MICROFINANCE CENTRE
for Central and Eastern Europe and the New Independent States

MICROFINANCE IN ECA ON THE EVE OF FINANCIAL CRISIS. 2009 EDITION.

MFC Bridging the Market Gap

MFC Bridging the Market Gap

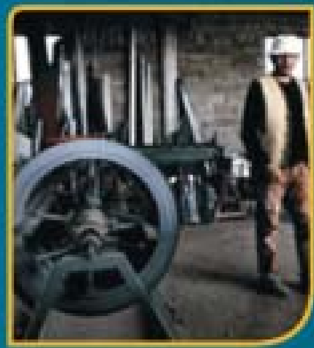
KEP

ONE STEP FORWARD

KEP Trust, formerly Kosovo Enterprise Program, is the largest microfinancial instutuition (MFI) in Kosovo with 33 branch locations covering all the cities throughout Kosovo. KEP is also the leading MFI in the country in terms of total assets and the number of customers it services.

KEP is committed to contribute in decreasing poverty among communities throughout Kosovo. This is achieved through support of groups that do not have access to financial resources: active people with low incomes, women, men and minorities that are engaged or are willing to engage in agriculture and micro-businesess, and other small businesses.



SUPPORTING WOMEN IN BUSINESS

KEP contributes directly to the enhancement of women's role inside their families and the community, by supporting them with financial resources tailored especially for them.

During the last ten years, KEP has supported over 21 thousand women with loans and different trainings. Loans to women are approximately 40% of the loans given by KEP per year.

SUPPORTING MINORITIES

One of KEP's main principles is to offer equal opportunities to all people regardless of their ethnicity, nationality or religion.

So far, KEP has supported 5,547 clients from minority groups, with purpose to help them in initiating activities in micro-business and contribute in a better integration in the Kosovo community.

SUPPORTING AGRICULTURE AND LAND CULTIVATION

Agriculture is a very important sector in our country, especially in the rural areas where economic opportunities are scarce. KEP helps farmers to establish mini-farms and cultivation of different agricultures, so that farmers can get the most out of their land.

Only in the last four years, KEP has given over 5,000 loans for farmers and stockbreeders. This has facilitated and improved the living conditions of our farmers and their families.

Number of Active Clients	19,343
Portfolio Outstanding	42,854,775 €
Clients served	45,866
Loans Disbursed	86,379
Cumulative Disbursements	199,317,120 €

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Microfinance in ECA on the Eve of Financial Crisis. 2009 Edition

November 2009

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List of Acronyms

Bel/Rus/Ukr – Belarus/Russia/Ukraine
CA – Central Asia
CEE – Central and Eastern Europe
ECA – Eastern Europe and Central Asia
EU-15 – European Union 'old' members
EAP – East Asia and Pacific
GNI per capita – Gross National Income per capita
LAC – Latin American and Caribbean
MENA – Middle East and North Africa
MFI – microfinance institution
PAR>30 – Portfolio at Risk over 30 days
SE Asia – South-east Asia
SME – small and medium enterprise
SSA – Sub-Saharan Africa
W Africa – Western Africa

Executive Summary

As in much of the rest of the word, the economic situation in the ECA region worsened at the end of 2008 – GDP growth slowed down, inflation peaked and the current account deficit widened in the majority of the region's countries.
The economic crisis had an effect on microfinance clients' households, resulting in lower business income, fewer income sources, a higher share of food expenditures in family budgets and lower remittances.
The impact on the demand for microcredit has been unequal – while many MFIs observed increased interest in their products, they also saw that loan condition preferences moved to long-term credit with a prolonged grace period.
The crisis has also brought the threat of overindebtedness. Many MFIs realized that up to a quarter of their clients might be overindebted. To cope with it borrowers usually ask for loan rescheduling, or borrow from other sources (both formal and informal) thus deepening their indebtedness. Recognizing the threat many MFIs introduced more rigid lending policies and moved towards a more careful selection of less risky clients and closer monitoring of loan performance.

At the end of 2008 the portfolio at risk over 30 days has not deteriorated dramatically – it was 3.8% for NGOs/NBFIs (up from 2.8%) and 2.1% for microfinance banks.

Despite the economic crisis MFIs in the ECA region continued growing at a rate of 33% with the total outstanding loan portfolio reaching USD 18.5 billion. The decelerating trend of growth seen since 2005 showed as yet no sharp decline thanks to the high growth of commercial banks' downscaling programmes supported by international investors. Other types of MFIs saw a significant slowdown of their growth rates of the gross loan portfolio. Some were affected by the slower expansion of their client base and others by the shrinking USD value of their portfolios due to the depreciation of local currencies.

The number of active borrowers at the end of 2008 was almost 6 million and the growth rate was higher than a year earlier. It was possible thanks to lower average loan amounts per clients. Almost half of the borrowers were served by credit unions and 70% lived in Europe and Russia.

Client deposits remain the dominant source of funds for credit operations of credit unions and microfinance banks. However, despite the growth of the total volume of collected deposits both credit unions in the majority of countries and most of microfinance banks decreased the share of savings in funding structures. For these two types of institutions other sources of funding – borrowings and equity investments - were more available than client savings, compared to the year earlier. Also NGOs/NBFIs increased the share of borrowings in their funding structure.

The majority of borrowed funds came from international investors to whom the outstanding debt of microfinance banks and NGOs/NBFIs totaled USD 2.95 billion. Although slower than a year earlier the growth rate international debt was 23% for microfinance banks and 37% for NGOs/NBFIs.
Local lenders, usually commercial banks, decreased their already low level of work in financing microfinance.

While funding liabilities of credit unions are mainly denominated in local currency, for microfinance banks almost half of their obligations to lenders and depositors come in USD or EUR and for NGOs/NBFIs as much as two-third of debt is in foreign currencies.

Chapter 1

Macroeconomic Conditions and Business Environment

The financial crisis that spread throughout the world in September 2008 following the insolvency of a large number of banks meant that financial conditions have become much tighter, capital flows to developing countries have dried up and huge amounts of market capitalization have evaporated. The crisis began in high-income countries but developing and transition countries have been caught up in its wake.

Macroeconomic Performance of the ECA Countries

While the macroeconomic performance during the financial crisis varied substantially across the Europe and Central Asia (ECA) region, many countries entered the crisis already in a weakened position which made their economies more vulnerable to shocks. Factors that contributed to this increased vulnerability include relatively high current account deficits and external debt levels, rapid credit growth, and a consumption boom financed by foreign currency borrowing. At the same time sharp decrease in commodity prices halted economic growth, especially in the countries of the Eastern part of the Region such as Russia and Kazakhstan, which are dependent on natural resources exports. Slowing down of exports led to the general economic recession with many secondary effects, including lowered demand for migrant labor and consequently reduced flow of remittances to labor exporting countries such as Moldova, Kyrgyzstan or Tajikistan.

For these reasons, ECA countries have been hit relatively early and with greater severity than other developing regions. In particular, the effects of the crisis were felt through three key transmission mechanisms – financial, product, and labor markets.

In the financial sector, spillover risks for countries with high current account deficits have created a highly uncertain environment. Before the crisis, there were differences within ECA in public sector deficits, but private sector savings gaps were large almost everywhere. This resulted in a growing current account deficit and big capital inflows, especially in Central Europe. In 2009, current account deficits in ECA will halve from -8.4 in 2008 to -4.6 percent of GDP in 2009, while fiscal deficit will triple from -1.5 to -4.8 percent of GDP. So while the private sector savings gaps shrink, government dissavings rise[1].

As a government spending decreased, unemployment rose significantly at a rate as high as 1 percent a month in some countries. The high levels of unemployment in Russia and other destination countries for migrants is especially bad news for countries that are dependent on remittances, such as Tajikistan, Moldova, Albania, and Armenia. It is estimated that Tajikistan experienced a 30 percent decline in remittances which is likely to increase number of people living in poverty. In these and other countries, the financial crisis hit poor households at the worst time, after they had been weakened by the food and fuel crises.

[1] Source: World Bank ECA -- http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/0,,contentMDK:21722062~pagePK:146736~piPK:146830~theSitePK:258599,00.html

World Bank Survey of Businesses in Eastern Europe Suggests Long-Lasting Effects of the Financial Crisis on Growth

New cross-country data from business surveys in Eastern Europe, released by the World Bank today, reveal for the first time the scale of the demand crisis that hit the region this year and how firms have responded so far. The data show a varied impact across different types of firms. These differences could have significant implications for the economic recovery of Eastern Europe and Central Asia, the region most affected by the global financial crisis.

The survey, conducted by the World Bank's Enterprise Survey team, collected data from 1,686 businesses in six Eastern European countries—Bulgaria, Hungary, Latvia, Lithuania, Romania, and Turkey—during June and July 2009. According to the data, more than 70 percent of firms identified a drop in demand as the most important effect of the crisis—even more so than the credit crunch experienced so far.

The survey found that young, innovative enterprises and companies employing a large share of qualified workers experienced severe declines in sales. "Young and innovative firms were thought to be better equipped to withstand the crisis and lead future growth," said Paulo Correa, Senior Economist, Private and Financial Sector Development, Europe and Central Asia, World Bank. "The disproportionately severe impact of the crisis on these firms raises questions about the pace of recovery of the six economies," he added.

Yet a significant number of enterprises, including domestic-oriented firms and firms in non-tradable sectors, have actually grown—indicating that the global downturn may be causing structural changes in the economy. Firms responded to the crisis by relying more on internal funds to finance working capital, delaying payments to tax authorities or suppliers, and attempting to restructure their debt. The majority of firms expected sales to fall no further, and layoffs to continue between August and December 2009.

“Data from the next two rounds of data collection will shed more light on how quickly countries in the region will recover. The next rounds of data collection will take place in January and June 2010,” said Jorge Luis Rodríguez-Meza, Program Coordinator, Financial and Private Sector Development, World Bank Group. “These rounds will be used to monitor the impact of the crisis and the pace of recovery over time,” he added.

Source: http://www.enterprisesurveys.org/documents/PR-ECA-crisis.pdf

Overall GDP growth worldwide declined to 2.5% in 2009. In developing and transition countries overall GDP growth remained high in 2008 but experienced a slowdown through the decline of investment, lower commodity prices, slackening remittance receipts and scaling back of aid flows.

Figure 1.1. Growth of real GDP (annual change) in the regions of the world

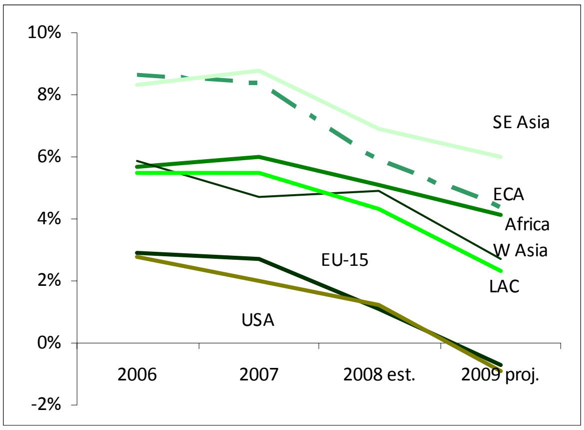
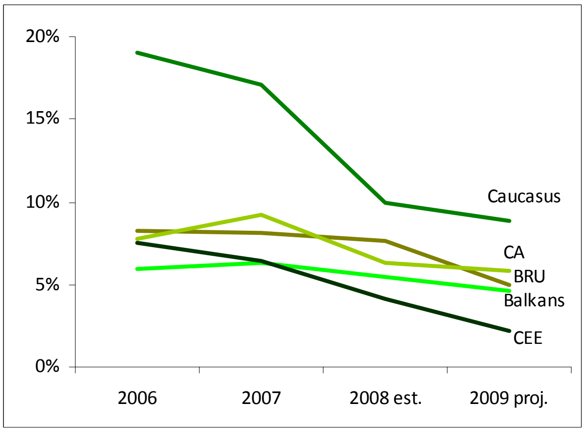


Figure 1.2. Growth of real GDP (annual change) in ECA sub-regions



Source: UN/DESA

The economies of the ECA region continued to grow at a high rate compared to other regions, despite a deceleration from the previous year's strong economic growth. Aggregate GDP grew by about 7% in 2008 and is expected to fall to 5.4% at the end of 2009.

The CEE countries saw the greatest slowdown, mostly acute seen in the Baltic States while the Caucasus, notably Azerbaijan, continued growth of more than 10%.

Inflation accelerated in the ECA region in the first half of 2008 driven by increasing world food and energy prices, strong domestic demand and rising real wages. During the second half of the year inflationary pressures weakened as the world commodity prices started to fall and domestic inflationary pressures subsided.

Food expenses accounted for a significant share of the consumer basket hence rising food prices have had a marked impact on headline inflation. In some countries such as Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan and Ukraine consumer price inflation peaked at around 20%.

Figure 1.3. Consumer price inflation (% change) in the regions of the world

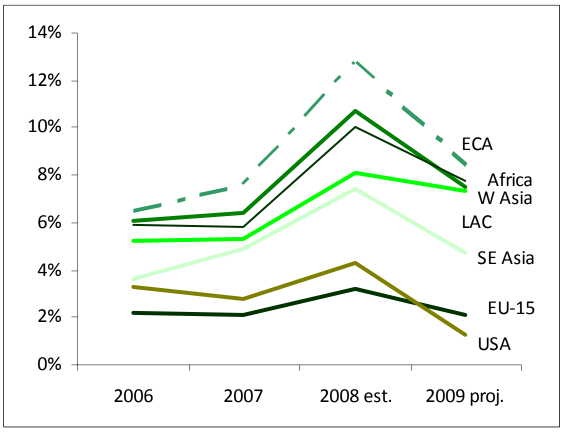
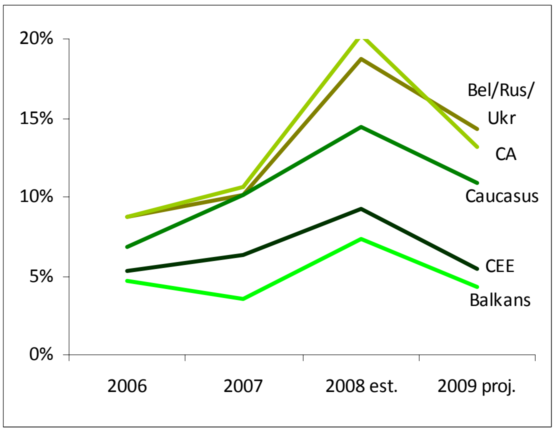


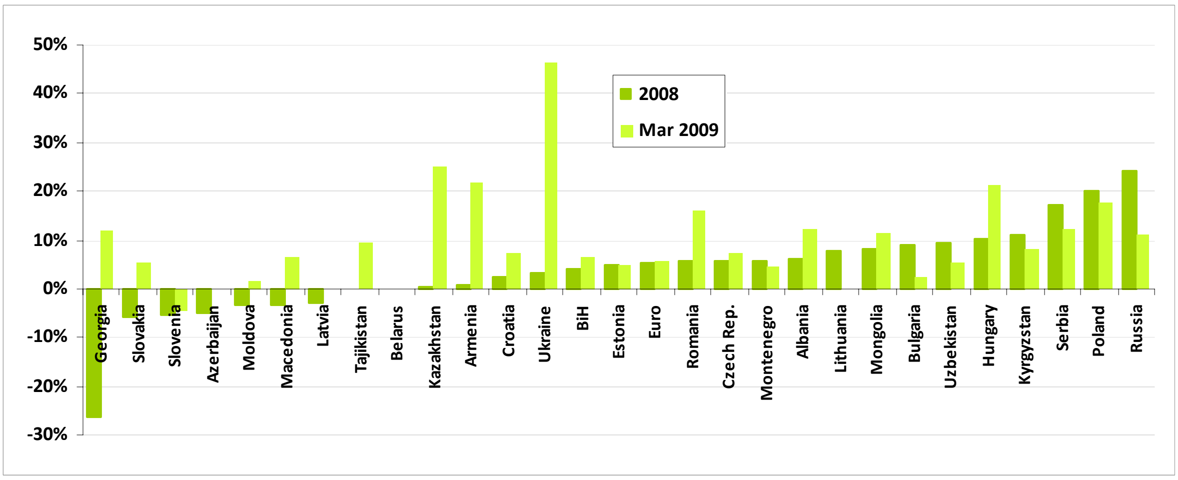
Figure 1.4. Consumer price inflation (% change) in ECA sub-regions



Source: UN/DESA

The increased volatility and losses in the banking sector caused local currencies to depreciate vis-à-vis the EUR and USD. Until September 2008 currencies were firm against the EUR and USD and then started depreciating strongly towards the end of the year.

Figure 1.5. Currency exchange rates to USD (% change) in the ECA region



Source: Central Banks of the respective countries

Global Financial 'Crisis Hits Home' in Europe, Central Asia

The global financial crisis is having a devastating impact on families in emerging Europe and Central Asia, with the risk of the region giving back a fifth of the poverty reduction gains of the past decade, according to a new World Bank report. By 2010, there could be over 10 million more poor people in the region, and close to an additional 25 million more who were almost middle class but now just above the poverty line (relative to pre-crisis projections) with the potential of losing their homes, jobs, and basic services.
The new report, The Crisis Hits Home - Stress-Testing Households in Europe and Central Asia, takes a unique look at the impacts of the global financial crisis at the household level in this region. According to the report, families are being hit by credit market shocks, the increasing prices of goods and services, and rising unemployment.

"The global financial crisis risks reversing the substantial gains and improvements in living standards achieved by the Europe and Central Asia region over the last few years," said Luca Barbone, Director for Poverty Reduction and Economic Management in the World Bank's Europe and Central Asia Region. "One of the tragic impacts of the crisis has been that the middle income countries that had turned the corner are the ones hardest hit. Across countries in the region, unemployment levels have risen while economic activities have collapsed. Poverty will rise. Families are being stretched to the limit."

Credit market shocks
The report says that stress tests recently conducted by the World Bank on household loans show that ongoing macroeconomic shocks to interest rates, exchange rates, and household income may increase the numbers of families that are unable to pay back their debt. For example, up to 20 percent more families with mortgages and other loans in Lithuania and Hungary could be at risk of defaulting on their loans.

Price shocks
The food and fuel crisis may not be over. International commodity price levels have not returned to pre-2007 levels. In addition, falling currencies in some countries are resulting in a new round of price increases. Because food represents a very large share of the poor's total consumption - in some of the low-income countries of Europe and Central Asia, the food share of consumption among the poor is 70 to 80 percent - the poorest consumers will again be vulnerable.
In addition, in a number of countries, such as Belarus, Moldova, and Ukraine, the utility reform program remains largely incomplete. As a result, a number of countries will have to adjust their energy tariffs to cost-recovery levels in the coming years.

Employment and income shocks
Over the recovery period following the 1998 Russian crisis through 2006, more than 50 million people moved out of poverty in the region. However, the poverty impact of the crisis will be enormous. The rapidly deteriorating global economic environment is eroding the region's substantial gains and, given the increased poverty projections, is threatening the welfare of a total of about 160 million people - close to 40 million people who are poor and about 120 million people who are just above the poverty line. According to the report, it is the middle-income Commonwealth of Independent (CIS) countries that have seen the largest and most significant downward revisions to their gross domestic product growth projections.

Coping with the crisis
According to the report, lessons from the region's own experiences with previous crises suggest that temporary economic shocks have a lasting impact on human development, as families cut back their education and health investments in response to a banking or exchange rate crisis. Compared to past crises, the scope for households in Europe and Central Asia to fall back on their traditional coping strategies - from secondary employment and money transfers from friends and family to working abroad - is much more limited.

Against this background, social safety nets will play a crucial role and should be protected even though revenues are expected to fall. Indeed, protecting these programs - and possibly expanding the well-performing ones where some reallocation of resources is possible - is critical to helping families deal with the crisis.
The region's social protection systems currently vary in size and targeting performance across countries. However, according to the report, most countries in the region have at least one targeted safety net program that can possibly be scaled up in response to the crisis by increasing the value of benefits they provide or by expanding their coverage to reach those households still currently outside the system.

Source: US Fed News Service, Including US State News. Washington, D.C.: Dec 8, 2009

CoopEst

finance for social economy | initiatives in central eastern europe

CoopEst is an investment facility founded by key players in Social Economy in France, Belgium, Italy, Malta, Norway and Poland, and supported by the International Finance Corporation (World Bank Group) and by the European Investment Fund through the Jasmine Facility. CoopEst has recently doubled its investment capacity up to €30 million.

CoopEst aims to provide quasi-equity and long-term financial support through subordinated loans, long-term senior loans, and guarantees to sustainable and socially responsible projects in Central and Eastern Europe, enabling them to leverage further funding for the development of their activities.

Eligible institutions and initiatives are cooperative banks, savings and credit unions, micro-finance companies, and other banking and non-banking financial institutions that are economically sustainable with a strong attachment or interest in socially responsible businesses.

