufficiency and financial self-sufficiency. Undermining their profitability, however, is the extremely high level of revenue taxes they are forced to pay, which pushes their average return on assets (AROA) into the red - roughly negative two percent.[7] As a result, only two Georgian MFIs generated positive AROAs. Still, even with the unfavorable tax situation, on average Georgian MFIs outperformed the ECA Small group.

Revenues

Georgian MFIs are among the world's top institutions in terms of revenue generation. This is a result of their high yields on loan portfolio and exceptional asset allocation. Evidently, Georgian MFIs are providing a service their clients value, as demonstrated by their willingness to actively repay loans. Such yields are starting to attract attention from the local banks, but as of yet there remains little competition. Should banks move into this market segment by offering smaller loans, it will likely put downward pressure on interest rates and lead to lower yields.

Expenses

Georgian MFIs have significantly higher expense levels compared to the rest of the world and their ECA peers. Georgian MFIs spend over 40 cents to manage each dollar of their assets, which is characteristic of the region. This is partially due to Georgia's high general cost level related to a quickly growing economy[8]. Additionally, high personnel expenses are the result of above average social insurance and personal tax burdens. Georgian MFIs' initially were focused on extending services to key populations, many times to the detriment of their bottomline. However, their recent shift in orientation towards sustainability, will likely result in the streamlining of operating procedures and will likely bring down expenses over time.

[5] Summary Analysis and Report of the USAID GMSE Microfinance Demand Survey, June 2004

[6] In February 2005 several amendments were entered to the Georgian Civil Code due to efforts of the GMSE (Georgia Microfinance Stabilization & Enhancement) project, as a result of which MFIs will be re-registered as Microfinance Institutions. This will enable MFIs to implement their activities legally, thus avoiding the fear of impending foreclosure MFIs have faced in the past. The National Bank of Georgia has already started working over the MFI draft special law which should be presented to the Parliament of Georgia by October 1, 2005.

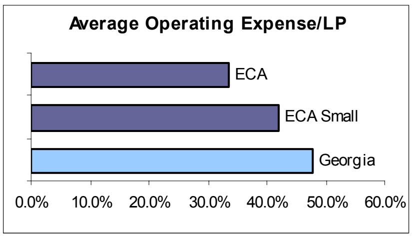
[7] The formula for financial self-sufficiency ratio does not take into account profit tax

[8] In Georgia GDP growth rate in 2003 reached 9% and was among the highest in the ECA (IMF Statistics)

OVERALL FINANCIAL PERFORMANCE		Georgian MFIs	MBB ECA Small	MBB All ECA	MBB ECA FSS	MBB All MFIs
Return on Assets	Adjusted Net Operating Income, net of taxes/ Adjusted Average Total Assets	**-1.9%**	**-3.9%**	**-0.3%**	**7.0%**	**-0.8%**
Return on Equity	Adjusted Net Operating Income, net of taxes/ Adjusted Average Total Equity	**5.3%**	**-3.9%**	**1.2%**	**13.5%**	**5.9%**
Operational Self-Sufficiency	Financial Revenue/ (Financial Expense + Net Loan Loss Provision Expense + Operating Expense)	**118.7%**	**126.8%**	**130.7%**	**152.2%**	**122.8%**
Financial Self-Sufficiency	Adjusted Financial Revenue/ Adjusted (Financial Expense + Net Loan Loss Provision Expense + Operating Expense)	**106.1%**	**100.1%**	**109.3%**	**130.7%**	**107.7%**
	REVENUES					
Financial Revenue Ratio	Adjusted Financial Revenue/ Adjusted Average Total Assets	**42.9%**	**36.9%**	**33.5%**	**37.5%**	**29.1%**
Profit Margin	Adjusted Net Operating Income/ Adjusted Financial Revenue	**-3.0%**	**-15.8%**	**-3.7%**	**21.3%**	**-15.7%**
Yield on Gross Portfolio (nominal)	Adjusted Financial Revenue from Loan Portfolio/ Adjusted Average Gross Loan Portfolio	**55.3%**	**48.3%**	**42.4%**	**45.3%**	**38.7%**
Yield on Gross Portfolio (real)	(Adjusted Yield on Gross Portfolio (nominal) – Inflation Rate)/ (1 + Inflation Rate)	**48.2%**	**36.9%**	**33.9%**	**37.1%**	**29.5%**
	EXPENSES					
Total Expense Ratio	Adjusted (Financial Expense + Net Loan Loss Provision Expense + Operating Expense) / Adjusted Average Total Assets	**42.8%**	**39.6%**	**32.9%**	**29.6%**	**29.4%**
Financial Expense Ratio	Adjusted Financial Expense/ Adjusted Average Total Assets	**4.9%**	**8.7%**	**6.9%**	**6.6%**	**7.1%**
Loan Loss Provision Expense Ratio	Adjusted Net Loan Loss Provision Expense/ Adjusted Average Total Assets	**1.7%**	**1.5%**	**1.5%**	**1.1%**	**2.3%**
Operating Expense Ratio	Adjusted Operating Expense/ Adjusted Average Total Assets	**36.1%**	**29.4%**	**24.6%**	**21.9%**	**20.0%**
Personnel Expense Ratio	Adjusted Personnel Expense/ Adjusted Average Total Assets	**19.3%**	**15.3%**	**13.3%**	**12.7%**	**11.0%**
Administrative Expense Ratio	Adjusted Administrative Expense/ Adjusted Average Total Assets	**16.9%**	**14.1%**	**11.3%**	**9.2%**	**9.1%**
Adjustment Expense Ratio	(Adjusted Net Operating Income - Unadjusted Net Operating Income)/ Adjusted Average Total Assets	**4.1%**	**5.9%**	**4.5%**	**3.5%**	**3.8%**

