

Overview of the Microfinance Industry in the ECA Region in 2003

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Introduction

Microfinance in Central and Eastern Europe and the Commonwealth of Independent States, also called the ECA region, has been a dynamically developing sector in the past few years. New MFIs are being opened and the existing ones are growing, transforming and adapting to the changing environment.

This paper summarizes the results of research carried out among microfinance institutions whose goal was to quantify these recent developments. The objective of the research was to study the state of the microfinance sector at the end of 2003 among different institutional models – credit unions, NGO MFIs, downscaling commercial banks and microfinance banks – that operate in the following five sub-regions¹: the Balkans, Central and Eastern Europe (CEE), the Caucasus, Central Asia and Russia/Ukraine/Belarus. Areas of interest included the size of the sector in terms of the volume of loans and numbers of clients served; types of products offered; operating environment; new developments on an organizational level; institutional performance, and funding issues.

The report builds on the results of a similar study conducted by the Microfinance Centre for CEE/NIS (MFC) in 2001-2002² and provides a comparative analysis of the observed changes.

Dimensions of the outreach in the ECA region

Portfolio Size and the Number of Borrowers

At the end of 2003 nearly 6,000 microfinance institutions operated in the region. Together they managed a gross loan portfolio of US\$2 billion. The biggest share of this portfolio was managed by credit unions (37%), closely followed by microfinance banks (35%). Compared to September 2001, microfinance banks gained a significant share of the total loan portfolio volume (up from 20%).

More than 2 million people were classified as active borrowers from microfinance institutions in 2003. Credit unions remained dominant, serving 72% of all microfinance borrowers. But regarding portfolio volume, their share decreased at the expense of microfinance banks.

The volume of deposits reached US \$ 1.7 million from 3 million depositors. Credit unions served the vast majority of depositors (86%). Also, microfinance banks managed an important share of microfinance savings although their number of depositors was much lower.

NGO MFIs did not attract voluntary savings as this activity is not permitted by law. Instead, some of them mobilized their clients to collect small deposits within a solidarity group or a

¹ The following countries comprise sub-regions:
Balkans – Albania, Bosnia and Herzegovina, Croatia, Kosovo, Macedonia, Serbia and Montenegro, Slovenia
CEE – Bulgaria, Czech Rep., Estonia, Hungary, Latvia, Lithuania, Moldova, Poland, Romania, Slovakia
Caucasus – Armenia, Azerbaijan, Georgia
Central Asia – Kazakhstan, Kyrgyzstan, Mongolia, Tajikistan, Turkmenistan, Uzbekistan
Russia/Ukraine/Belarus

² Forster S., Greene S., Pytkowska J., “The State of Microfinance in CEE and the NIS”, CGAP 2003



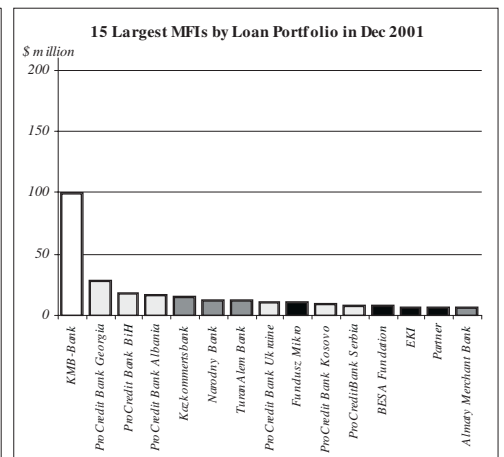
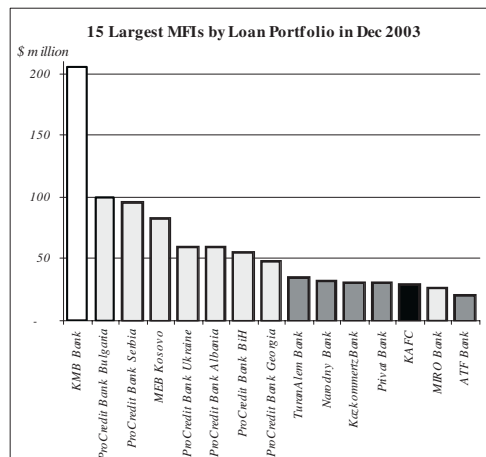
village bank. Commercial banks were not surveyed on this issue as they do not divide the savings of microfinance clients from the entire volume of deposits collected.

Table 1: Lending and Savings Volume by MFI Types (as of December 30, 2003)

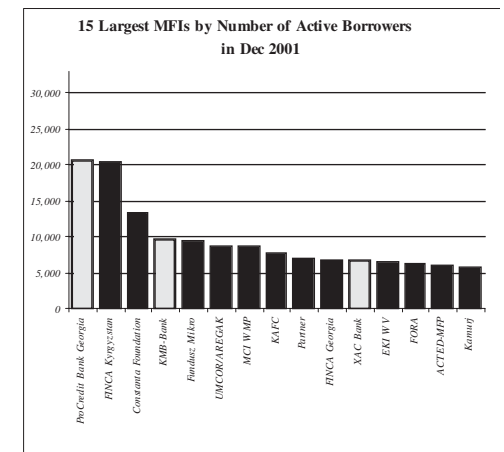
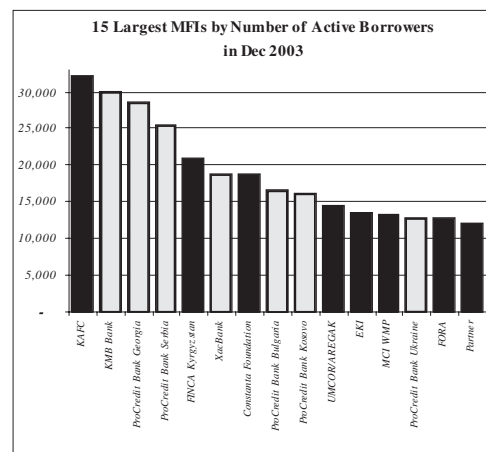
	N	Gross Loan Portfolio		Number of Active Borrowers		Total Deposits		Number of Depositors	
		US\$	%		%	US\$	%		%
Credit Unions	4,567	835,609,740	37%	1,649,612	72%	1,057,530,080	62%	2,563,703	86%
NGO MFIs	117	320,602,368	14%	374,407	16%				
Commercial Banks	45	315,377,911	14%	71,245	3%				
Microfinance Banks	15	779,740,885	35%	186,620	8%	652,574,477	38%	425,621	14%
Total	4,744	2,251,330,904	100%	2,281,884	100%	1,710,104,557	100%	2,989,324	100%