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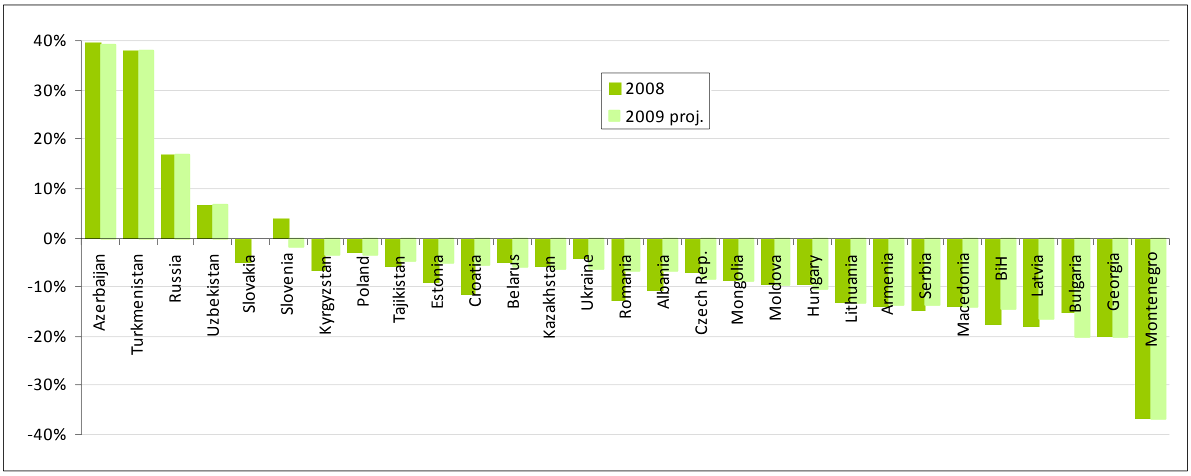
The price increases had major economic effects. High oil prices increased current account deficits in a number of countries which are heavily dependent on food and energy imports. Only in oil-rich countries, rising exports coupled with high oil prices helped to generate current account surplus.

Figure 1.6. Current account balance/GDP (% change) in the ECA region



Source: EBRD Selected Economic Indicators

Remittances

After several years of high growth, remittance flows in the ECA region dropped sharply in 2008 from 34% to 12%. However, in some countries such as Macedonia, Kazakhstan, Ukraine a two-digit growth in transfers was observed. In the sub-regions the highest growth in the volume of inflows was seen in Kyrgyzstan, Russia and Uzbekistan.

Although the flows were still positive in 2008 they are expected to show negative growth of -10% in 2009.

Figure 1.7. Remittances inflow (% change) in the regions of the world

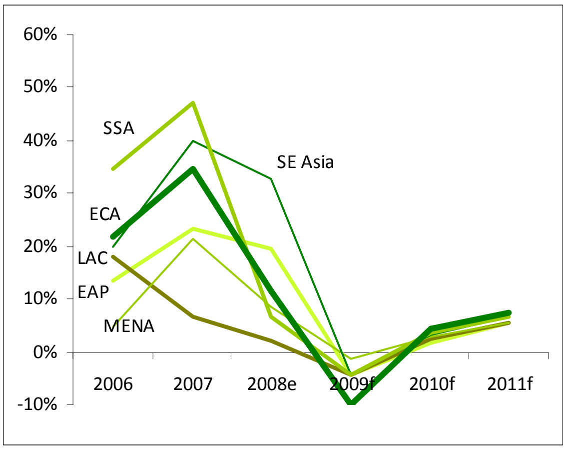
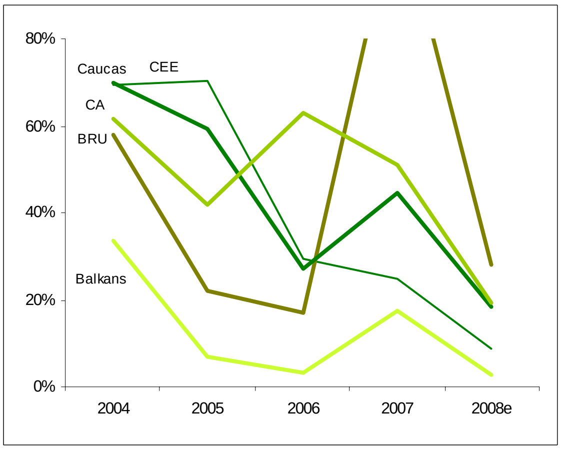


Figure 1.8. Remittances inflow (% change) in ECA sub-regions



Source: World Bank Remittances Database

Banking Sector and Lending

Banks in Eastern Europe and NIS countries have been badly affected by the crisis. The banking system was privatized in 1990's and suffered substantial losses by the end of the last century, only to recover with the help of foreign capital. At present most banks in the CEE and SEE region, and to a lesser degree in CA and Russia are foreign-owned. Many banks in Germany, Austria, Italy, Sweden and other states awarded loans amounting to several hundred billion Euros to Eastern European countries. These loans are now overdue. Even the loss of just one of these loans could lead to the state bankruptcy of some countries. According to the World Bank, credits of least €200 billion are under threat.

The situation in other countries is equally gloomy. Many banks in Russia and Kazakhstan were exposed to toxic assets by participating in international financial operations which before the crisis was seen as a sign of progress and financial sophistication. The crisis left many banks insolvent forcing the government to offer substantial bailouts, including purchase of equity of some major banks (as was the case of Kazakhstan). To prevent runs on banks by the public trying to withdraw their deposits, many governments also introduced and enhanced the deposit insurance protection.

While these and other efforts may have helped to avert the collapse of the banking system, the immediate effect was a drastic reduction of credit to firms and households, which led to further contraction of the real economy. In Romania[2], for example, during March to May 2008 the growth rate of loans granted to the private sector slightly reduced and posted a faster decline between June and August 2008, so that in the September-November 2008 the growth rate of lending to private sector diminished rapidly, reaching the lowest level of the last three years (-9.3% to 34.9%). The trend of decline that characterized the dynamics of credits both in lei and foreign currency, posting a three and a half year low. However, loans in foreign currency continued to be more dynamic than those in domestic currency (particularly in case of households) so that the average share of foreign

Kazakhstan: Bank Nationalizations - Crisis to Run Further

In 2009 Kazakhstan has nationalized BTA Bank and Alliance Bank after both failed to meet capital and liquidity ratios. The government purchased a 78% stake in BTA, the country's largest lender, injecting US$2.07bn in new capital in the process. Alliance has offered to sell a 76% equity stake to government welfare fund Samruk-Kazyna for a token sum of KZT100.

This is the first major bank nationalization in the CIS region to occur during the ongoing financial crisis, though several minor banks have been nationalized in Russia. Combined, BTA and Alliance have assets worth US$34.5bn or over one-third the entire banking system's market share. The latest nationalizations follow earlier government purchases of 25% stakes in the second and third largest lenders: **Kazkommertsbank** and **Halyk**. Combined, these two banks control US$36.3bn or 34.8% of total banking system assets.

The government of Kazakhstan claims that the purchase of BTA equity is only a temporary measure and that they would be looking to sell at least part of its stake as soon as the initial purchase transaction is completed. Indeed, senior officials from Russian bank **Sberbank** have already flown to Kazakhstan to negotiate the purchase of a significant portion of the government's BTA holdings. This was confirmed by comments from Prime Minister Karim Masimov on February 2, where he explicitly stated that the government was in talks with Sberbank.

The Kazakh financial regulation agency has dismissed BTA Chairman Mukhtar Ablyazov as part of the nationalization. Under amendments to the financial stability law, introduced in 2008, key shareholders and top managers can be prosecuted in criminal courts in the event of a bank failure.

[2] Driga, Imola and Guta, Anca Jarmila, Romanian Bank Lending during the Financial Crisis. Young Economists Journal, No. 12, April 2009. Available at SSRN: http://ssrn.com/abstract=1431628

currency loans in total lending to the private sector recorded a peak of the last three years (55.9%).

So far the International Monetary Fund has been forced to intervene to provide financial help for Hungary, Romania and Ukraine in order to prevent the collapse of their economies. The latest prognoses for the region are gloomy.

During the past two years, Latvia's economy shrank by more than 24 percent and, according to the IMF, the country's gross domestic product will decline a further 4 percent this year. Estonia's total indebtedness amounts to 140 percent of its GDP and is only exceeded by Romania, with 160 percent. Baltic states are estimated to have the highest levels of toxic assets (14.5 percent) followed by Estonia (12 percent), Romania (11.2 percent) and Bulgaria (10.1 percent). Levels are also high in Lithuania and Hungary. With the economic downturn set to continue in these countries in 2010, the levels of these bad loans are also set to rise.

An additional factor is rapidly rising unemployment, which in turn increases indebtedness of individual consumers. Unemployment in Eastern Europe is already clearly higher than in the West, and this difference will continue to grow. The number of Eastern European countries with an official unemployment rate of more than 10 percent has grown in the past few months.

Latvia has the highest official level of unemployment at 22 percent, while double-digit jobless rates exist in Poland, Hungary, Slovakia, Slovenia, Serbia and Croatia. According to figures from the First Bank AD Novi Sad, unemployment in Serbia will rise from the current 16.5 percent to 18.5 percent in 2010. At the same time, such official unemployment figures invariably tend to underestimate the real situation. Taking into account underemployment, the real unemployment rates are likely to be much higher.

Business Environment

Structural reforms in most countries have driven ECA's ongoing success. According to the 2008 Doing Business Report, ECA countries are reforming the most rapidly, surpassing even East Asia on the ease of doing business, and four ECA countries (Croatia, FYR Macedonia, Georgia, and Bulgaria) were among the top 10 performers worldwide. Integration with the European Union (EU) has been key to the reform process in many ECA countries. Bulgaria and Romania joined the EU in January 2007, bringing the number of member countries to 27. Slovenia joined the Euro currency area as the bloc's 13th member state.

Despite strong growth, ECA countries still face significant challenges, including large sub-national disparities, rapidly aging and declining populations, persistent youth unemployment, and, especially in the low-income countries, weak public and corporate governance. Countries must also work to mitigate the threats posed by HIV/AIDS, drug addiction, human trafficking, natural disasters, and environmental degradation.

Summary

ECA countries have been severely impacted by the financial crisis, although the extent of that impact was uneven across the region. There have been major changes in economic activity and a reshuffling of financial sector, including government interventions to salvage commercial banks.

Chapter 2

Microfinance and Financial Crisis

Background

The impact of the crisis on the microfinance sector is less spectacular and less visible: it did not get reported widely in the media and less attention was paid by the regulators and policy makers as MFIs do not pose a systemic risk to the financial system in the way that the big banks do. Nevertheless, it is important to review the immediate consequences of the economic slowdown due to the global financial meltdown on microfinance operations.

At the beginning of 2009, when the impact of global crisis had already been felt for a few months, MFIs were able to reflect on the change that happened in the lives of their clients, in MFI operations and their access to funding. MFC gathered information about post-crisis situation through a survey[3], whose results are briefly summarized in this chapter.

Who Was Affected Most?

When asked for the assessment of the situation in their clients' lives, the majority of MFIs observed that entrepreneurs, in particular those engaged in trade, were the most affected by the crisis due to lower demand for their products. In generally unfavorable economic conditions customers tend to spend less on goods and services. In the opinion of 60% of the surveyed MFIs food has become an even larger part of expenditure while other items such as health expenses became less substantial.

World Vision: Client Challenges in the ECA Region

Despite the many challenges arising from the financial crises World Vision-affiliated MFIs in the Eastern Europe region, including the Balkans and Caucasus, are striving to maintain stable operations and ensure a sense of security for their clients.

'Microfinance institutions in our region are facing serious problems but also opportunities. The current situation opens horizons for new markets and clients, as traditional banks have almost completely stopped their lending to small businesses and farmers. It's exactly in difficult times like this where microfinance shows that it's different from commercial banking', said Gerlof De Korte, VisionFund Regional Director. The MFIs are under pressure to reduce budgets and optimize work but also to try and gain support for sufficient funds to maintain the MFIs through this downturn.
As clients struggle with reduced income, the quality of the portfolio of the MFIs has deteriorated. Their portfolio at risk has increased in the past two months as a direct result of the financial crisis. MFIs have adjusted their lending policies and procedures to better protect clients from becoming over indebted and improve the portfolio quality.

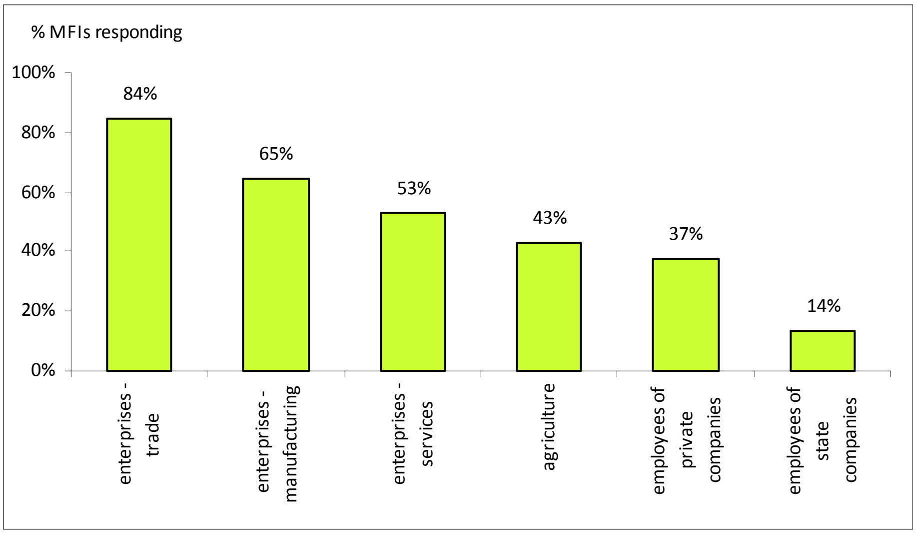
Of all the World Vision regions, the Eastern Europe region has the largest loan portfolio making up more than 72% of the global portfolio. Seven MFIs showed a growth of 12.8% in 2009 in the number of active borrowers. The outstanding portfolio of US$274 million was invested in more than 151,000 clients by March 2009. Microfinance impacted nearly 144,000 children in the same period.

Source: http://www.alertnet.org/thenews/fromthefield/wvmeero/eb70eb66e9cfd542a87a6adcba07ccb0.htm

[3] 55 MFIs were surveyed between February and May 2009 (47 NGOs/NBFIs, 4 microfinance banks, 4 credit unions)

Farmers and enterprises working in agriculture are considered to be in a better situation as the demand for food (mostly basic foodstuffs) remained unchanged.

Figure 2.1. MFI perception of the most affected types of clients by employment type



The effect of the crisis on businesses shows in lower business income of microfinance clients and fewer opportunities to earn additional income. More than half of MFIs observed that there were lower remittances flows to their clients.

Figure 2.2. MFI perception of the impact of the crisis on client livelihood

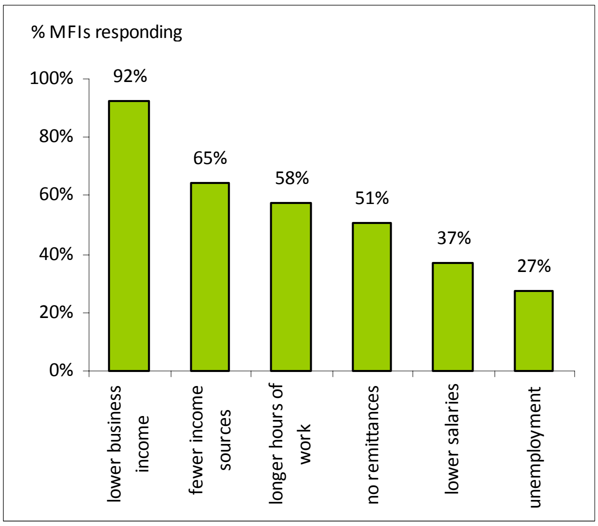
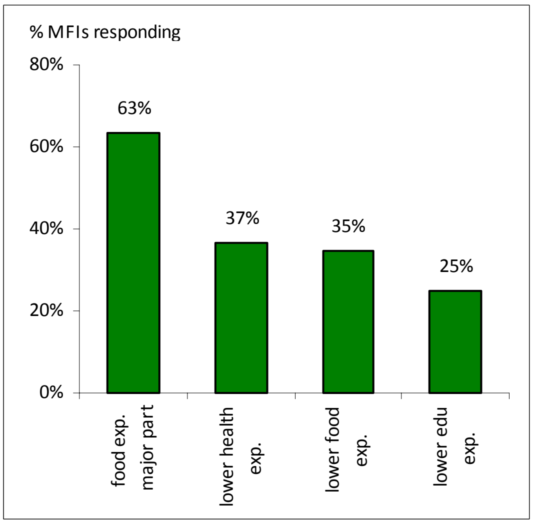


Figure 2.3. MFI perception of changes in the household expenditure structure of their clients



Demand for Credit

The new conditions translated into a change in the demand for credit. Despite the recession almost half of the surveyed MFIs observed an increase in the demand for credit. Only 30% of MFIs noticed that fewer clients applied for loans. Several MFIs observed the inflow of a new type of clientele – former bank clients. In times of crisis commercial banks in several countries stopped lending to

microenterprises leaving MFIs as the only source of microcredit. Additionally, the increasing number of returning migrants turned to MFIs for loans that would finance their start-up enterprises.
Also, preferences changed - clients started asking for longer term loans and with an extended grace period.

Figure 2.4. Changing demand for credit among MFI clients

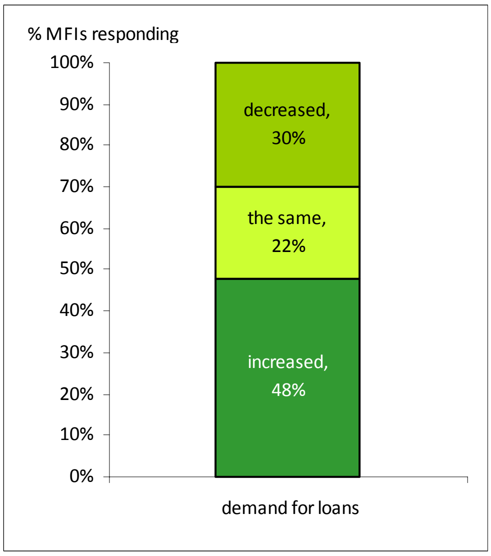
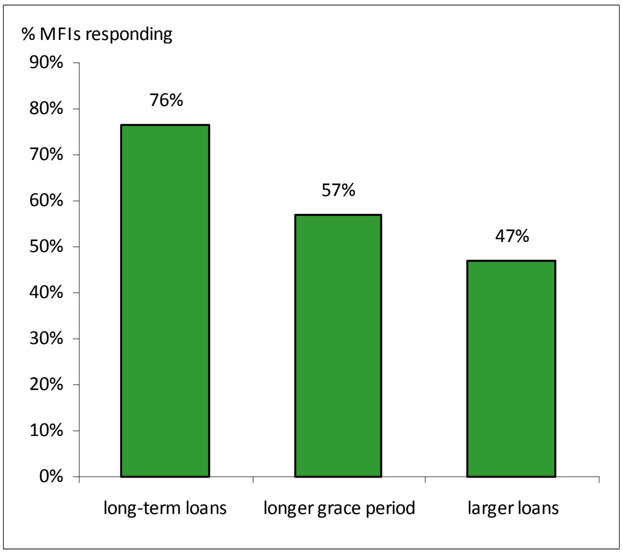


Figure 2.5. Preferred loan conditions



In answer to the new situation MFIs reviewed their lending procedures. In order to respond better to the change in demand MFIs adapted loan conditions – term (mostly longer) and grace period (longer). Some MFIs introduced new loan products while others reduced the variety they offered to clients.

Those institutions which observed a diminishing interest in credit engaged in PR campaigns, loyalty programmes, introduced new marketing methods to retain old clients and attract new ones.

Indebtedness

The majority of MFIs observed that up to a quarter of their clients are overly indebted. 40% of respondent MFIs found that up to a half of their clientele have too much debt. In such cases MFIs see

Client Indebtedness Crisis: Bosnia and Herzegovina

Bosnia, once a poster child for microfinance experiences serious challenges as a result of the financial crisis and economic recession. While not all of them are an immediate result of the financial crisis, economic slowdown exacerbated the weaknesses of the microfinance system, which worked well in good times but proved inadequate in times of a severe crisis.

The microfinance sector experienced a period of rapid growth and high profitability since 2006 and consolidation of the sector with high portfolio quality with PAR>30 days less than 1%, low foreign exchange risk (local currency pegged to the Euro) and strong equity position. Subsequent very high competition among MFIs chasing growth targets led to excessive lending and over-indebtedness of clients, resulting in credit risk reaching 30% of outstanding loans for some institutions. Many clients took out loans from various MFIs as there was no system to verify their outstanding debt from other institutions, and found it impossible to repay the loans.

One of the key lessons from the crisis is the need for a “return to basics”: focus on portfolio quality and client needs, and in particular avoiding excessive lending by better information-sharing among MFIs and use of the Credit Bureau services.

Source: “Microfinance Meltdown in Bosnia: A View from the Field” – the SEEP Network Conference session notes

clients turning to them for loan renegotiation, so that the terms of their debt obligations are easier to meet. However, half of the MFIs also realize that borrowers look for the support of their families in raising money for debt repayment or borrow from another financial institution, thus falling into even deeper indebtedness. Interestingly, almost 25% of MFIs observed that their clients often do not undertake any action to solve their excessive indebtedness problems.