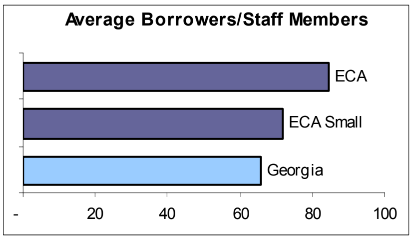
Efficiency

Georgian MFIs are less efficient than their ECA peers. Their total operating expenses represent nearly half the value of their loan portfolios. Georgian MFIs typically offer loans with short maturities and frequent repayment schedules. This is one of the reasons they are able to charge relatively higher interest rates; however it is also more costly for them to service the same size portfolio. At the same time, their group lending methodology enables them to serve a relatively high number of borrowers. So, despite their high operating expense to loan portfolio, Georgian MFIs reach more clients at a lower cost as shown in their low cost per borrower, which is comparable to that of all MFIs in the MBB.



EFFICIENCY		Georgian MFIs	MBB ECA Small	MBB All ECA	MBB ECA FSS	MBB All MFIs
Operating Expense/ Loan Portfolio	Adjusted Operating Expense/ Adjusted Average Gross Loan Portfolio	**47.8%**	**42.1%**	**33.7%**	**27.7%**	**33.2%**
Personnel Expense/ Loan Portfolio	Adjusted Personnel Expense/ Adjusted Average Gross Loan Portfolio	**25.7%**	**21.5%**	**17.9%**	**16.1%**	**17.9%**
Average Salary/ GNP per Capita	Adjusted Average Personnel Expense/ GNP per capita	**643.6%**	**548.8%**	**670.9%**	**789.9%**	**748.4%**
Cost per Borrower	Adjusted Operating Expense/ Adjusted Average Number of Active Borrowers	**185**	**242**	**299**	**196**	**158**

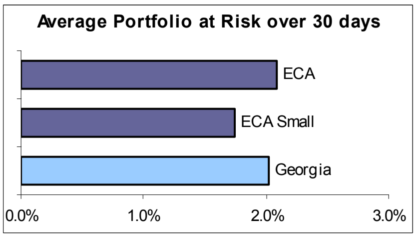
Productivity



Loan officer productivity in Georgia is on par with that of its ECA peers. However productivity in the region remains well below the average for that of the rest of the world. One reason for this is that Georgian MFIs primarily offer individual loans: MFIs that serve clients individually, either through traditional individual loan products or through a modified solidarity group lending method, generally have lower productivity levels. Georgian MFIs have a low number of loan officers per staff member that drives down the total staff productivity figures below the ECA average. In the case of Georgia, less than 45 percent of all employees are directly involved with the clients. This is well below the average for all MBB MFIs of 54 percent. This often occurs with young MFIs that are forced to allocate more resources to back office functions and have not yet achieved economies of scale. Productivity will likely improve as Georgian MFIs expand and loan officers begin to make up a larger share of their work forces.

	PRODUCTIVITY	Georgian MFIs	MBB ECA Small	MBB All ECA	MBB ECA FSS	MBB All MFIs
Borrowers per Staff Member	Adjusted Number of Active Borrowers/ Number of Personnel	**65**	**72**	**84**	**102**	**136**
Borrowers per Loan Officer	Adjusted Number of Active Borrowers/ Number of Loan Officers	**149**	**136**	**151**	**177**	**269**
Personnel Allocation Ratio	Number of Loan Officers/ Number of Personnel	**44.7%**	**53.7%**	**56.0%**	**58.9%**	**53.7%**

Risk and Liquidity



Georgian MFIs, have very low delinquency which is also generally the case in the region. Georgian MFIs achieve superb loan portfolio quality through effective incentive schemes and by employing strict repayment policies. They offer incentives for long-term clients with good credit histories in the form of better loan conditions in the subsequent cycles. This seems to be an effective strategy especially in view of the fact that contract enforcement through Georgian courts is often slow and costly. They also tend to have strict repayment policies that are respected by clients who do not want to risk losing access to future loans. Efficient tracking of late loans and collecting on overdue loans does however add to the already high costs and lowers staff availability to be generating new loans.