Figure 2.6. MFI perception of overindebtedness of their clients

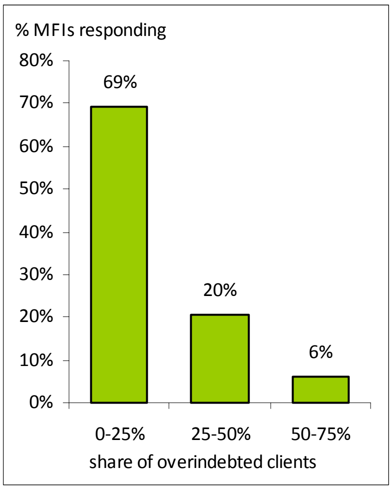
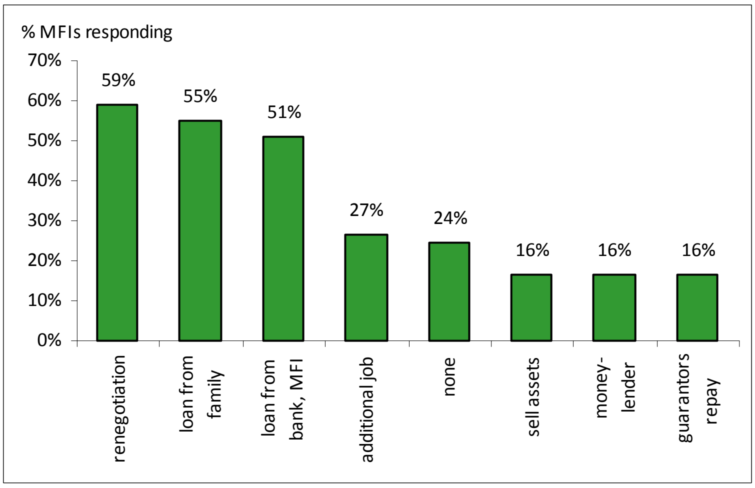


Figure 2.7. MFI perception of coping mechanisms utilized by microcredit clients in case of repayment problems



Loan Repayment

In order to prevent the increase of indebtedness MFIs introduced several kinds of changes in their loan disbursement procedures. The most common is a more thorough analysis of the loan applicant, including site visits, stricter eligibility criteria, higher collateral requirements. MFIs also use more often information from a credit bureau, if one exists. In total, 60% of surveyed MFIs stated that they introduced more rigid lending policies and 76% now reject more applications than in the past.

Some MFIs give preference to repeat clients, thus relying on the relationship with the borrower as a form of security. Others, quite to the contrary, restrained the reliance on the past credit performance as the indicator of future repayment discipline. They see that instability of client's economic situation influences the ability and willingness to repay far more than the character-based sense of obligation.

In dealing with clients who have repayment problems MFIs make more frequent visits to their business place (88% of MFIs stated that loan officers make more field visits), make reminder calls about the repayment date (80% of MFIs). An individual approach and personal dealing with the repayment issue usually results in reducing delinquency.
Rescheduling, despite being the preferred solution for clients is done by less than half of the surveyed MFIs (48%).

Efficiency and Operational Budgets

On an operational level, some MFIs had to review their budgets and forecasts, but the overall cost efficiency did not worsen. In total, 74% of MFIs declared that their operational efficiency either improved or did not change. In order to achieve such a situation MFIs utilized the following techniques: better cost management, reduction of inefficiencies through process mapping and reengineering, limitations on staff development or personnel reduction, higher loan officer productivity (caseload), delinquency reduction. 57% of MFIs did not increase their interest rates on microcredit or even lowered them, but 43% raised the rates in order to improve income flows.

Access to MFI Funding

Figure 2.8. Change in the access to funding and cost of borrowing

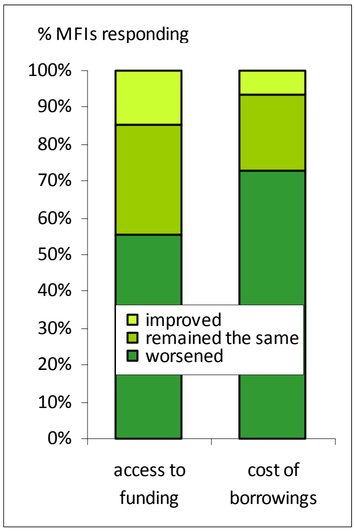


Figure 2.9. Change in the access to funding in various currencies

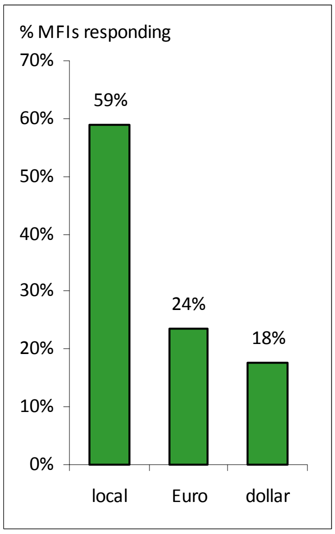
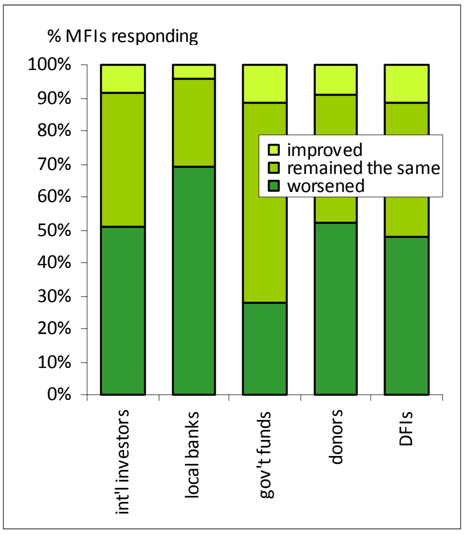


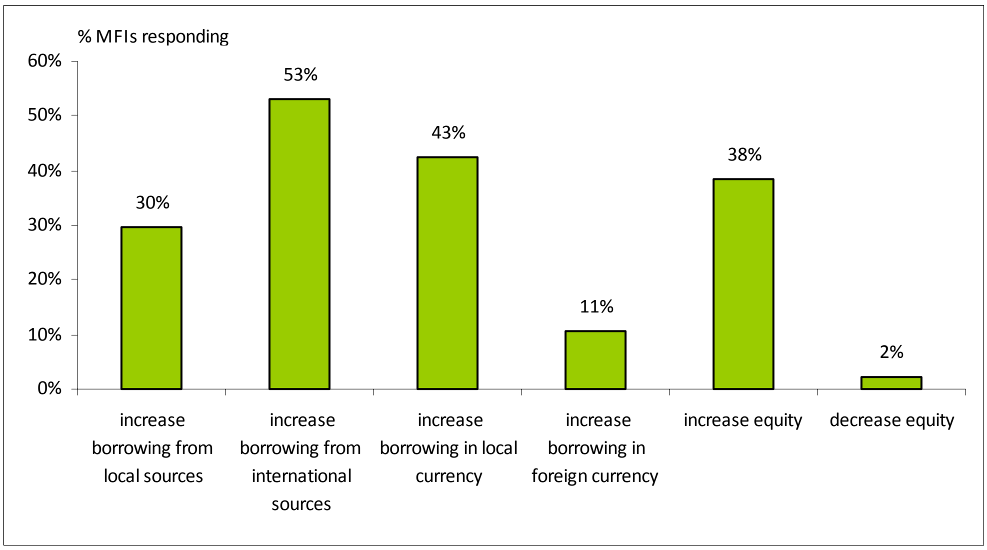
Figure 2.10. Change in availability of funds from various sources



Over half of the surveyed MFIs have already seen that there was lower availability of funding at the beginning of 2009, mostly from local banks and in the local currency. 45% did not see any change in the supply of funds from international investors and some 10% even experienced easier access to funds from international investors or development financial institutions. The increase of the cost of funding was observed by 73% of MFIs.

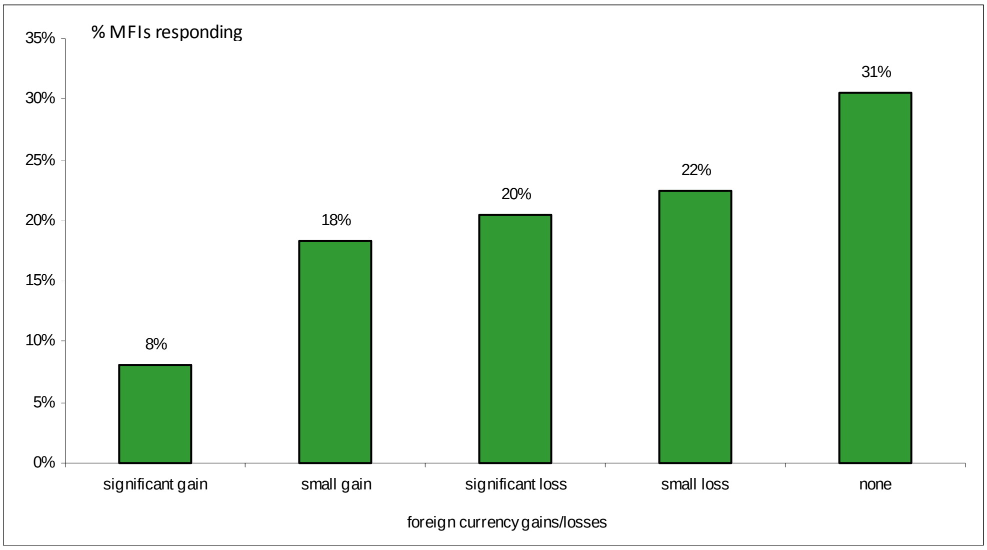
Despite the difficulties, 43% of MFIs plan to attract more local currency funding, counting mainly on international investors rather than local sources. Over one-third of MFIs plans to raise more equity.

Figure 2.11. Planned changes in funding sources



As the majority of currencies depreciated against the EUR and USD after several years of strengthening vis-à-vis foreign currencies more MFIs experience foreign currency losses, 20% of them even significant losses. Only 10 MFIs, the largest ones, use hedging mechanisms to protect themselves against fluctuations of the currency rates in which they borrow funds.

Figure 2.12. Share of MFIs affected by foreign currency exchange gains and losses



Summary

As the surveys shows, microfinance has been severely impacted by the crisis in many ways. The immediate impact came from two transmission mechanisms: weakened demand for microcredit due to lower demand for goods and services in local markets also reinforced by the lower disposable income due to the decreased flows of remittances. At the same time funding sources available to microfinance institutions diminished as lending became more risky, leading to less funding at much higher interests rates.

At the same time the crisis exposed many weaknesses of MFIs which were overlooked or ignored in good times, but which had a pronounced impact during the crisis. An example of Bosnian microfinance system overextending credit beyond borrowers' ability to pay, without proper checks and balances, led to a widespread repayment crisis, which to a larger degree could have been avoided.

Yet overall microfinance sector fared well during the crisis and again proved to be quite resilient to macroeconomic shocks, although a general slowdown of activities has been noted in all countries throughout the region.

Chapter 3

Microfinance Sector Overview

Microfinance in the ECA Region

The Europe and Central Asia (ECA) region consists of 22 countries, with a total population of about 360 million people. For the purpose of the analysis the region has been divided into five sub-regions: the Balkans, Central and Eastern Europe (CEE), Belarus/Russia/Ukraine, Caucasus, and Central Asia (CA). These sub-regions are characterized by various levels of economic growth, stage of financial sector development, wealth and poverty levels. There are also differences in the level of maturity and consolidation of microfinance between the regions:

- More mature microfinance markets are in the South Eastern Europe, with Bosnia being the leader in the region,
- Belarus/Ukraine/Russia are relatively younger markets, with Belarus barely starting to develop microfinance
- Microfinance in Central Asia is highly fragmented, with the presence of a large number of very small institutions in addition to a few larger providers: an average microfinance institution (MFI) in Central Asia is twenty times smaller than an average MFI in the Balkans
- Microfinance in the Caucasus region is less fragmented than in Central Asia but MFI's are still much smaller than those in South Eastern Europe
- The new EU entrants in Central Europe have relatively little in terms of new microfinance and the lower end market is dominated by credit unions and banks.

Overall, microfinance in the ECA region is very diverse, dominated by the traditional credit unions and a very strong role of specialized microfinance banks and bank following downscaling strategies.

Number of Microfinance Institutions

The microfinance industry in the ECA region continues to be dominated by credit unions which constitute the majority of MFIs. There have not been any substantial changes in the number of institutions that provide microcredit in the ECA region.

Figure 3.1. Number of microfinance providers by institutional type

	credit unions	NGOs/NBFIs	downscaling banks	microfinance banks	total
Balkans	128	30	21	7	186
CEE	3,791	78	10	3	3,882
Belarus/Russia/Ukraine	2,451	10	31	2	2,494
Caucasus	48	28	18	5	99
Central Asia	538	93	15	4	650
ECA total	**6,956**	**239**	**95**	**21**	**7,311**

During 2008 three microfinance banks started operating in the ECA region – two as a result of a transformation from non-bank financial institutions (Georgia and Moldova) and one greenfield bank which started lending operations in Armenia.

ProCredit Group Opens a New Bank in Armenia

In early 2008 ProCredit Group expanded and enhanced its global presence by opening a new bank - ProCredit Bank Armenia, serving small businesses in this country. Including ProCredit Bank Armenia, the group now comprises of 22 financial institutions throughout Latin America, Europe and Africa.

ProCredit Bank in Armenia is a customer-oriented, socially responsible bank, providing high-quality and affordable services to ordinary people, placing emphasis on lending to very small, small, and medium-sized businesses and developing a savings culture among ordinary people. This new entrant is seen as a vital addition to the banking sector challenging more traditional banks in the country largely ignoring the SME and microenterprise segment.

Active Borrowers

At the end of 2008 almost 6 million people were borrowers of microfinance institutions. Almost half of them were indebted in credit unions and another quarter in NGOs/NBFIs. In each of the sub-regions except the Caucasus the number of active credit users exceeded 1 million.

Figure 3.2. Number of active borrowers by institutional type

	credit unions	NGOs/NBFIs	downscaling banks	microfinance banks	total
Balkans	38,198	519,204	50,656	393,774	1,001,832
CEE	1,827,339	75,075	32,228	108,747	2,043,389
Belarus/Russia/Ukraine	814,837	55,687	240,460	59,285	1,170,269
Caucasus	7,057	297,619	135,037	254,332	694,045
Central Asia	133,325	378,144	110,795	439,134	1,061,398
ECA total	**2,820,757**	**1,325,729**	**569,176**	**1,255,272**	**5,970,933**

Figure 3.3. Active borrowers growth rates

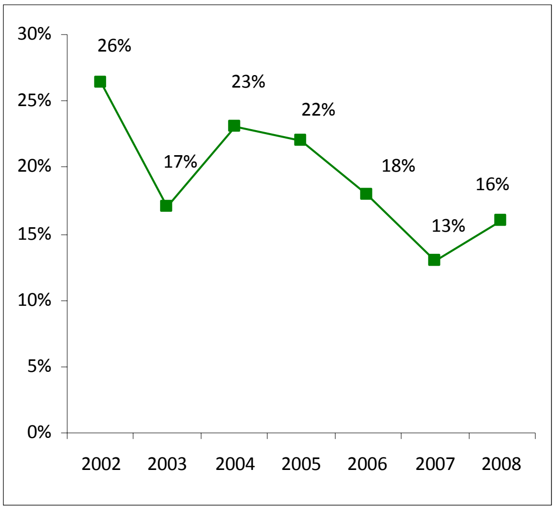
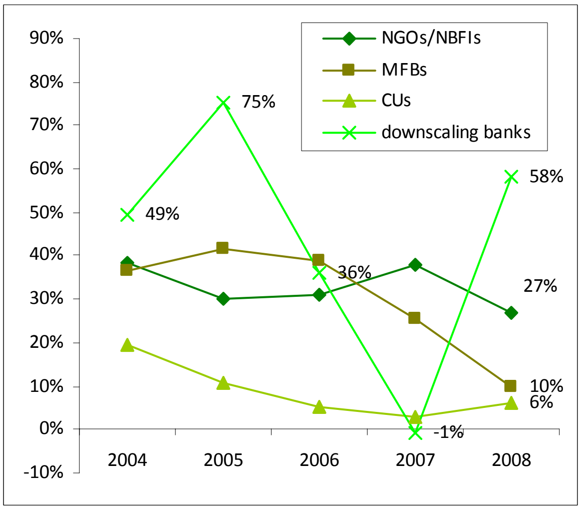


Figure 3.4. Active borrowers growth rates by institutional type



Mongolia: Successful Outreach

In the course of the last ten years the Mongolian microfinance industry has experienced rapid growth and the largest MFIs have generated profits. Taking into account the very low population density of rural Mongolia, a nomadic population, a harsh climate, the seasonality of demand for financial services, high covariance risk, and very poor rural physical infrastructure, the achievements of these MFIs is impressive.

Khan Bank, XacBank, and the Mongol Post Bank dominate the microlending market in terms of the number and volume of loans outstanding. In terms of depth of outreach, however, the NBFIs Vision Fund and TransCapital are the leaders. Contrary to microfinance methodologies used in other countries, the majority of loans in the microfinance sector are individual collateralized loans with terms of 12 months. There are no licensed apex banks in Mongolia. There is, however, a government-led wholesale lending institution, the MicroFinance Development Fund (MDF).

Although nearly every financial institution in Mongolia provides a significant percentage of its services to low-income clients, not all classify these activities as microfinance. Only one commercial bank and three NBFIs *specifically* market themselves as “microfinance” institutions: XacBank, Vision Fund, TransCapital, and Credit Mongol. The typical “microloan” refers more to enterprise loans, which are usually greater in value than the *MicroBanking Bulletin* proxy of 64.9 percent of per capita gross national income (GNI) in Central Asian nations. For example, XacBank reported in its 2007 annual report that its average microloan size was $19,600.

Microfinance is regulated by the same laws and regulations that govern the mainstream financial system. This means that specific laws do not directly relate to microfinance institutions, their creation, or licensing, nor do specific tax breaks or a regulatory or supervisory regime apply to them. Likewise, there is no specific national policy on microfinance.

A considerable portion of the loan portfolio of the key microfinance players is financed through external borrowing, a large share of which is in foreign currency. Since only part of these foreign currency borrowings can be offset by onlending in foreign currency, these liabilities are a growing concern. With the current turmoil in the financial sector and increased inflation, microfinance banks will not be able to rely on customer deposits as a source of financing.

Source: Mongolia: Microfinance and Financial Sector – Diagnostic Study. Final Report. MIFA, January 2009

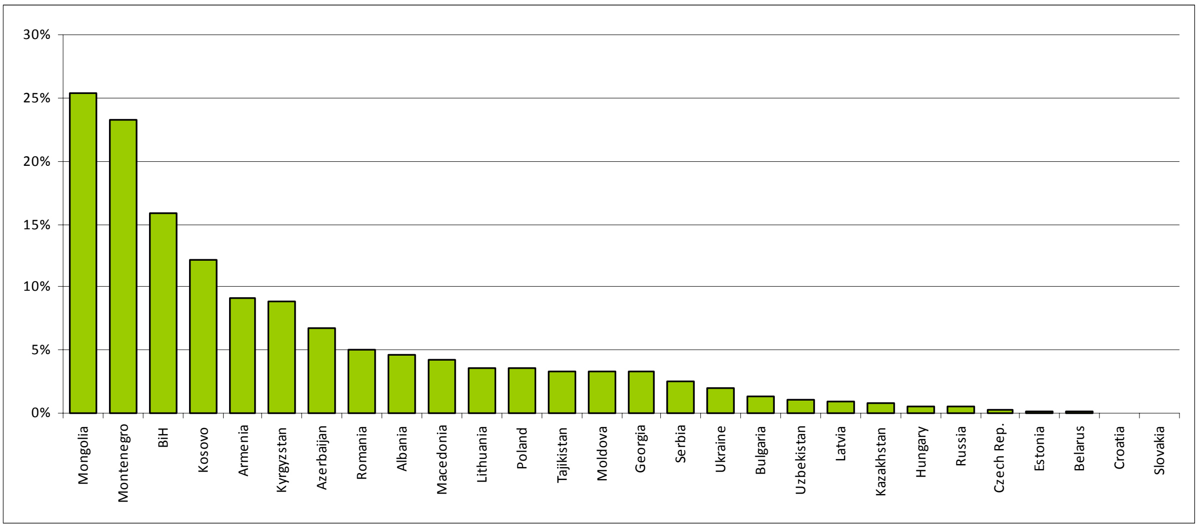
The increase of the total number of borrowers was more substantial than last year – the number of microcredit users in the ECA region grew by 16%. Downscaling banks impressively increased their client base by 58%, most notably in Belarus/Russia/Ukraine. Credit unions also slightly improved their growth rates.

The other two institutional types - NGOs/NBFIs and microcredit banks – grew more slowly than a year earlier and one-third of them even reduced their outreach and observed a drop in the number of active borrowers.

At the end of 2008 2.2% of the economically active population of the ECA region used microcredit, a slight increase compared to 2007.

In four countries – Mongolia, Montenegro, Bosnia and Kosovo - microcredit is used by over 10% of the population in the productive age. In Mongolia rural lending provided by banks reached even over a quarter of the population between 16 and 65 years old. However, in 20 other countries of the ECA region microcredit providers serve less than 5% of that population.

Figure 3.5. Penetration rate of microcredit in ECA (all institutional types)[4]



Loan Portfolio

Gross Portfolio

The total loan portfolio of microfinance providers in the ECA region reached more than USD 18 billion, one-third of which was managed by credit unions. The largest volume of outstanding microcredit was seen in Central and Eastern Europe and Belarus/Russia/Ukraine where credit unions are most active.

Figure 3.6. Distribution of the total gross loan portfolio by institutional type and sub-region (USD million)

USD million	credit unions	NGOs/NBFIs	downscaling banks	microfinance banks	total
Balkans	98	1,096	366	2,078	3,639
CEE	4,424	410	174	921	5,929
Belarus/Russia/Ukraine	1,479	107	3,942	398	5,925
Caucasus	15	322	304	853	1,494
Central Asia	114	344	333	688	1,479
ECA total	**6,129**	**2,279**	**5,120**	**4,938**	**18,466**

2008 saw a slight deceleration of growth of the cumulative portfolio, continuing the downward trend observed since 2006.

While last year NGOs/NBFIs were 'fast growers' this time downscaling banks outdistanced all other institutional types. They managed to increase their gross loan portfolio by 71% with the largest expansion in Belarus/Russia/Ukraine.

The other types of institutions significantly slowed down to below 30% rates with credit unions and microfinance banks having the lowest growth rates.

[4] Penetration rate – number of active borrowers divided by the country's population aged between 16 and 65 years old

Figure 3.7. Total gross loan portfolio annual growth rates

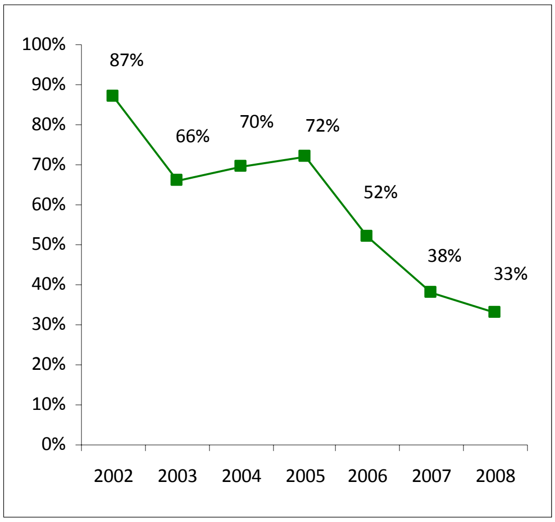
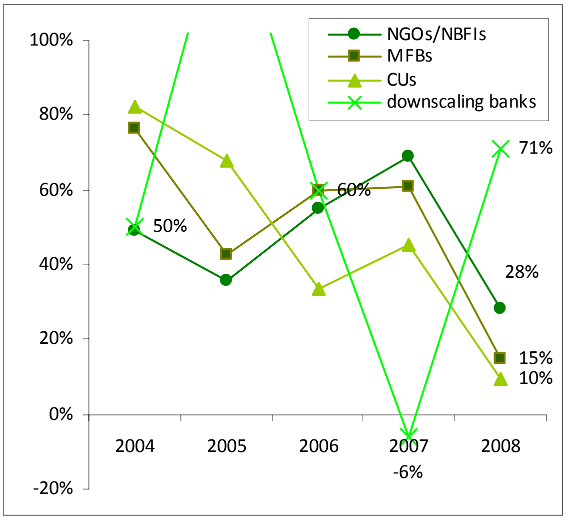


Figure 3.8. Gross loan portfolio growth rates of different institutional types



Among NGOs/NBFIs the smallest MFIs showed the highest growth rates, contrary to what was observed in the previous years when the largest MFIs found more growth opportunities than the smaller ones.

Caucasian NGOs/NBFIs grew more quickly (a total portfolio increase of 50%) than the other sub-regions while those in the Belarus/Russia/Ukraine sub-region showed negative growth (-13%). The portfolio growth (in USD) was affected by the depreciation of many local currencies far more than in the previous years. In the whole ECA region there was a drop of the USD value of the gross loan portfolio in 20% of NGOs/NBFIs, whereas in 2007 a drop was observed in only 7% of the institutions.

Similar trends can be seen for microfinance banks. In a quarter of microfinance banks the value of gross loan portfolio decreased in USD terms. Among credit unions, Central Asian institutions observed the highest growth.

Portfolio at Risk

The portfolio at risk (PAR) of NGOs/NBFIs at the end of 2008 was still on a reasonable level of 3.8%, although much higher than a year earlier (2.8%). Central and Eastern Europe continued to be affected by the worst portfolio quality (average of 7.5%) while the Balkan and Central Asian NGOs/NBFIs showed the best performance in keeping delinquency at a relatively low level.

Figure 3.9. Average PAR >30 days of NGOs/NBFIs by sub-region

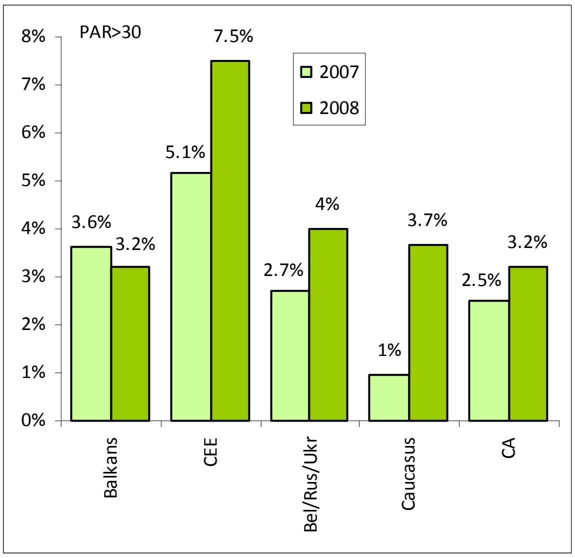
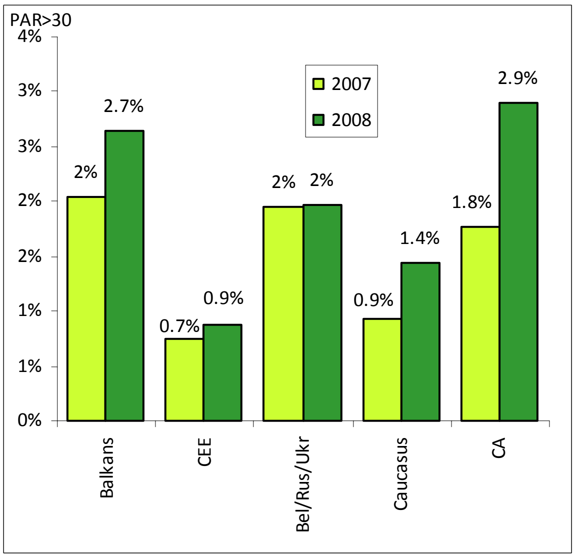


Figure 3.10. Average PAR >30 days of microfinance banks by sub-region



In the whole ECA region 85% of NGOs/NBFIs experienced an increase of PAR>30 in 2008, while a year earlier the number of NGOs/NBFIs which saw a worsening in the quality was 50%. For microfinance banks the quality of portfolio also decreased during the year but the average PAR>30 was only 2.1% (up from 1.5% in 2007). Similarly to NGOs/NBFIs more microfinance banks increased the value of PAR than a year earlier (71% versus 61%).

Portfolio at Risk (PAR)

Portfolio at Risk (PAR) is a standard international measure of portfolio quality that measures the portion of a portfolio which is deemed at risk because payments are overdue. The leading MFIs show portfolios at risk of 1-5%, with few exceeding 10%. Generally speaking, PAR>30 above 5% is a sign of trouble in microfinance any portfolio at risk over 30 days exceeding 10% should be cause for concern, because unlike commercial loans, most microcredits are not backed by bankable collateral.

Good portfolio quality is one of the requirements for accessing funds from international microfinance investors. Although some investors lend to MFIs with PAR>30 nearing 10%, the majority requires their investees to keep the portfolio at risk on a below 5% level.

Portfolio at Risk (PAR) – cont.

Incofin Investment Management manages several funds, each having its own specific profile. Eligibility criteria for large and experienced MFIs require them to keep the portfolio at risk (PAR30) below 5% while smaller and younger MFIs are allowed for higher delinquency levels of up to 10%.

Fund name:			
Incofin	**Impulse Microfinance Investment Fund**	**Rural Impulse Fund**	**VDK MFI Loan Portfolio**
Early stage MFI nearing OSS	positive OSS	3 years historical positive OSS	5 years historical positive OSS
	preferably rated	preferably rated	preferably rated
Portfolio > 1,000,000 Euro	Portfolio > 2,000,000 Euro	Portfolio > 2,000,000 Euro	Portfolio > 10,000,000 USD
Portfolio quality: PAR30 below 10%	Portfolio quality: PAR30 below 10%	Portfolio quality: PAR30 below 5%	Portfolio quality: PAR30 below 5%

Source: '2009 Directory of Funders Active in Eastern Europe and Central Asia (ECA)'. MFC 2009
http://www.mfc.org.pl/images/pliki/FINAL%20DIRECTORY%202009.pdf

Credit Products of NGOs/NBFIs

The majority of NGOs/NBFIs in the ECA region provide individual loans - 74% of the portfolio was disbursed using individual methodology, 9% through village banking and 8% through solidarity group lending. The method of disbursement of the remaining 9% was determined on a case by case basis depending on the client's preferences and ability to provide guarantees. Group methodology is more often used in Central Asia and in the Caucasus, while village banking is more often seen in the Balkans.

Figure 3.11. Distribution of gross loan portfolio of NGOs/NBFIs by loan product type

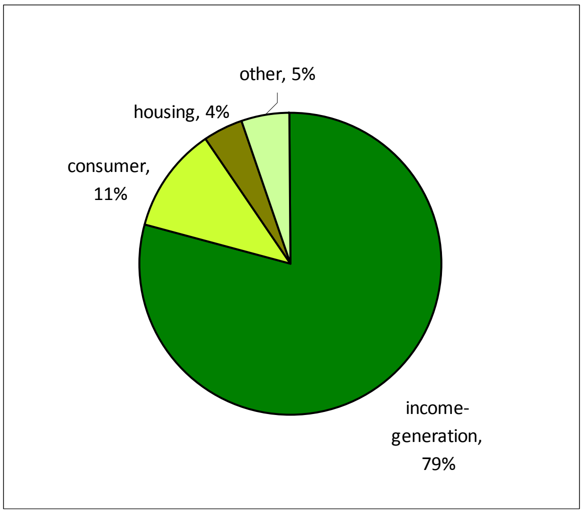
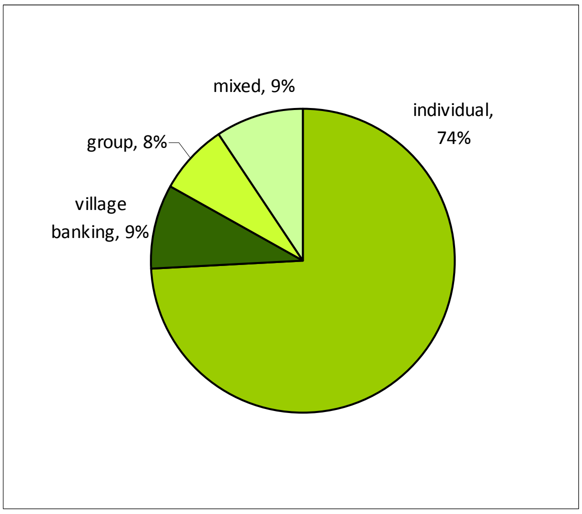


Figure 3.12. Distribution of gross loan portfolio of NGOs/NBFIs by disbursement methodology



Loans for income-generating activities make up 79% of the total outstanding portfolio of NGOs/NBFIs. The remaining part of the portfolio take consumer loans (11%) and housing loans (4%).

Income generation loans

Loans for productive purposes range from small micro loans 10% the size of GNI per capita to large SME loans or leasing for as much as 2000% of GNI per capita. At least one-third of the portfolio of business loans is specifically allocated to finance agricultural businesses.

Consumer loans

Consumer loans are the largest part of the portfolio of Balkan MFIs (17%) compared to other sub-regions, especially the CEE region where lending for consumption purposes is marginal. Usually, consumer loans are smaller than the ones for business purposes but there are MFIs that provide quite large sums for non-business purposes.

Housing loans

Housing loans constitute 5% of the total loan portfolio of NGOs/NBFIs.
Only a small number of MFIs in the ECA region (28) offer housing loans as a separate product, out of which only 5 provide loans for house construction; the vast majority offers financing for small repairs, renovation of existing houses or flats. Some of the remaining MFIs, especially those which provide consumer loans, often also finance home improvement activities such as small repairs, renovation, sometimes even small construction, but their product is not packaged in that way.

Figure 3.13. Share of MFIs providing housing loans for different purposes

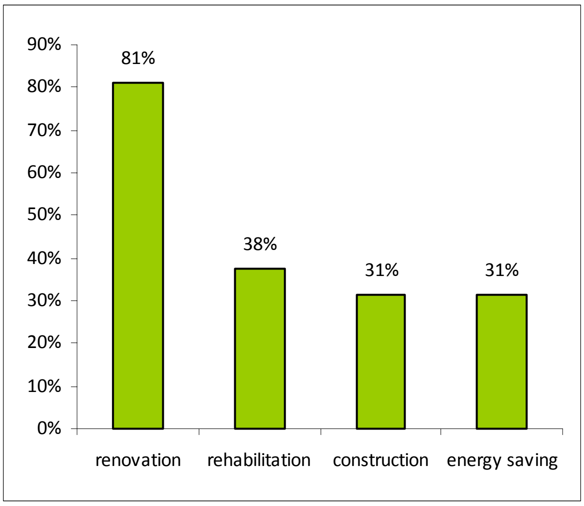
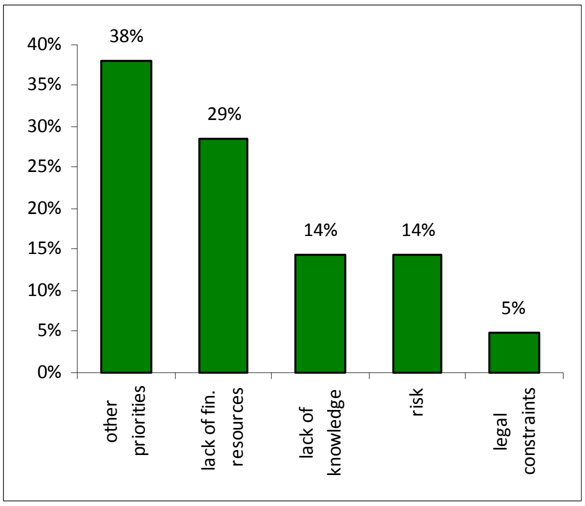


Figure 3.14. Reasons for not providing housing loans



The prevailing reason why most MFIs do not finance housing projects of their clients is their focus on entrepreneurship and development of microenterprises, rather than on the overall household well-being. However, almost 30% of responding MFIs see the lack of financial resources as a major obstacle in offering loans for housing purposes.

HUMO: Group Lending

The organization uses the world-renowned system of group lending. The main element of this strategy is the use of groups - composed of 3 to 10 borrowers - created either by the organization's employees or the borrowers themselves. The principle of group lending depends on the guarantee that each member of the group makes:

- Every member of the group is responsible for their own loan repayments, as well as for the overall funds received by the group.
- The groups select their members themselves, as it's important for each group to choose the people they can trust and feel are responsible.
- The group receives a complete disclosure regarding the details of their loan, as well as repayment schedule and other procedures, through consultations provided by the loan officers.
- Once the group is formed, the loan officers offer continued support to the clients through consultations in areas of management, bookkeeping and marketing.
-

The main advantage of this method is that population residing in rural and far regions of the republic, that do not have enough income or collateral to receive a traditional bank loan, can get access to credit through the creating of solidarity groups.

Source: http://humo.tj

Deposits

Credit unions continue to be the leader in deposit collection, with USD 4.8 billion of client savings captured at the end of 2008 compared to USD 3.9 billion of microfinance banks. Credit unions are mostly active in deposit collection in CEE and Belarus/Russia/Ukraine while microfinance banks dominate in the remaining sub-regions.

Figure 3.15. Distribution of client deposits collected by credit unions and microfinance banks

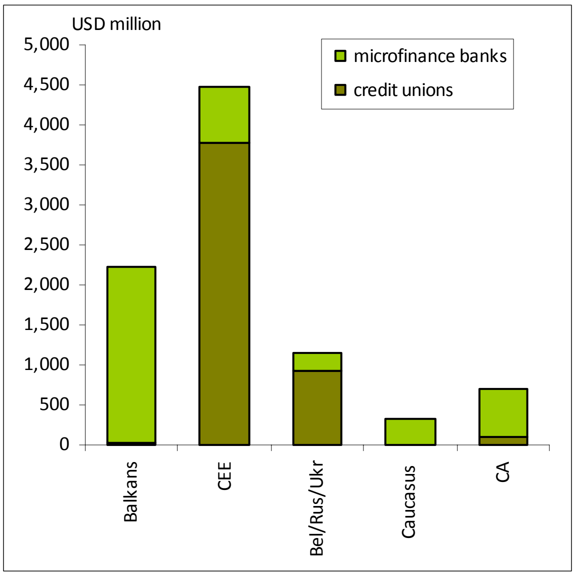
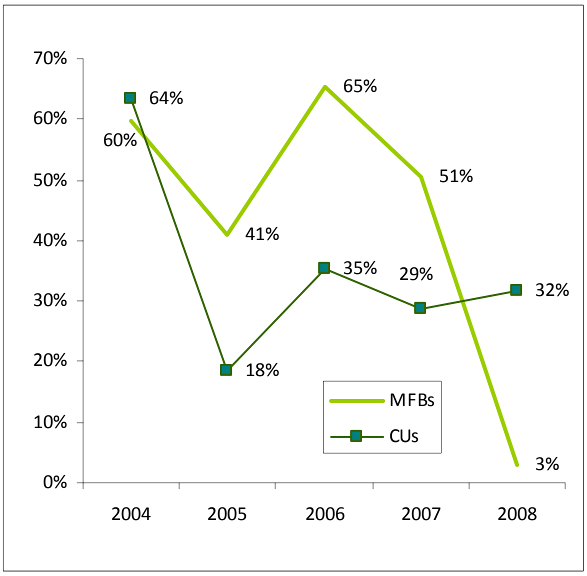


Figure 3.16. Annual growth rates of the volume of deposits by institutional type



The total value of deposits collected by credit unions and microfinance banks grew by 16%. Credit unions continued to increase the volume of savings by about 30% each year, while microfinance banks experienced a significant slow-down -the total volume of client deposits grew by only 3%.

Credit unions showed impressive growth of deposits in Poland and the Czech Republic (increase of USD 3.5 billion), but also in Kyrgyzstan (26 times increase in savings volume). However, in some other countries the USD value of collected savings dropped (Estonia, Hungary, Moldova, Russia).

Growth of Credit Unions in the Czech Republic during The Crisis

	31 Dec 2006	31 Dec 2007	31 Dec 2008
Number of credit unions	20	19	17
Credit union members	36,637	44,789	35,942
Membership growth in the period	9,590	8,152	-665
Equity capital (million CZK)	1,129	1,263	1,156
Capital adequacy (%)		24.56	17.39
Total Clients Deposits (million CZK)	5,218	7,032	10,291
Client Deposits growth (%)	37%	35%	46%
Total profit (million CZK)	39	83	51

Source: National Bank of the Czech Republic, www.cnb.cz

Among microfinance banks the most successful in deposit attraction were those in Kosovo and Mongolia which more than doubled the volume of attracted savings but for over one-third of the microfinance banks the total value shrank in USD terms.

Figure 3.17. Total volume of deposits collected by credit unions in 2007 and 2008 by sub-region

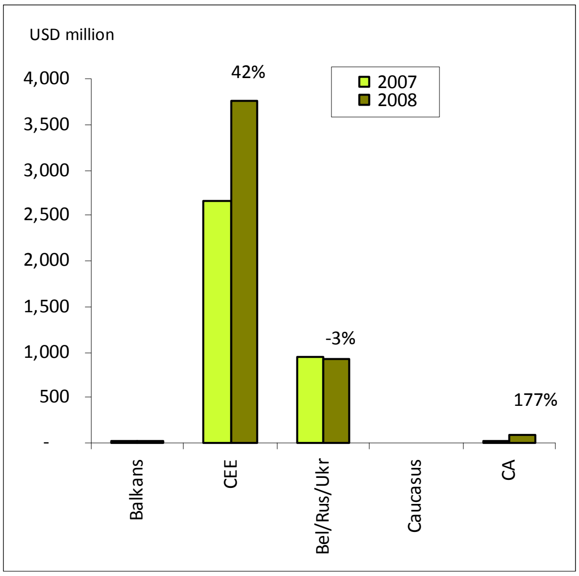
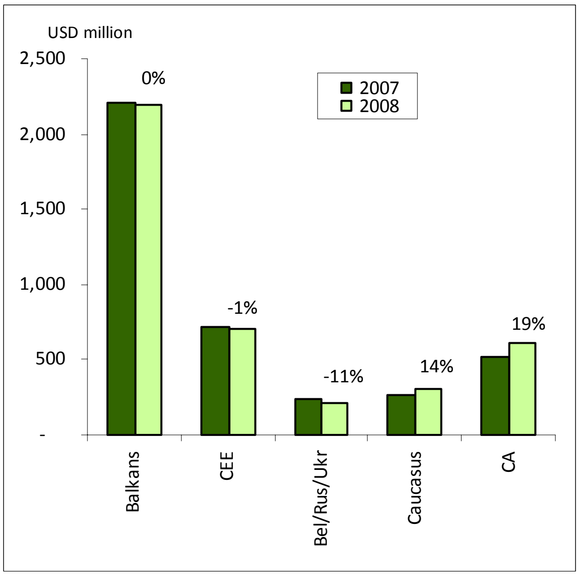


Figure 3.18. Total volume of deposits collected by microfinance banks in 2007 and 2008 by sub-region



The total number of depositors grew by 17% and faster growth was seen in microfinance banks than credit unions.