Although loan loss reserve levels are sufficient to cover the delinquency risk, the Georgian risk coverage rate is much lower than other MFI in ECA and elsewhere. It seems that in other countries the MFIs are more risk averse and create higher provisions for part of healthy portfolio unaffected by overdue payments.

	RISK AND LIQUIDITY	Georgian MFIs	MBB ECA Small	MBB All ECA	MBB ECA FSS	MBB All MFIs
Portfolio at Risk> 30 Days	Outstanding balance, loans overdue> 30 Days/ Adjusted Gross Loan Portfolio	**2.0%**	**1.7%**	**2.1%**	**1.2%**	**5.2%**
Portfolio at Risk> 90 Days	Outstanding balance, loans overdue> 90 Days/ Adjusted Gross Loan Portfolio	**1.4%**	**0.8%**	**1.1%**	**0.5%**	**2.8%**
Write-off Ratio	Adjusted Value of loans written-off/ Adjusted Average Gross Loan Portfolio	**1.5%**	**1.0%**	**1.6%**	**1.2%**	**3.0%**
Loan Loss Rate	Adjusted Write-offs, net of recoveries/ Adjusted Average Gross Loan Portfolio	**1.2%**	**0.9%**	**1.3%**	**1.0%**	**2.5%**
Risk Coverage	Adjusted Loan Loss Reserve/ PAR > 30 Days	**130.2%**	**319.4%**	**372.2%**	**394.9%**	**278.7%**
Non-earning Liquid Assets as a % of Total Assets	Adjusted Cash and banks/ Adjusted Total Assets	**11.0%**	**12.8%**	**10.1%**	**7.7%**	**11.9%**
Current Ratio	Short Term Assets/ Short Term Liabilities	**64923.8%**	**29437.7%**	**13692.7%**	**2458.2%**	**7822.8%**

Conclusion
Georgian microfinance exhibits many characteristics of a young and growing sector. However, Georgian MFIs have, despite their smaller scale and higher than average operating costs achieved financial self-sufficiency in a relatively short period. Were it not for high revenue taxes, they would also likely already be profitable as well. Driving their success thus far has been their discipline in maintaining exceptionally high quality loan portfolios, their devotion of a high percentage of their assets to loan portfolios, and their ability to effectively price and place products with clients who value and can use them. As a result, Georgian MFIs generate financial revenues as a percentage of total assets that are well above the ECA average, which has the highest average of all regions. However, success usually has its consequences. Georgian commercial banks have seen the impressive revenues and are poised to enter the market. This coupled with the foreseen growth in MFIs' scale will increase competition for borrowers, which will eventually put downward pressure on interest rates. Nevertheless, Georgian MFIs have overcome many challenges thus far, which bodes well for their future growth.

Notwithstanding their impressive revenue generation, Georgian MFIs have several mountains left to climb. Among them are: controlling their extremely high personnel and administrative costs, gaining access to funds to fuel growth, raising staff productivity, and working with the government to clearly define their legal status and scope of operations. The recent introduction of legal amendments to Georgian law regulating MFI operations and the political stabilization expected with the new democratic government are two important signs of progress towards creating a more efficient and conducive operating environment for microfinance.

MFC - Microfinance Centre for Central and Eastern Europe and the New Independent States – is membership-based microfinance resource centre. Its mission is to contribute to poverty reduction and human potential development by promoting a socially oriented and sustainable microfinance sector that provides adequate financial and non-financial services to a large number of poor families and micro-entrepreneurs. MFC fulfills its mission by providing high quality services and building long-term relationships with the microfinance community. www.mfc.org.pl

GMSE - Georgia Microfinance Stabilization and Enhancement - is a project funded by the U.S. Agency for International Development (USAID). The principle objective of the GMSE Project is to stabilize and strengthen microfinance institutions in Georgia. To accomplish this objective, the project awards grants to Georgian microfinance institutions based on best practices, and provides technical assistance to microfinance institutions in order to ensure their long-term stability and sustainability. Special effort will be made to ensure that rural and women-owned enterprises benefit from GMSE's work. www.microfinance.ge

The MIX - Microfinance Information eXchange - is a non profit organization that works to support the growth and development of a healthy microfinance sector. The MIX's mission is to help build the microfinance market infrastructure by offering data sourcing, benchmarking and performance monitoring tools, as well as specialized information services. The MIX is supported by the Consultative Group to Assist the Poor (CGAP), Citigroup Foundation, Deutsche Bank Americas Foundation, Open Society Institute, Rockdale Foundation and others. www.themix.org