Figure 3.19. Total number of depositors by institutional type and sub-region

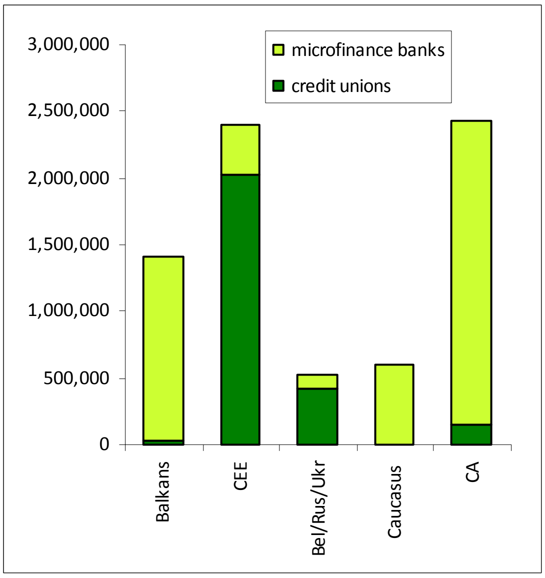
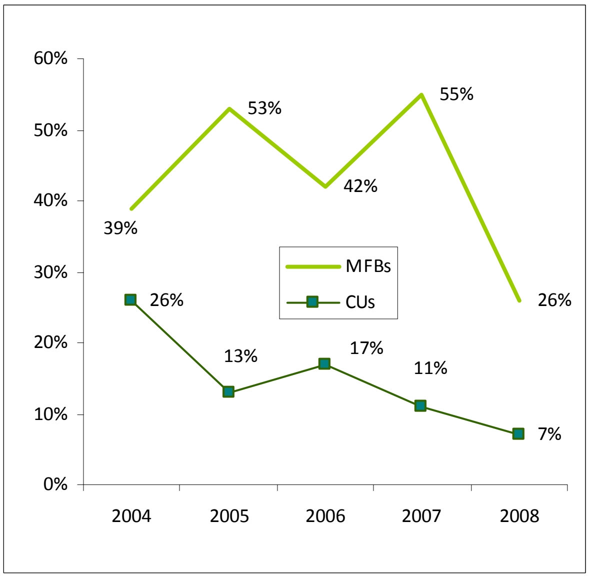


Figure 3.20. Growth rates of the number of depositors by institutional type



Credit union members, with the exception of Central Asia, deposit larger amounts (relative to GNI per capita) than clients of microfinance banks.

Figure 3.21. Average savings balance per depositor in USD and relative to GNI per capita

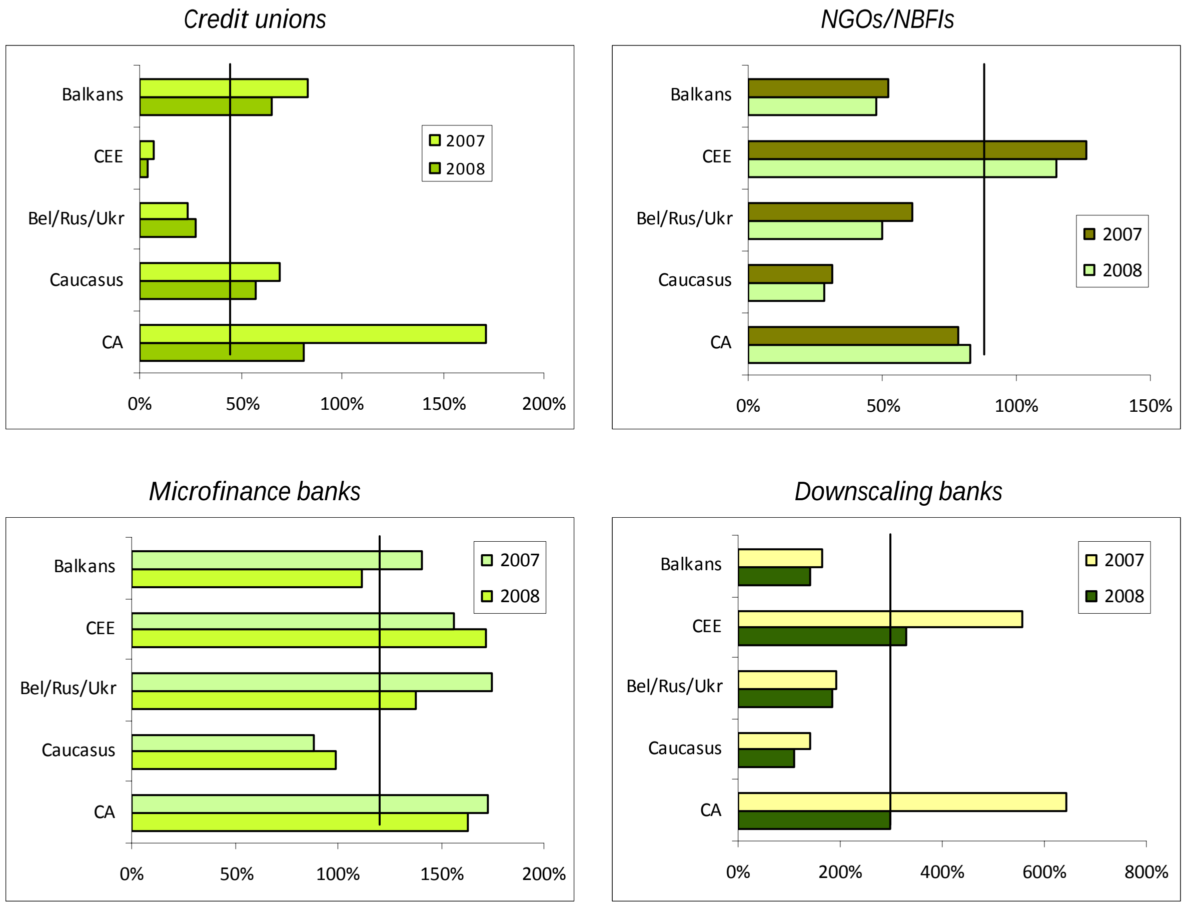
	Average savings balance per depositor (USD)		Average savings balance per depositor to GNI per capita (%)	
	credit unions	microfinance banks	credit unions	microfinance banks
Balkans	2,485	1,747	64%	53%
CEE	4,978	1,585	69%	43%
Belarus/Russia/Ukraine	1,872	1,657	52%	52%
Caucasus		706		21%
Central Asia	563	799	49%	148%
ECA average	**3,211**	**1,293**	**62%**	**53%**

Social Performance

Depth of outreach

Unlike the previous years when the upscaling of microfinance was observed throughout the region the year 2008 was the first in many years when the majority of all types of institutions improved their depth of outreach[5].

Figure 3.22. Median depth of outreach of microfinance institutions



[5] Depth of outreach = average loan balance divided by GNI per capita

The majority of credit unions provide small loans of up to 40% of GNI per capita. Institutions of the remaining types mostly serve a broad market with loans of between 40% and 150% of GNI per capita. Only for downscaling banks the predominant clientele are SMEs (average loan size over 250% GNI per capita) and high-end clients (150% to 250% of GNI per capita).
For NGOs/NBFIs the largest number of SME lenders is seen in Central Asia, while the largest number of microcredit providers to low-end clients is found in the Caucasus.

Figure 3.23. Distribution of microfinance institutions of different types by target market

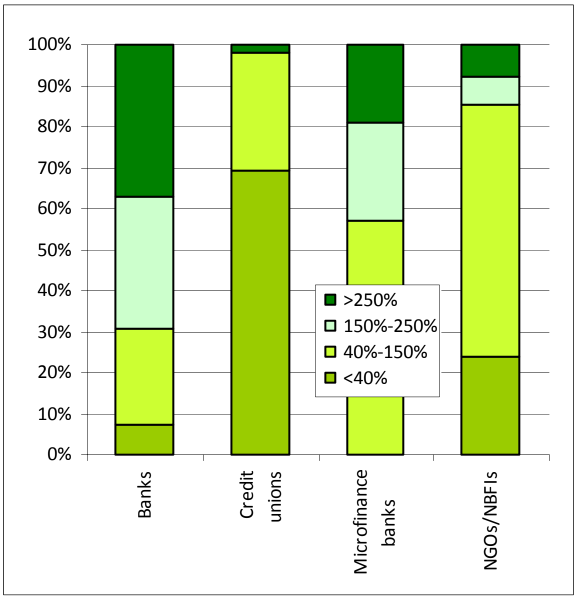
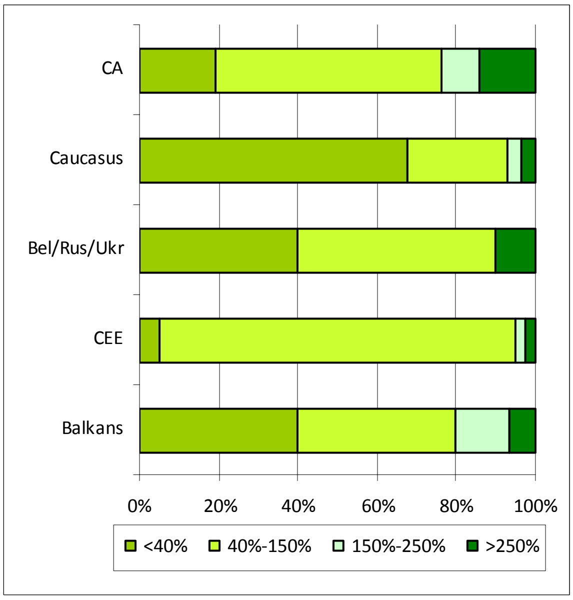


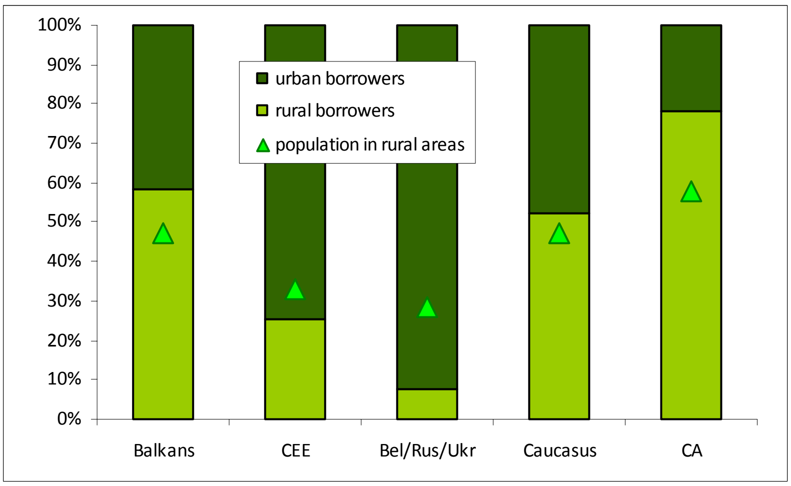
Figure 3.24. Distribution of NGOs/NBFIs by target market and sub-regions



Rural borrowers of NGOs/NBFIs

Central Asian NGOs/NBFIs have the highest share of rural borrowers in all sub-regions and exceeding the actual percentage of the population living in rural areas. In two other regions – Balkans and the Caucasus –rural clients are also over-represented compared to the proportion of the population living outside towns. In the remaining sub-regions NGOs/NBFIs focus on serving urban enterprises.

Figure 3.25. Distribution of NGOs/NBFIs borrowers by settlement type



Quality Audit Tool: the MFC Experience

Social performance does not happen automatically. Your target clients (women, low-income, poor, farmers) will not come only because you are called "microfinance". You need to manage your institution towards achieving social results: be clear what you want to achieve (social goals), set up the strategy (i.e. opening branches in rural areas only; accepting clients below certain income level), adapt your products and services to the needs of clients (collect feedback and adapt), align internal systems to support your goals.

Quality Audit Tool is a simple to use tool helping the managers to diagnose the status and effectiveness of their management systems from the perspective of improving social performance. It produces a concise report on the strengths and weaknesses of an MFI in each dimension of social performance management: social goals and strategy, monitoring social performance information, improving performance. The report also provides key supporting evidence and prioritizes activities to be undertaken by an MFI in order to improve.

Up to date, more than 30 MFIs worldwide used QAT to improve their SPM. The examples of findings may cover:

- Staff understands the broad purpose of MFI existence on the market, but is not clear who are the target clients, thus better off population is accepted as clients
- There is a clear definition of various target clients groups, but the institution offers one product to all kind of clients. The institution reports high drop out rate and low clients' satisfaction
- There are no clear social objectives of what an institution wants to achieve
- Institution assess the client's capacity carefully to prevent over-indebtedness and communicates the product terms and conditions correctly. However, the system for clients' complaints is not effective.
- A lot of SP information is collected, but little or nothing is used
- An institution collects feedback from clients, but the information is not used to adapt products or services
- There is a good internal reporting system, but management uses only financial information to make decisions. Social performance goals stay on paper.
- Board represents good balance of social and financial background, but the social performance agenda is not discussed at the meetings, thus there is no commitment to SP presented by the top management

QAT helps to win staff buy-in and understanding of SPM, to monitor progress in SP mainstreaming and to prepare to social rating. To learn more about QAT, visit www.mfc.org.pl/QAT or contact directly Ewa@mfc.org.pl. To learn about other QAT users' opinion on the tool's costs and benefits, visit User Reviews at www.sptf.info.

Women borrowers of NGOs/NBFIs

The number of women among NGOs/NBFIs borrowers continues to exceed 50% and compared to 2007 hardly changed. The highest and increasing percentage of women among microcredit borrowers is seen in Belarus/Russia/Ukraine. In Central Asia the percentage is also quite high but decreasing.

Figure 3.26. Gender distribution among NGOs/NBFIs borrowers in 2007 and 2008

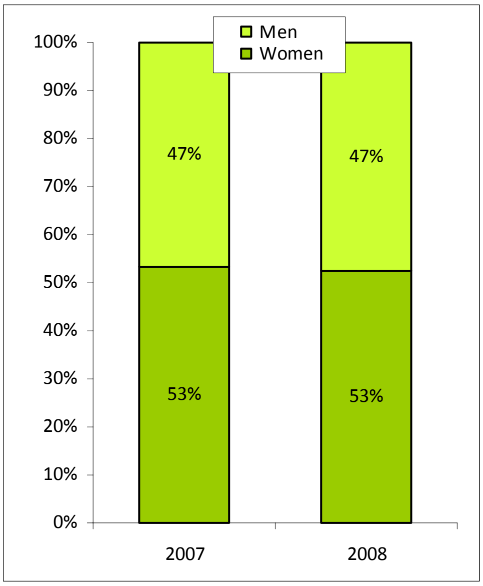
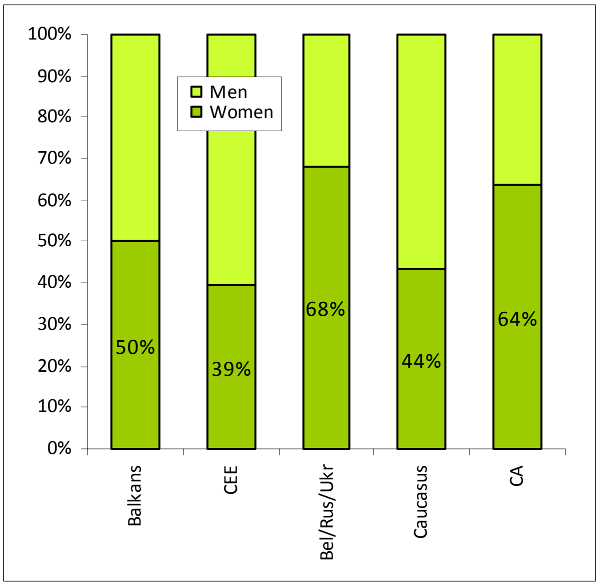


Figure 3.27. Gender distribution among NGOs/NBFIs borrowers by sub-region



Summary

Despite the first signs of the crisis the microfinance sector in ECA continued growing at a pace similar to that of the previous years – the number of borrowers increased by 16% and the gross loan portfolio grew by 33%. Only the deposit market slowed down – while in previous years the deposits increased by over 40% annually, in 2008 the value of deposits went up by only 15%.
An important development in 2008 was also worsening of the quality of the credit portfolio. Although still within the reasonable range, the portfolio at risk over 30 days increased in all sub-regions, except for the NGOs/NBFIs in Balkans which in the majority improved already good quality of the portfolio.

The social performance of NGOs/NBFIs continues to be strong – the percentage of rural borrowers and female clients exceeds 50% and has not changed during the year. The depth of outreach of not only NGOs/NBFIs but also of both types of banks and credit unions increased for the first time in many years.

Chapter 4

Funding Sources

Introduction

The total volume of assets of three institutional types – credit unions, microfinance banks and NGOs/NBFIs – of USD 23 billion was financed mainly from deposits (67%) and borrowed funds (18%). Compared to 2007 the importance of client savings went down by 3 percentage points to reach USD 16 billion. The bulk of the sum was collected by credit unions. Altogether, savings collected by credit union funded half of the total assets of the institutions of the three types.

The share of borrowings in financing of the total assets increased by 4 percentage points to reach USD 4.3 billion. The largest lenders to microfinance institutions were ProCredit Holding, EBRD, EFSE and KfW.

NGOs/NBFIs[6]

The total volume of assets of NGOs/NBFIs in the whole ECA region was USD 2.3 billion (up by 29%) and 70% was financed from borrowings from international investors and donors, local commercial banks, government funds and local private sources. Bosnia and Herzegovina hosted the largest share of the investment (39%), followed by Azerbaijan and Kyrgyzstan.

After two years of very dynamic growth of NGOs/NBFIs from debt funding, 2008 was the year of a considerable slow-down, although there was still a considerable growth level of 37%.
In total, the USD 430 million increase of the volume of borrowed funds was again predominantly attracted by the institutions in the Balkans where the largest investments were made – 51% of the new funding attracted by NGOs/NBFIs went to the Balkans, 22% to the Caucasus and 16% to Central Asia. The highest growth was seen in the Caucasus (60% increase).

[6] The analysis covers 200 NGOs/NBFIs operating in the Balkans (27), Central and Eastern Europe (76), Belarus/Russia/Ukraine (8), Caucasus (26) and Central Asia (63)

Figure 4.1. Funding structure of NGOs/NBFIs in 2006-2008

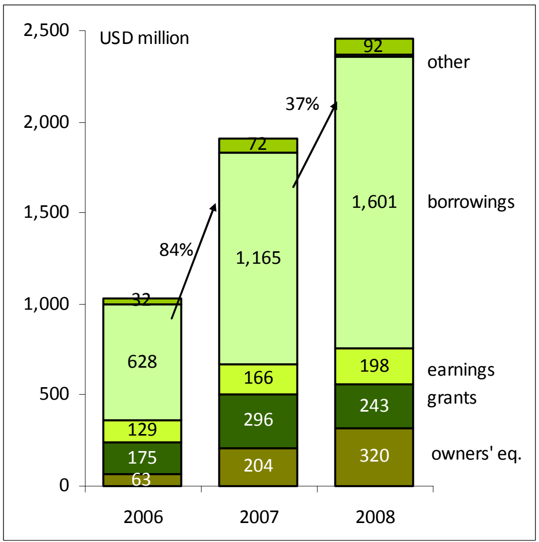


Figure 4.2. Distribution of borrowed funds by country (in 2008)

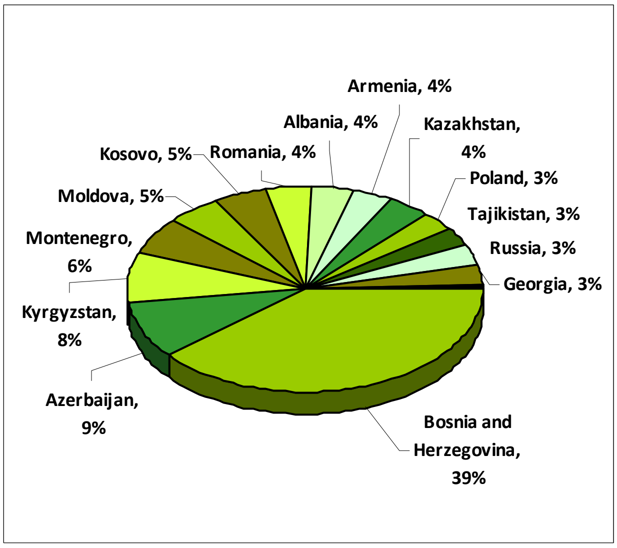
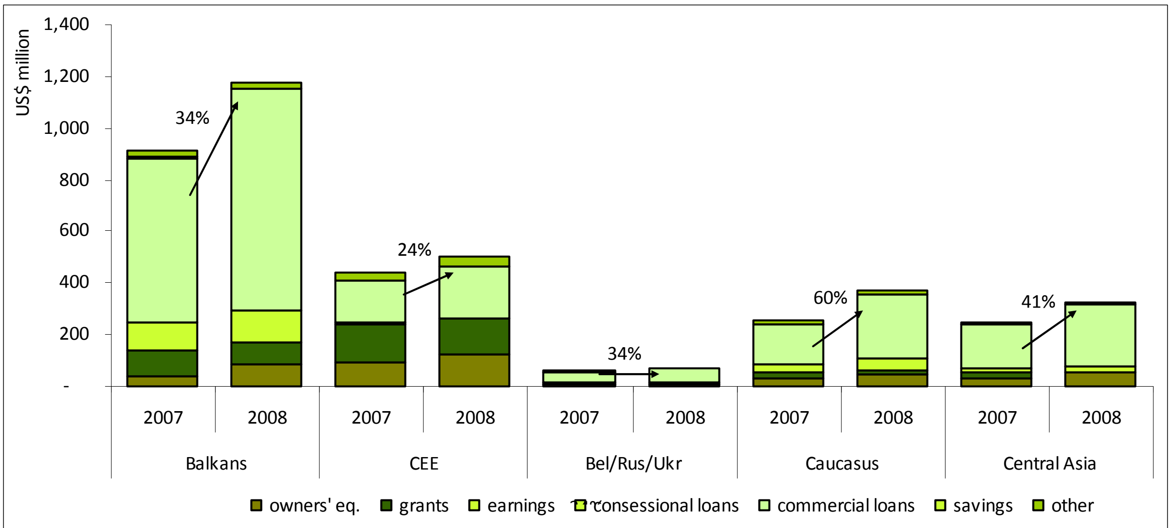


Figure 4.3. 2007-2008 Changes in NGOs/NBFIs funding structure by sub-regions



Leverage

As borrowed funds make up a major source of funds for growth, the increase in the borrowed funds volume led to increased leverage. The debt amount of the average NGOs/NBFIs was at the end of 2008 2.5 times higher than its equity.

Figure 4.4. Average debt to equity ratio of NGOs/NBFIs by sub-region

	2006	2007	2008
Balkans	1.8	2.4	2.9
CEE	2.9	3.7	3.6
Belarus/Russia/Ukraine	1.1	2.3	2.1
Caucasus	1.6	2.3	3.1
Central Asia	1.2	2.5	2.0
Total	**1.6**	**2.5**	**2.5**

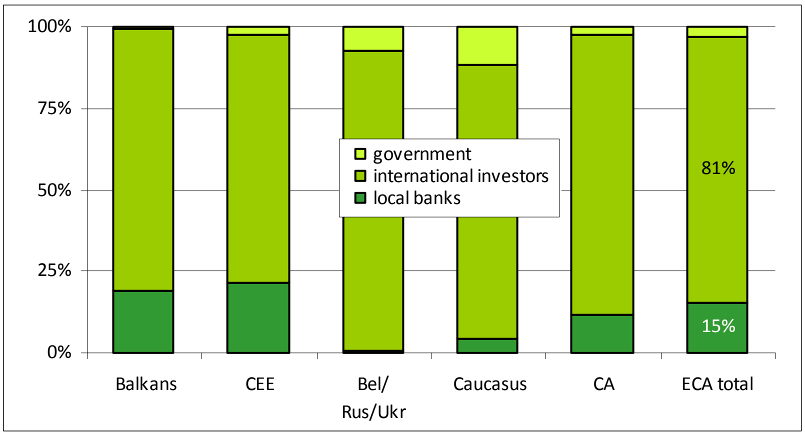
Larger institutions are far more leveraged while the smallest ones still struggle to attract more funds.

Figure 4.5. Average debt to equity ratio of NGOs/NBFIs by loan portfolio size

	2006	2007	2008
GLP >USD 15M	3.2	3.8	3.9
USD 5-15M	2.9	3.2	2.7
USD 1-5M	1.5	2.4	2.1
<USD 1M	0.7	1.5	1. 5
Total	**1.6**	**2.5**	**2.5**

Further analysis of borrowings of the sub-sample of NGOs/NBFIs[7] showed that the majority of borrowed funds come from international investors, with a small and decreasing proportion (from 21% in 2007 to 15% in 2008) sourced from local commercial banks. CEE institutions led in the degree of usage of local bank loans. Governmental sources were mostly used in the Caucasus.

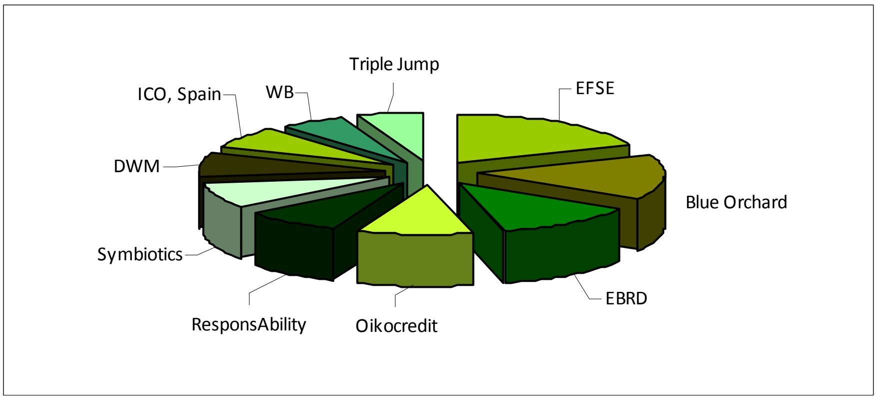
Figure 4.6. Distribution of borrowed funds by type of provider and sub-region



Key Funding Sources

The leading providers of funding remain the same, with EFSE, Blue Orchard, EBRD and Oikocredit as the four largest investors, but the concentration of investment increased further. In 2007 50% of debt was provided by 13 investors, in 2008 the figure decreased to 10 investors.

Figure 4.7. Distribution of 50% of NGOs/NBFIs debt by lending institutions



[7] The sub-sample consisted of 95 NGOs/NBFIs with 958 fixed-income deals which at the end of 2008 constituted 88% of the outstanding volume of borrowings of NGOs/NBFIs in ECA.

Figure 4.8. Five largest investors in each sub-region

Balkans	CEE	Belarus/Russia/Ukraine	Caucasus	Central Asia
EFSE	Oikocredit	responsAbility	responsAbility	Symbiotics
Blue Orchard	EFSE	Deutsche Bank Ltd. (Moscow)	Symbiotics	Oikocredit
EBRD	PAEF	Minlam	DWM	Blue Orchard
ICO, Spain	BZ WBK	OXFAM/NOVIB	Oikocredit	Deutsche Bank
WB	EBRD	Oikocredit	Triple Jump	Incofin

Currency

EUR remains the dominant currency of borrowing as the majority of funds comes from Europe and is allocated to European countries. Bosnia and Herzegovina is the largest destination country for EUR borrowings followed by Montenegro and Kosovo where it is the national currency.
Local currency borrowings make up 24% of the total volume of borrowed funds.

Figure 4.9. Distribution of borrowed funds by currency

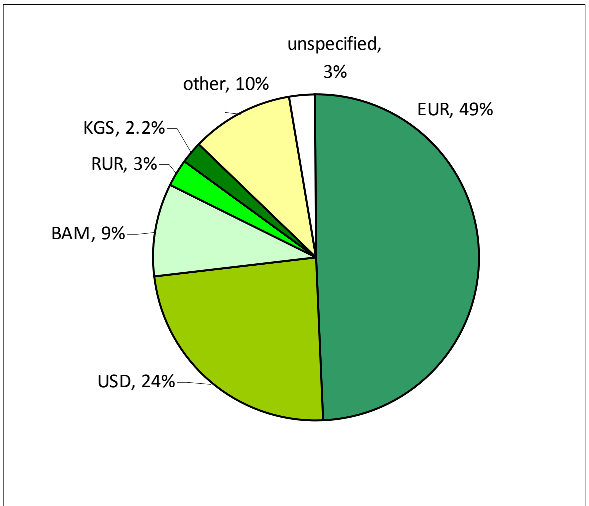
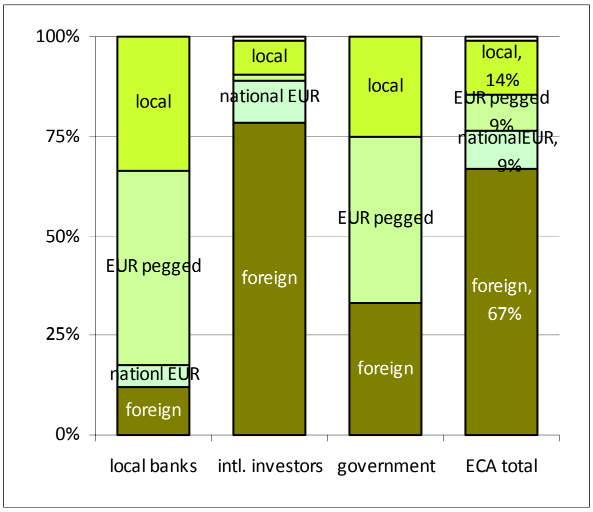


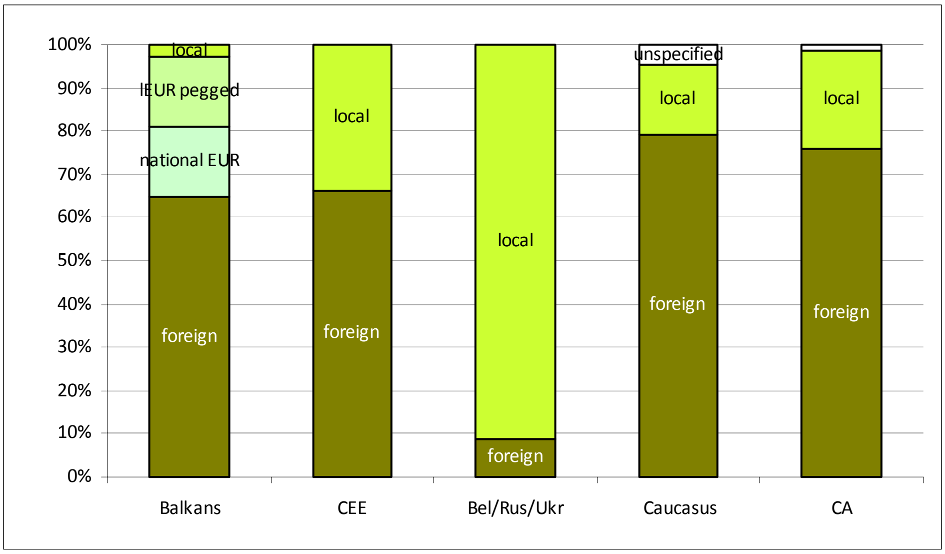
Figure 4.10. Distribution of NGOs/NBFIs borrowed funds by source and currency type[8]



Local currency funding is more often available from government and local commercial banks while international investors continue to lend mostly in foreign currencies.
In the sub-regions, the currency distribution follows the presence of international versus local investors, except for Belarus/Russia/Ukraine, where despite minimal level of lending by commercial banks local currency borrowings prevail.

[8] Bosnian and Bulgarian currencies (BAM and BGN) are pegged to Euro therefore lending in these currencies does not pose exchange rate risk to Euro.

Figure 4.11. Distribution of NGOs/NBFIs borrowings in the sub-regions by currency type



Price

The average nominal interest rate on NGOs/NBFIs borrowings in the ECA region was 8.9% at the end of 2008, up by 3 percentage points from 8.6% a year earlier. The average price on funds in EUR increased while it decreased in USD, but the largest difference was observed in the cost of local currency funding.

Figure 4.12. Average nominal interest rate on NGOs/NBFIs borrowings in EUR and USD

	EUR		USD	
	2007	2008	2007	2008
Balkans	7.0%	7.4%	2.3%	2.2%
CEE	8.0%	9.3%	7.9%	8.2%
Belarus/Russia/Ukraine	-	-	9.8%	9.6%
Caucasus	8.8%	8.5%	9.6%	9.6%
Central Asia	7.3%	7.9%	10.2%	8.4%
ECA average	**7.2%**	**7.7%**	**9.5%**	**8.8%**

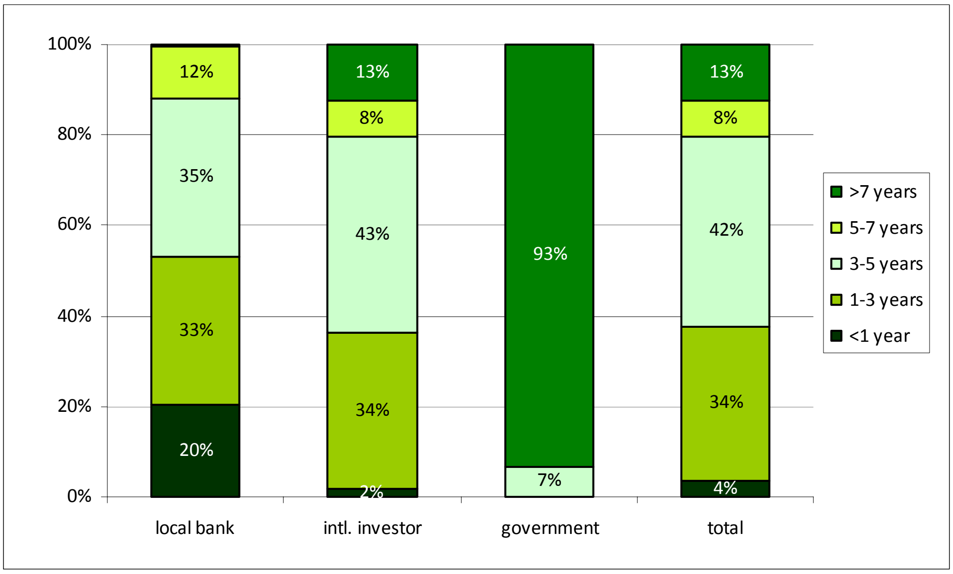
Figure 4.13. Average nominal interest rate on NGOs/NBFIs borrowings in local currency

	2007	2008
Balkans	7.1%	10.6%
CEE	13.5%	13.3%
Belarus/Russia/Ukraine	13.4%	14.1%
Caucasus	9.6%	11.7%
Central Asia	12.8%	14.1%
ECA average	**11.3%**	**13.1%**

Term

The maturity of fixed income deals differs depending on the source – funds borrowed from governmental sources are most often long-term, while those coming from local banks have on average the shortest maturity. The median term of 36 months did not change from the last year.

Figure 4.14. Distribution of NGOs/NBFIs borrowing by source and maturity



The JSC MFO Crystal is a dynamically growing microfinance institution supporting micro and small business development in Georgia. Committed to good corporate governance, transparency and sustainable development, Crystal aims at balancing an uncompromised financial performance with the social return.

The mission of Crystal is to offer the wide range of high quality financial services to micro and small entrepreneurs throughout Georgia. With the US$ 1.4 m equity and US$ 5.7 m in assets, Crystal serves more than 4,500 clients (40% rural), managing the portfolio of approximately USD 4.2 million. It operates across Georgia through the network of 14 offices and has a proven track record of prudent and successful financial performance.

Crystal offers a wide range of tailored lending products, including micro, small business, agricultural and limited portion of consumer as well as housing loans. The company is focused on regional micro business financing, including start-ups, with the loans up to USD 10,000. Early in 2009, Crystal joined the International Campaign for Client Protection – called Smart Campaign, by adopting responsible lending principles. Crystal also implements long-term community and social investment programs.

Crystal is mainly financed by international microfinance investors, such as the Deutsche Bank Global Commercial Microfinance Consortium, DWM Asset Management, Finethic Microfinance S.C.A./via Symbiotics S.A., Oikocredit, Cordaid, IFAD/IDA and UNDP. In December 2009, Crystal received approvals on new funding from EBRD, Symbiotics and TBC Bank through the USAD/DCA portable guarantee.

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Contact person - Malkhaz Dzadzua (CEO), director@crystal.ge

Microfinance Banks[9]

The total assets of microfinance banks increased in 2008 by 9% to reach USD 6.9 billion. Microfinance banks continue to be funded mainly from collected deposits (58% of the total assets) and to a much lesser extent from borrowed funds (28%).

Figure 4.15. Funding structure of microfinance banks in 2006 – 2008

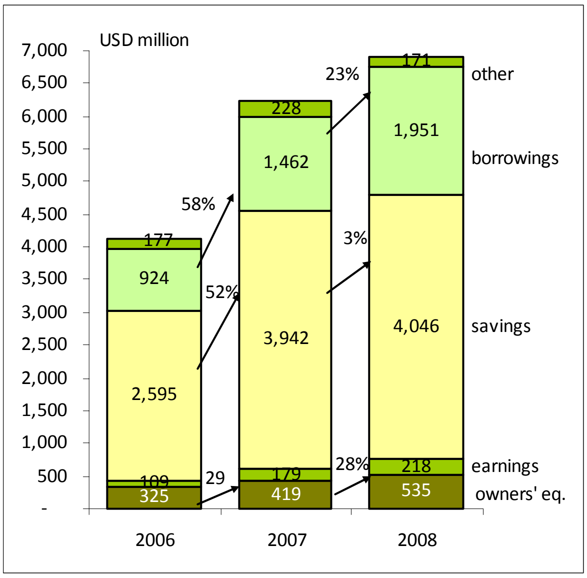
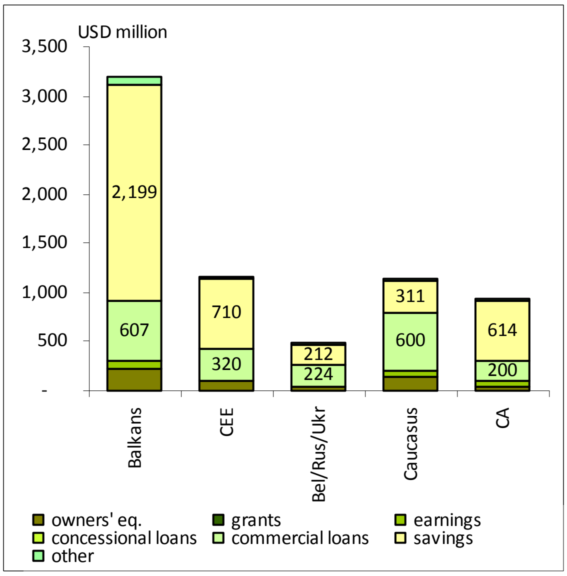


Figure 4.16. Funding structure of microfinance banks in 2008 by sub-regions



In 2008 the rate of growth of each source was significantly reduced. Collected savings grew only by 3% but in fact the total volume of savings increased only in the Caucasus and Central Asia while in the other sub-regions the value of deposits shrank despite the increasing number of deposit accounts.

Leverage

Microfinance banks are quite highly leveraged, the highest debt to equity ratio reaching 16, with the largest banks more leveraged than the smaller ones.

In 2008 several big microfinance banks attracted equity investments which led to lowering their debt to equity ratios. The average debt to equity rate for the whole ECA region dropped to 7.1.

Figure 4.17. Average debt to equity ratio of microfinance banks by loan portfolio size

	2006	2007	2008
Gross loan portfolio >USD 200M	11.3	10.8	8.9
USD 50-200M	7.6	7.1	7.1
<USD 50	3.0	2.5	3.4
Total	**7.8**	**8.2**	**7.1**

[9] The analysis covers all 21 microfinance banks

Figure 4.18. Average debt to equity ratio of microfinance banks by sub-region

	2006	2007	2008
Balkans	10.2	9.5	8.3
CEE	11.6	12.7	7.5
Belarus/Russia/Ukraine	5.3	7.1	10.8
Caucasus	4.9	5.5	4.2
Central Asia	5.1	6.3	6.4
Total	**7.8**	**8.2**	**7.1**

Deposits, being the largest sources of funds are mostly sourced from individual savers (58% of the volume of savings collected by microfinance banks), followed by legal entities, including financial institutions.

The highest share of borrowings is obtained from international investors. In the CEE microfinance banks borrow substantially more from commercial banks and in Central Asia from governmental sources and other (foreign partner banks).

Figure 4.19. Distribution of total savings collected by microfinance banks by source

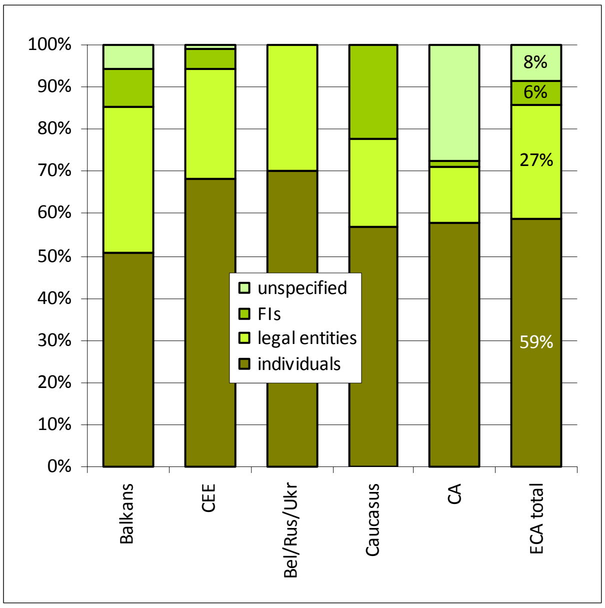
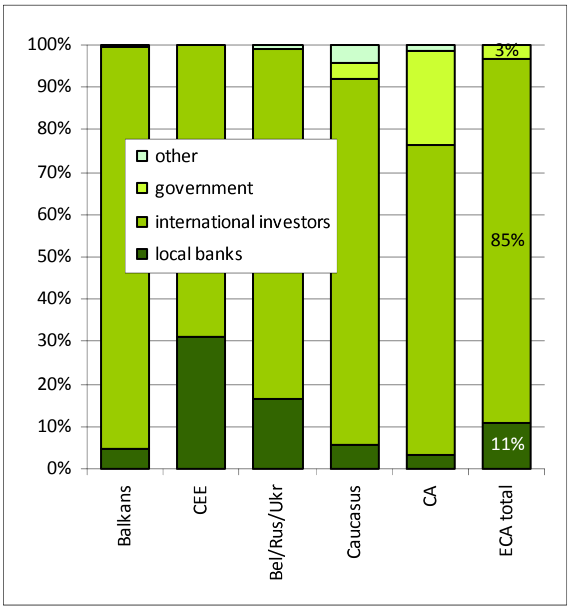


Figure 4.20. Distribution of total borrowings of microfinance banks by source



Similarly to NGOs/NBFIs the inflow of borrowings considerably slowed down in 2008. After several years of rapid growth of liabilities to financial institutions the pace somewhat decelerated.
Borrowings are geographically concentrated in four largest receiving countries (Armenia, Georgia, Serbia and Ukraine) where half of all funds were allocated.

Key Funding Sources

In total, funding from international investors comes from 40 different sources, but due to high concentration half of the investment is sourced from only 5 institutions.
ProCredit Bank remains the largest lender to microfinance banks.

Figure 4.21. Distribution of borrowed funds of microfinance banks

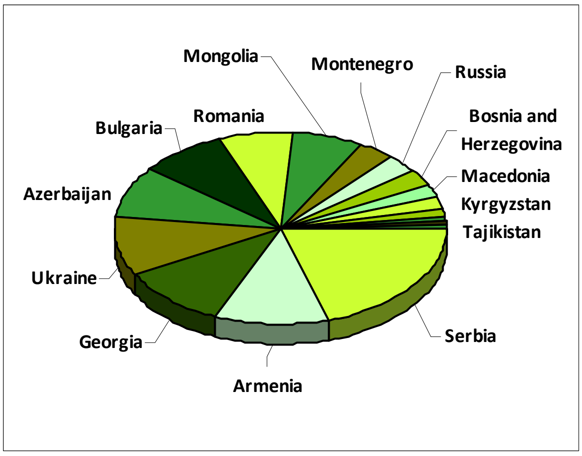
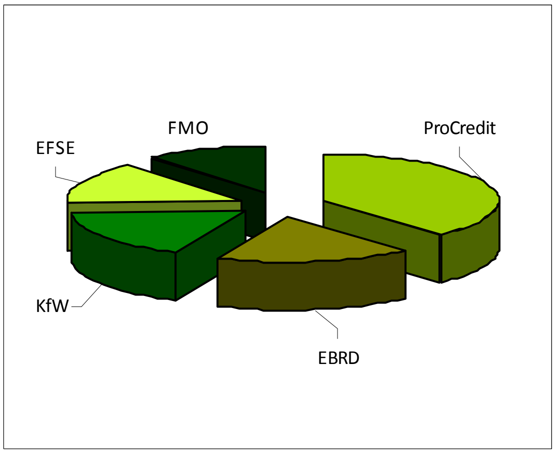


Figure 4.22. Distribution of 50% of microfinance banks' debt by lending institutions



Currency

Liabilities of microfinance banks are predominantly denominated in foreign currencies. Foreign currency borrowings and client deposits taken together constitute 56% of liabilities. In case of client savings 40% are deposited on foreign currency accounts, mostly in EUR. As the majority of borrowed funds come from abroad they are denominated in foreign currencies. Only 15% is attracted in a local currency, usually from local banks and governmental sources.

Figure 4.23. Distribution of deposits attracted by microfinance banks by currency and type of source

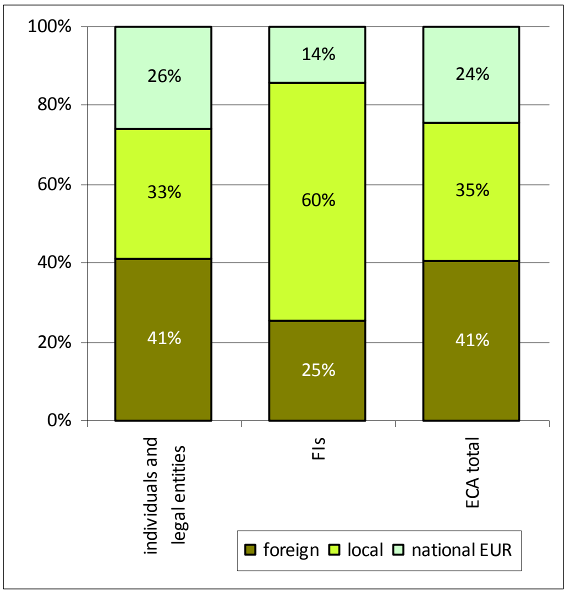
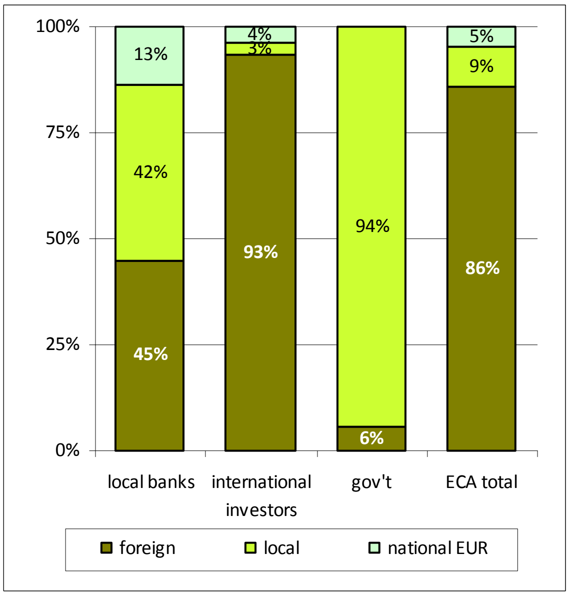


Figure 4.24. Distribution of microfinance banks borrowings by currency and type of source



In the sub-regions, Central Asian microfinance banks are the most effective in attracting local currency savings.

Figure 4.25. Distribution of savings attracted by microfinance banks by currency type and sub-region

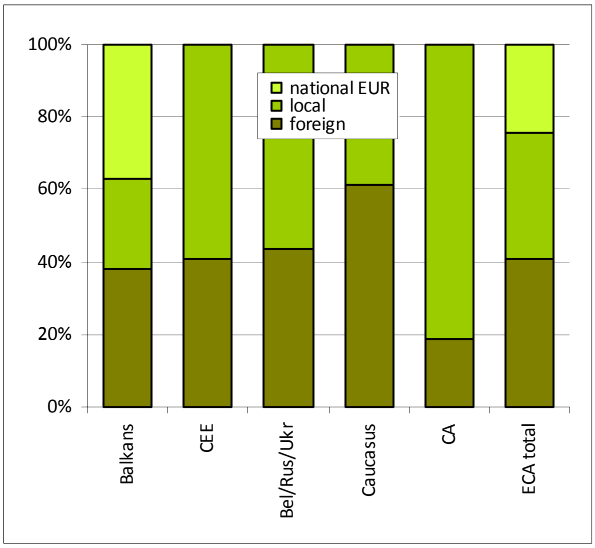
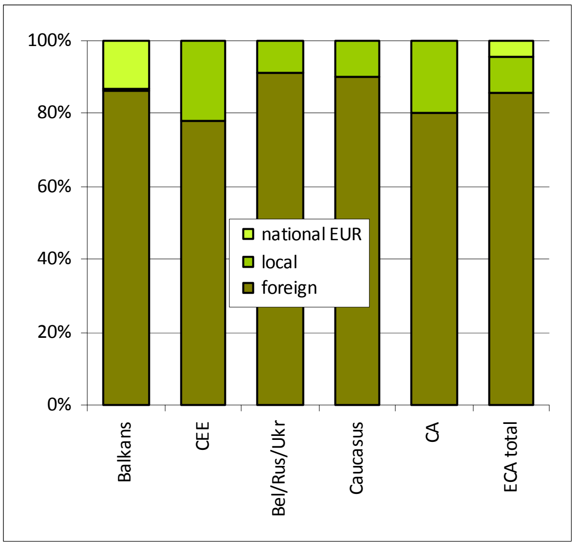


Figure 4.26. Distribution of funds borrowed by microfinance banks by currency type and sub-region



EUR is the preferred currency of savings both in the countries where it is a foreign currency as well as in those where it is a national currency (Kosovo and Montenegro).
As the majority of microfinance banks borrow in foreign currencies the biggest part of the volume of borrowings is denominated in EUR or USD[10] .

Figure 4.27. Distribution of savings attracted by microfinance banks by currency

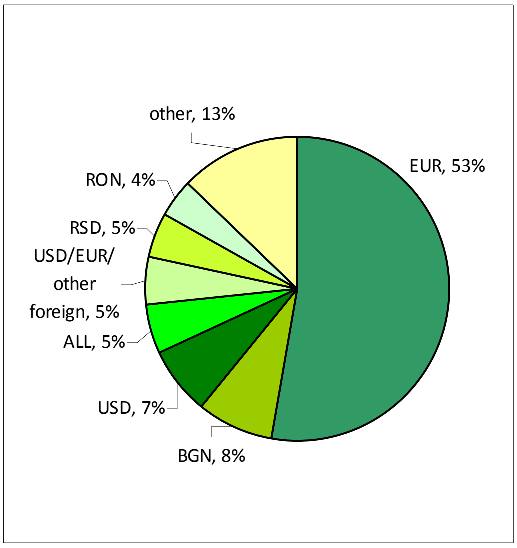
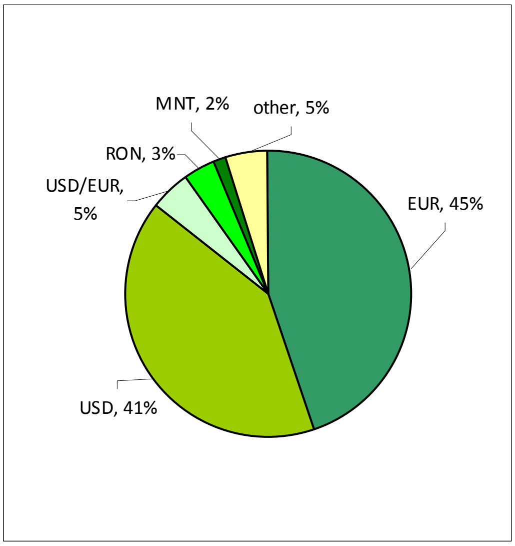


Figure 4.28. Distribution of borrowed funds of microfinance banks by currency



Price

The average nominal interest rate on borrowing deals in EUR increased while it remained the same for USD-denominated transactions.
Local currency transactions became on average cheaper, in particular in Central Asia, thanks to the availability of subsidized funds.

[10] Borrowings denominated in Euro include both local currency deals in Kosovo and Montenegro and foreign currency borrowings in other countries

Figure 4.29. Average nominal interest rate on microfinance banks' borrowing in Euro and USD

	EUR		USD	
	2007	2008	2007	2008
Balkans	6.2%	7.3%		-
CEE		-		-
Belarus/Russia/Ukraine		-	7.8%	7.7%
Caucasus		5.0%		8.8%
Central Asia	2.0%	-	8.2%	7.7%
ECA average	**6.0%**	**7.1%**	**8.0%**	**8.0%**

Figure 4.30. Average nominal interest rate on microfinance banks' borrowing in local currencies

	Local currency	
	2007	2008
Balkans	3.9%	2.5%
CEE		-
Belarus/Russia/Ukraine	9.7%	-
Caucasus		8.1%
Central Asia	9.9%	6.2%
ECA average	**9.3%**	**6.2%**

Term

Out of all savings in microfinance banks 67% are placed on term deposit accounts and 28% on current or demand accounts.
Maturities of borrowed funds differ depending on the source – local banks more often supply short-term liquidity funds while international investors more often provide longer term funds.

Figure 4.31. Distribution of client deposits of microfinance banks' by type

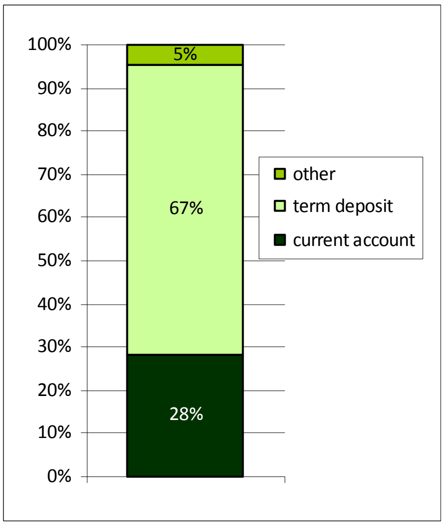
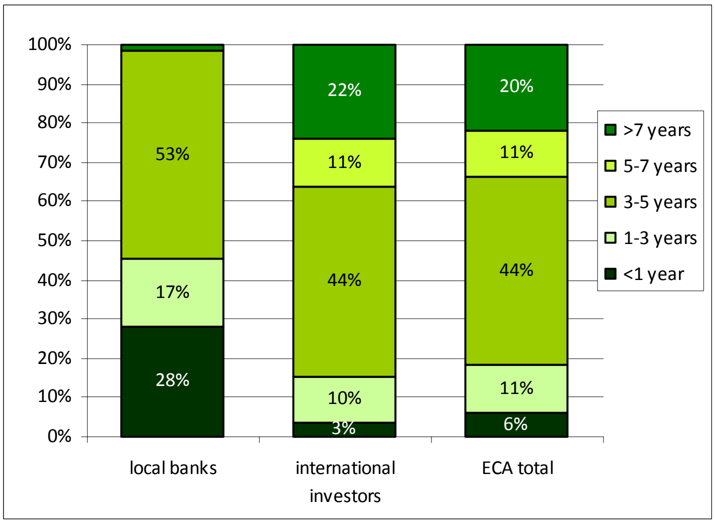


Figure 4.32. Distribution of microfinance banks' borrowing by source and maturity



FINCA Armenia

Visit of the founder of FINCA International Inc. Mr. John Hatch to Armenia in 2009.

The microfinance market began developing in Armenia in the 1990s after the country's independence.

"FINCA" Armenia was established in 1999. "FINCA" UNIVERSAL CREDIT Organization CJSC was registered and licensed by the Central Bank of Armenia (CBA) on March 28, 2006. The founder of the company is the US-based "FINCA" International Inc.

FINCA Armenia celebrated its 10th anniversary in 2009. It was a great honor for FINCA Armenia to host more than 75 top managers from FINCA International Head Quarters and other FINCA Eurasia programs for our anniversary.

Currently, FINCA has established 17 offices throughout almost all regions of Armenia. The MFI provides loans to micro- and small-businesses in many sectors including trade, service, production, and agricultural fields.

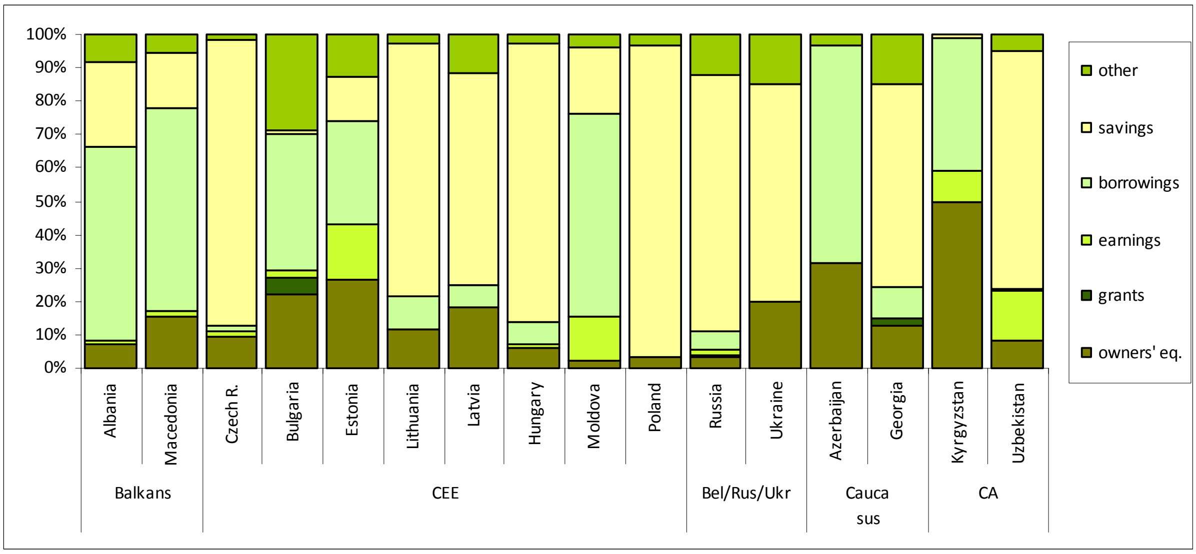
Eighty percent of FINCA's activities focus on the regions outside the capital (remote and neighboring regions, villages and cities) where the credit risk factor is higher, and where other financial institutions are not active and conditions are difficult.
The company keeps all its clients at the center of attention by mobilizing highly qualified credit specialists and support staff. FINCA and all its employees are committed to providing financial services to the Armenia's lowest-income entrepreneurs, so that they can create jobs, build assets and improve their standard of living.

FINCA Armenia
Agatangeghos str., bld. 2a; 0023 Yerevan, Armenia
Tel/fax +374 10 54 55 32, +374 10 54 55 31

Credit Unions

The total value of credit union assets at the end of 2008 reached USD 14 billion and was predominantly funded from liabilities. High leverage was seen among Polish credit unions (leverage ratio of 35) and Hungarian cooperatives (leverage ratio 13.4). On the opposite end of the spectrum Kyrgyzstan credit unions financed almost 50% of their assets from equity reserves (leverage ratio 0.7) and in non-deposit taking Bulgarian cooperatives (leverage ratio 0.8) member equity contributions were a substitute for client savings.

Figure 4.33. Funding sources of credit unions in ECA



Credit unions remain highly diversified in terms of funding sources, with many of those in the CEE region and Belarus/Russia/Ukraine mostly using member deposits to finance their lending operations and the others more dependent on borrowed funds from international institutions or government.

In several countries apex institutions channel funds from investors to associated credit unions. This is seen in Albania, Moldova, Azerbaijan and Kyrgyzstan. In other countries, such as Lithuania and Russia, a liquidity facility funded from credit union deposits helps member institutions patch up temporary liquidity shortages.

Liquidity Facility of Lithuanian Central Credit Union

Lithuanian Central Credit Union is a credit insitution established by credit unions and the Lithuanian government in order to integrate operations of the cooperatives and facilitate pooling of resources.
LCCU is funded by capital contributed by members and performs the functions of liquidity maintenance and solvency recovery to credit unions. LCCU operates a Liquidity Fund which provides additional liquidity for credit unions. In 2008 the fund increased by 3% to USD 2.3 million. LCCU operates a USD 1.6 million Stabilization Fund which ensures that capital adequacy requirements are met by credit unions facing temporary capitalization difficulties.

LCCU facilitates inter-credit union lending by accepting deposits from credit unions with surplus liquidity and lending to credit unions that are in need of additional lending funds.

In 2008 LCCU helped solving short-term liquidity problems of eleven credit unions.

Source: Association of Lithuanian Credit Unions www.lku.lt

In most countries, the importance of savings in the total assets of credit unions slightly decreased on behalf of equity or borrowed funds.

Summary

Deposits collected from clients remained the predominant source of funds for lending operations of credit unions and microfinance banks, while NGOs/NBFIs relied on borrowed funds, mainly from international investors. Local banks still have very low participation in financing of microfinance institutions and more often provide short-term loans.

Chapter 5

Policy Environment

Introduction

Central and Southern Europe and the NIS countries present a highly diversified microfinance policy landscape. Microfinance is relatively new to the region and its applications vary substantially from country to country. Overall, most of the countries created conditions allowing microfinance to exist legally, but not all countries have done so to allow the microfinance institutions to strive and grow.

Some countries (such as Bosnia and Herzegovina, Kyrgyzstan and Tajikistan) have introduced specialized, tiered microfinance laws. Others have adopted narrower laws focused on specific types of microfinance institutions (Georgia, Kazakhstan), while other countries have made adjustments to existing financial sector regulations to "fit" microfinance (e.g. Armenia). And in a number of countries, microfinance is carried out under the existing financial sector and general legal and regulatory framework with little or no adjustments. Another example is Azerbaijan which recently introduced microfinance law and made strides to improve customer protection, but at the same time maintains inappropriate treatment of credit unions, which are forced to operate as private companies, pay taxes and are prohibited from collecting deposits. There are also countries that make the existence of microfinance a challenge (Serbia and Croatia).

The development of financial infrastructure for the microfinance sector in ECA has not received enough attention. In most countries, general banking customer protection and loan conditions disclosure requirements are not fully applicable to non-bank financial institutions.

Typology of Policy Regimes for Microfinance in the ECA Region

Looking at the region, one can find various types of policies in relation to microfinance development and financial inclusion (see Table 5.1). Few (if any at all) countries fall into the 'proactive' position, offering financial assistance and creating supportive policy environment. The majority of countries fall into the 'rational' category offering modest financial support and focusing on improving the regulatory and business environment to operate microfinance.

There are also examples of 'irrational' approaches whereby countries offer support for microfinance development yet within a very constraining and unfavorable environment. Last but not least, there are still cases of 'repressive' treatment of microfinance as is the case in Serbia or Croatia where independent microfinance institutions have been practically eliminated. However, it has to be pointed out that the situation is even more complicated: one country can maintain a rational approach in some respects and continue policy repression in others (as is the case of Azerbaijan).

Figure 5.1. Typology of the policy regimes for microfinance development in the ECA region

<table>
<tr><td colspan="2" rowspan="2"></td><td colspan="2">Policy Environment</td></tr>
<tr><td>Enabling</td><td>Constraining</td></tr>
<tr><td rowspan="2">Government Support</td><td>Strong</td><td>“Proactive”
Mongolia</td><td>“Irrational”
Kazakhstan
Uzbekistan</td></tr>
<tr><td>Weak</td><td>“Rational”
Albania
Armenia
Azerbaijan (NGOs/NBFIs)
Bosnia and Herzegovina
Bulgaria (NGOs/NBFIs)
Estonia
Georgia
Kosovo
Kyrgyzstan
Latvia
Lithuania
Montenegro
Moldova
Poland
Russia
Tajikistan
Ukraine (credit unions)</td><td>“Repressive”
Azerbaijan (credit unions)

Bulgaria (credit unions)
Croatia
Hungary (NGOs/NBFIs)
Macedonia
Romania (credit unions)
Serbia
Ukraine (NGOs/NBFIs)</td></tr>
</table>

While this typology is a higher order summary, it clearly shows the extent of diversity of policy and regulatory regimes that exist in the ECA region. The move towards ‘proactive’ and ‘rational’ policy environment is highly desirable.

Policy Challenges

Despite progress, specific market segments require special attention: rural and urban, low-income populations; and customers with lower financial literacy and sophistication.
For almost a decade, policy makers and regulators have been engaged in developing legal and regulatory frameworks for microfinance in the ECA region. Every two years MFC convenes them to participate in Krakow Policy Forum, the last one of which took place in October 2008.

The discussion at the Krakow Forum IV evolved around the following key themes:

- How appropriate legal and regulatory structures are able to respond to innovation;
- How market conduct, consumer protection and financial education measures complement sound legislation and regulations; and
- How governments can best play roles of protection, promotion and provision of financial services to under-banked households and businesses.

Specialized Microfinance Legislation

Princess Maxima, representing the UN Advisors Group on Inclusive Financial Sectors at the Krakow IV Policy Forum, called upon governments and regulators to **keep pace with rapidly evolving financial sectors**, focusing on the job of creating a helpful policy, legal and regulatory environment where a diverse range of institutions can provide financial products and services, technological innovations can be fostered and where customers are protected.

To regulate microfinance activities, several models have been used in the region: specialized, tiered microfinance legislation and regulation (Kyrgyzstan, Tajikistan), specialized legislation for specific types of institutions (Kazakhstan), adjustments to existing financial sector regulations (Armenia) and the use of existing financial sector and general legal and regulatory framework (Russia). Specialized laws or changes to existing legislation have been adopted for a number of reasons, including providing explicit permission to lend, enabling MFIs to take deposits from the public, facilitating access to financial markets, and ensuring consumer protection and transparency.
An in-depth examination of the Kyrgyz experience of putting into place tiered legal structures revealed that the regulation of credit-only MFIs has created the conditions to grow and innovate. Yet the hope that MFI models would increase outreach to rural areas has not yet been fulfilled, notably transformation to a deposit-taking organizations. While the National Bank has sought to balance allowing deposit taking and domestic resource mobilization with concerns for viability, there are indications of rigidity in the both the licensing process and regulations. “Specialized legislation has not proven to be a panacea.” The Kyrgyz example suggested that proportionality in regulation requires further consideration. It is also not a static process. New challenges arise, second generation issues appear, such as the management of deposits and whether / how to make nascent credit unions into strong credit unions (or let them wither away).
Policy makers need to be prepared to amend and adjust as the situation develops and changes. Participants concluded that the focus should be on content, balancing risk and benefits of putting into place special rules in relation to the goals of access with prudence and stability.

Institutional Transformations

Transformation was examined looking in the first instance at objectives from the point of view of the institution: capital, competition, client needs, changes in products, balance sheets, sources of funding, governance and tax status. Transformation is not a one-time change, but rather a process. Moreover, it is usually not an easy process, neither for the financial institution nor for its supervisors.

The prudential supervision of transformed institutions was examined at three different stages:

- barriers to entry (the licensing of deposit-taking MFIs);
- on-going prudential supervision of the activities of depository MFIs; and
- corrective actions (meaning responding to weaknesses in supervised MFIs).

Prudential supervision of transformed institutions is particularly complex because of the interaction of the following three factors:

- Supervisors are attempting to protect depositors and minimize systemic risk to the financial sector with limited supervisory resources;
- Supervised transformed institutions are often “double bottom line” businesses intent on achieving financial returns and positive social impact: and
- Microfinance is a fast growing, fast changing sector, which makes risk-based supervision very challenging.

The country discussion highlighted these points. Georgia is an example of a country in which institutions that do not take deposits have a heavier reliance on foreign capital. In Armenia, where MFIs were created by donors and transformation hadn't been foreseen, challenges included ownership issues, valuation issues, capital adequacy, assessment of management capacity and establishing financial reporting and other procedures. In Russia**,** the transformation of Russian Women's Microfinance Network into a non-bank deposit-taking company was undertaken primarily to attract financing from institutional investors; however, it has shown few other benefits of transformation.

Across these countries, supervisors' concerns included the strength of the equity base, the motivation and purpose of owners and the capacity of management. "No regulator wants to have to supervise a weak institution." The limited mobilization of deposits resulting from transformations to date, in a region marked by significant legislative changes to enable transformations, indicates that the full promise of transformation has not yet been fulfilled.
Where inadequate and not well thought through legislative changes were implemented, the resulting weakening of the MFIs indicates not only a stalling of the development of MFIs, but also their rapid deterioration and eventual disappearance from the financial scene.

Branchless Banking

Customers who could not be reached profitably with traditional branch-based financial services were encompassed by tapping into existing infrastructure that already reaches unbanked people — such as mobile phones and virtually limitless variety of local retail outlets for the cash-in/cash-out function. Prudential regulation and supervision represent only a fraction of the policy and regulatory relevant domains. Moreover, each domain is complex and regulatory authorities responsible for each tend to operate more or less autonomously. One of the pressing issues in a number of countries currently is how to create the appropriate regulatory space for the issuance of E-money and other stored value instruments.

Russia is an example of a country introducing both bank-based and nonbank-based models of branchless banking. Especially noteworthy among nonbank-based branchless banking in Russia are web-based e-money products and automated payment acceptance terminals. While light (or in some cases even nonexistent) regulation has left space for innovation, the Russian authorities have recognized that additional legislation/regulation is required. A draft law for a national payments system is under preparation but there are many important systemic issues that need to be clarified.

Supervision of Cooperative Financial Institutions

Despite differences in ownership structure, as well as potentially scale, product offerings and relationship to customers across the region, the regulation and supervision of financial cooperatives triggers many of the same issues that arise in banking regulation and supervision. At the same time, these differences also raise practical challenges that render blanket application of banking regulation and supervision to all financial cooperatives an impracticable idea. The focus of the session, therefore, was upon alternative approaches to financial cooperative regulation and supervision that nonetheless go as far as possible to ensuring the safety of poor-people savings, preventing regulatory arbitrage and opportunistic behavior, and allowing cooperative financial institutions to become steady and sustainable competitors in the financial system.

Consumer Protection and Financial Education

The development of consumer protection in the region lags behind other measures designed to promote access while protecting institutions and their clients. Participants discussed the importance of distinguishing among the differing challenges involved in:

- establishing financial consumers' rights in regulation;
- ensuring that consumers know about and understand their rights; and
- positioning consumers to feel confident in exercising their rights.

Effective consumer protection depends on all three.

Six principles underlie a sound approach to consumer protection: addressing the suitability of borrowers, transparency, collection practices, staff ethics, recourse mechanisms and data privacy and security. However, each country begins from a different start-point, and not all of the principles will necessarily be good candidates for addressing by regulation. Indeed, forum participants were encouraged to keep regulation "light-touch" and focus first on the most important products, providers and delivery channels.

Authorities in Armenia, the participating country that has moved the furthest on financial consumer protection regulation, have worked hard to fill gaps in previously existing regulation with the adoption of three new pieces of legislation. Of these, the law creating the Armenian Financial Ombudsman generated the most interest and discussion.

Key points highlighted by participants included:

- The importance of making consumers aware of the Ombudsman and their rights (e.g. mandated disclosure);
- The importance of independence of the Ombudsman (achieved through carefully thought through governance arrangements), the five-year appointment of the Chief Executive, guaranteed budget (from mandatory financial institution annual fees, fines and Central Bank budget top-up when necessary) and Central Bank oversight; and
- The importance of balancing consumer and creditor rights (e.g. the decision that credit providers could appeal the Ombudsman's decisions to the courts).

Financial education is a win-win proposition for consumers, the financial services industry and regulators. Consumers who are financially capable can take genuine responsibility for their financial affairs and can, as a group, positively influence the market. The key building blocks are: a strong and effective championing and leadership; development of a clear strategy; the use of a variety of channels; working with as wide a range of partners as possible; and consumer testing and evaluation to ensure materials and approaches are clear and engaging.

Financial Ombudsman's Office to Protect Customers of Armenian Banking System

The Office of the RA Financial Ombudsman launched its activities in Armenia on January 24, 2009. It aims at protecting the rights and interests of customers of the Armenian banking system, thereby building up the public confidence in the Armenian financial system. Ms. Piruz Sargsyan was elected RA Financial Ombudsman by the Board of Trustees of the Financial Ombudsman Office Fund at its maiden sitting on December 22, 2008.
The Financial Ombudsman's Office was founded in Armenia in conformity with the RA Law "On financial ombudsman". The RA Parliament adopted amendments to the law on September 30, 2008.
Under the amendments, banks are to effect compulsory payments to the office equal to 0.01% of their assets for the previous year instead of 0.001%. For credit institutions the rate is 0.07% instead of 0.007%.

The Office will follow the international principles of impartiality, transparency, efficiency and justice. Complaints can be filed against banks, credit institutions, insurance companies and brokers, investment companies, pawnshops, broker-dealers, and money transmitters. The Office will consider only individual complaints. An individual person's complaint will be considered if the actions or omissions it is based on took place after the relevant law took effect, namely, after August 2, 2008; if the complaint was first lodged with the financial institution but was rejected; if the complaint is lodged within six months after the customer receives a final answer from the financial institution; if the customer does not receive an answer from the financial organizations ten days after a complaint was lodged; if the claim of ownership is not worth over 10mln AMD or an equivalent.
The RA Financial Ombudsman has the right to decline a complaint if a verdict has been returned by court or by arbitration tribunal, if court or arbitration tribunal considers a relevant case, if a complaint contains libels or if the complainant resorts to unfair practices.

Source: ARKA News Agency – 23/1/2009

Summary

The Fourth Krakow Forum, taking place, as it did, in the first days of October 2008, was permeated by reflections and concern over the then-deepening global financial crisis. In light of the crisis, financial regulators around the globe started re-assessing their regulatory frameworks and considering the special challenge of rebuilding trust and confidence in the financial system. Against this backdrop, it would have been all too easy to for participants to advocate a radical reversal of the policy gains for financial inclusion in the region that have been achieved since the First Krakow Policy Forum. This did not happen, however. Instead, participants left the Forum committed to redoubling their personal engagement and commitment to expanding financial access in their respective countries and to continue the dialogue among the participating countries.

Appendix 1

List of Microfinance Institutions

Balkans

Country	NGOs/NBFIs	Microfinance banks	Downscaling banks	Credit unions and cooperatives
Albania	BESA Fund	ProCredit Bank Albania		ASC Union
	FAF-DC (former MAFF)			Jehona National Union of SCAs
	Opportunity Albania			
Bosnia and Herzegovina	EKI	ProCredit Bank BiH	ABS	
	Lider		Fima Bank	
	LOKmicro		Intesa Sanpaolo	
	MI-BOSPO		NLB Tuzlanska Bank	
	Mikra		Nova Banka Banja Luka	
	MIKRO ALDI		Raiffeisen Bank	
	Mikrofin		UniCredit Bank	
	SINERGIJAplus		Volksbank	
	Partner			
	Prizma			
	Sunrise			
	Women for Women			
	Zdravo			
Kosovo	AFK	ProCredit Bank Kosovo	NLB Prishtina	
	Beselidhja/Zavet MicroFinance		Raiffeisen Bank	
	FINCA Kosovo			
	KEP			
	Kosovo Grameen Missione Arcobaleno Microcredit Fund			
	KosInvest			
	KRK			
	Qelim			
	START			
Macedonia	Horizonti	ProCredit Bank Skopje	IK Bank	FULM Savings House
			NLB Tutunska Bank	Moznosti Savings House
			TTK Bank	
Montenegro	AgroInvest	Opportunity Bank Montenegro	Crnogorska Komercijalna Banka	
	Alter Modus		NLB Montenegrobanka	
	MI Credit			
Serbia	AgroInvest	ProCredit Bank Serbia	Cacanska Banka	
	Micro Development Fund	Stedionica Opportunity Bank	Komercijalna Banka	
			NLB Belgrade	
			Privredna Banka	

Central and Eastern Europe

Country	NGOs/NBFIs	Microfinance banks	Downscaling banks	Credit unions and cooperatives
Bulgaria	Mikrofond EAD	ProCredit Bank Bulgaria		Credit Cooperations Union Popular Mutual-Aid Funds
	USTOI			Nachala Cooperative
Czech Republic				Czech credit unions
Estonia				Estonian credit unions
Hungary	Mikrohitel			National Federation of Savings Cooperatives
Latvia				Latvian Cooperative Credit Union Association
Lithuania				Association of Lithuanian Credit Unions
Moldova	MicroInvest	ProCredit Bank Moldova	Banca Sociala	Savings and Credit Associations of Citizens
	ProCredit Moldova		FinCom Bank	
			MAIB	
			Mobiasbanka	
Poland	FDPA			SKOK
	Fundusz Mikro			
	Inicjatywa Mikro			
	Polish Association of LoanFunds (PSFP)			
	Rural Development Foundation			
Romania	CAPA Finance	ProCredit Bank Romania	Banca Comerciala Carpatica	Caselor de Ajutor Reciproc
	Express-Finance		Banca Transilvania	
	LAM			
	OMRO			
	Romcom			

Belarus/Russia/Ukraine

Country	NGOs/NBFIs	Microfinance banks	Downscaling banks	Credit unions and cooperatives
Belarus			Belarusian Bank for Small Business	Belarusian Credit Unions
			BelGazProm Bank	
			Belrosbank	
			Minsk Transit Bank	
			Prior Bank	
			Reconversion & Development Bank	
Russia	BFSB	FORUS Bank	Absolut Bank	Rural Credit Cooperatives
	ChFSBS		Center-Invest Bank	Russian Credit Union League
	Counterpart Enterprise Fund		Chelindbank	
	FINCA Russia		KMB Bank	
	Microfinancial Center		Locko Bank	
	RWMN		Master Bank	
	Sodruzhestvo Fund		MDM Bank	
	USFSBS		NDB Bank	
	Voronezh State Fund for Support of SMEs		Orient Express Bank	
			Probusiness Bank	
			RosevroBank	

			SBS-Agro	
			SovComBank	
			Spurt Bank	
			Stolichny Bank of Savings	
			Transcapital Bank	
			Uraltrans Bank	
			VTB 24 Bank	
Ukraine	HOPE Ukraine	ProCredit Bank Ukraine	Bank Lviv	National Association of Ukrainian Credit Unions
			Forum Bank	
			Kreditprom Bank	
			KredoBank	
			MegaBank	
			Rodovid Bank	

Central Asia

Country	NGOs/NBFIs	Microfinance banks	Downscaling banks	Credit unions and cooperatives
Kazakhstan	Abzal-Credit		Alliance Bank	
	A-Invest		Bank Caspian	
	Arnur Credit		CenterCredit Bank	
	Asian Credit Fund			
	Atyrau Valyut			
	Bereke			
	Damu-Akzhaiyk			
	Delta-Credit			
	FCF Shymkent			
	Fund for Financial Support of Agriculture			
	Kamkor			
	KazMicroFinance			
	Kyzylorda-Kredit			
	MKO 'BURA'			
	Moldir			
	ORTA Nesie			
	PF Akniyet			
	PF Aktobe			
	Sator			
Kyrgyzstan	AgroKredit Plus	Aiyl Bank	ECO Bank	Credit Unions of Kyrgyzstan
	Ak-Shoola-credit		KICB	
	Altyn Kyrym		KKB Bank	
	Arysh-Kench			
	Bai Tushum			
	Baedar Company			
	Bereke-Credit			
	Credit Systems			
	Dirigible			
	Economic Take-off			
	Elet-Capital			
	Express-Invest			
	Finca Microcredit Comany			
	First Microcredit Company			
	FNT Credit			
	FRP			
	Joldosh Group			

	Kompanion Financial Group			
	Mehr-Shavkat			
	Mol Bulak Finance			
	OXUS Kyrgyzstan			
Mongolia	Credit Mongol	XAC Bank		Mongolian Credit Unions
	TFS	Khan Bank		
	Vision Fund Mongolia			
Tajikistan	Amlok	First Microfinance Bank	Agroinvest Bank	
	Armon		Eskhata Bank	
	ASTI		Tajprombank	
	Baror		Tojiksodirotbonk	
	Bekhnamo			
	Borshud			
	Chiluchor Chasma			
	Credit-Express			
	Finansovyi Dom			
	FINCA Tajikistan			
	Furuz			
	Gender va Taraqieet			
	Haft-Gang			
	Haqiq			
	HUMO			
	Imdodi Hutal			
	Imkoniyat			
	IMON			
	Ishkoshim			
	Jovid			
	Kiropol			
	Madina			
	Maqsadi Dasigiri			
	Mekhnatabad			
	Microinvest			
	Muzafariat			
	Nasrin			
	Nisor Fom			
	Nov Credit			
	OXUS Microfinances			
	Phoenix			
	Rushdi Obshoron			
	Rushdi Zanon			
	Saodat Invest			
	SAS			
	Somit			
	Sugd Mikrofin			
	Tavildara			
	ZAR			
Uzbekistan	Barakat		Hamkorbank	Credit Unions of Uzbekistan
	Baror Biznes		Microcredit Bank	
	Extirom Plus			
	Garant Invest			
	IMKON Express Invest			
	Kafolatli Sarmoya			
	Kapital Plus Mikrokredit Tashkiloti			
	Konstanta Kapital			
	SABR			
	Sarmoya Sardor			
	Tadbirkor Invest			

Vision Fund AzerCredit

Vision Fund AzerCredit was established in 1996 as a program of World Vision Azerbaijan, a relief-and-development organization to provide credit to ensure people can take control over their own lives and livelihoods. In 2002 VF AzerCredit was successfully registered as a Limited Liability Company and obtained Central Bank license in 2003.

Although much has changed since then, the vision of VF AzerCredit is still to assist people in developing a positive and self-sustainable lifestyle.

The mission of VF AzerCredit is to provide financial services which have a positive impact on the lives of the poor.

The primary objective of VF AzerCredit has always been to provide loans to those who are not able to access facilities through the conventional banking system. This implies that AzerCredit works both in the urban and rural areas of Azerbaijan but the emphasis is placed on providing loans to micro and small rural entrepreneurs and self-employed poor, covering remote areas which are not bankable. However the sole focus on loan is being replaced by a wider view on microfinance now as VF AzerCredit has developed into a strong financial institution.

Recent product/process refinements and product developments introduced by VF AzerCredit brought innovation to the microfinance sector of Azerbaijan. New product delivery mechanism of Village council, which is tested and now is being practiced in remote areas, is a new way to improve the outreach into far-away villages and remote areas. Product diversification continues by means of extensive researches of target clients' needs.

Currently AzerCredit provides the next products to the target clients: Group Urban and Group Rural Loans, Individual Urban and Agriculture Micro Loans, Individual Urban and Agriculture Small Loans and Household Loans for Small and Micro Entrepreneurs.

AzerCredit operates in 18 regions, 13 of which are comparatively underserved rural areas. As a proof of commitment to rural expansion AzerCredit is in the process of launching a sub-branch in other rural locations of Aghdash region. Rapid growth of the branch network in underserved rural areas provides the foundation for continued growth in the coming years.

By the end of 2009 the total number of active borrowers increased by 35% reaching 32 000 and the portfolio 20% increase to over $20 mln. In line with these figures AzerCredit keeps an outstanding portfolio quality, as PAR>30d is 0.3%. Year to day Operational Sustainability is 118%. Being an equal employment opportunity provider, AzerCredit consists of 220 staff members, who are the main asset of the organization.

The organization is actively investing in developing social performance management system as a part of strategic plan, as it looks to support the double bottom-line. The poverty measurement tool has been introduced and permanently used at VF AzerCredit since October 2009. The poverty measurement tool provides an opportunity to measure the poverty level of targeted clients and in future will help gauge the impact of AzerCredit on the lives of the poor.

VF AzerCredit has recently started active development of Customer Service Strategy. The first step in this direction was creation of reliable feed-back system of customer grievance and suggestions. Client Relationship Management will be one of the core directions of VF AzerCredit in the coming years.

In 2009 VF AzerCredit went through Financial and Social Rating conducted by Microfinanza Rating. Thus, AzerCredit became the first institution in Azerbaijan to go through the social rating. This year AzerCredit was audited by a big four audit company and received an unqualified opinion, which is indeed a success for an MFI.

In 2009 AzerCredit's performance was highly recognized by the microfinance industry. AzerCredit received Silver award from CGAP, Ford Foundation and Michael & Susan Dell Foundation for reporting on Social Indicators to MIX. Also AzerCredit received acknowledgement for pioneering participation in the project Advancing Social Performance Management in Azerbaijan by MFC using MFC Quality Audit Tool. MF Transparency recognized AzerCredit as a leader in transparent pricing in Azerbaijani microfinance industry.

VF AzerCredit's leadership on Azerbaijan microfinance market and active improvement of internal systems creates a perfect environment for future development of the organization and expansion into many more rural and remote areas, which will be the focus of the MFI for the coming years.

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MFC Bridging the Market Gap

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