Biggest MFIs in the Region ³

The group of 15 largest MFIs is dominated by microfinance banks. Eight microfinance banks top the list of the largest MFIs by loan portfolio followed by downscaling commercial banks. Top 15 portfolio size ranged from US\$20.4 million to US\$206 million. This is quite a development compared to December 2001, when the gross loan portfolio of some US\$5.3 million was sufficient for an MFI to enter the top 15 list.



A similar development was seen on the list of the largest MFIs by number of active borrowers. In 2001 there were three microfinance banks listed among 12 NGO MFIs. By the end of 2003, four more microfinance banks were added to the list. Each of these MFIs served at least nearly 12,000 borrowers (in 2001 - 5,500 borrowers).



³ Data on individual size of credit unions were unavailable



Credit Unions

Credit unions dominate the microfinance scene in terms of the number of institutions and clients they serve. The biggest network of credit unions is in Romania (well over 3,000 unions) which serves the largest number of clients (over 1.5 million members). Other large networks of credit unions operate in Poland (nearly 1 million members) and Ukraine (300,000 members). The biggest loan portfolio was managed by Polish credit unions (SKOK) – nearly US\$600,000,000.

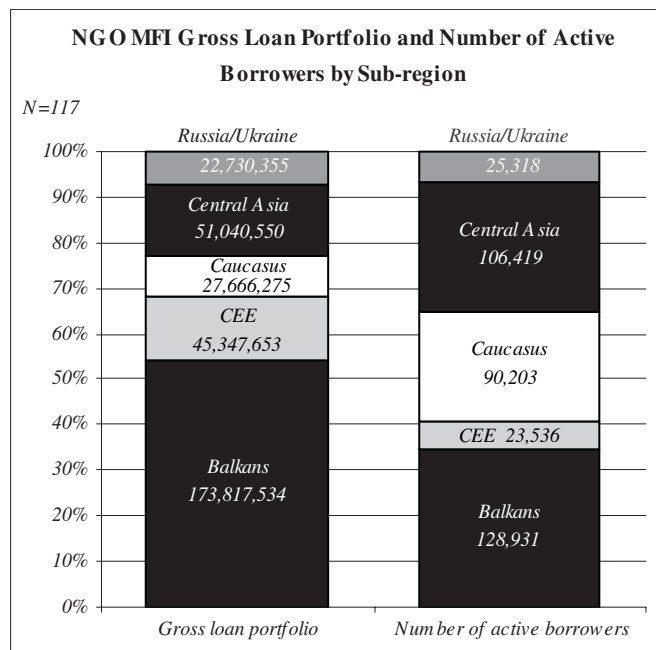
In several countries networks of CUs operate solely in rural areas. In Russia (nearly 300 credit unions), Moldova (over 230 CUs) and Albania (94) such networks answer the needs of entrepreneurs engaged in agriculture where there is no access to other financial services.

Credit unions are also leaders among all institutional types in terms of the numbers of depositors that serve and the volume of deposits collected.

NGO MFIs

NGO MFIs are the second type of MFIs (after credit unions) that together reach the largest numbers of borrowers. At the end of 2003, all NGO MFIs reached 370,000 borrowers with a gross loan portfolio of more than US\$320 million.

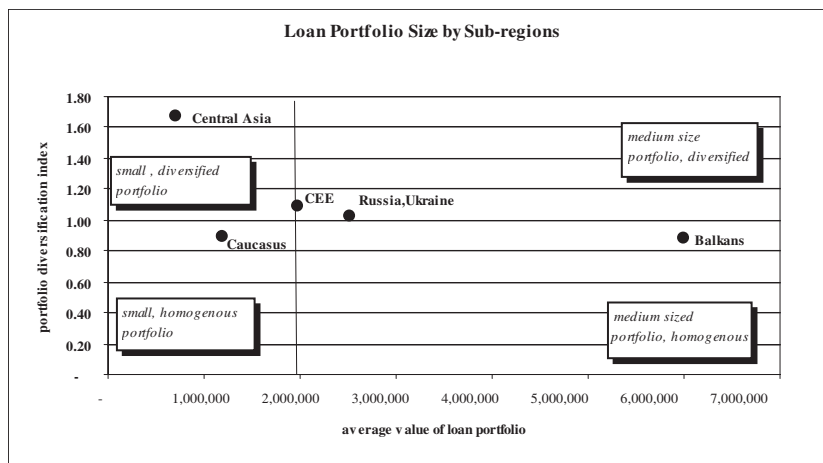
Over half of the total value of their gross loan portfolio was utilized in the Balkans. The other sub-regions managed much smaller levels of funds. The Balkans also led in the number of active borrowers.



For an individual NGO MFI, the average size of the gross loan portfolio is small or medium-sized⁴ depending on the sub-region. An average NGO MFI in Central and Eastern Europe, Central Asia and the Caucasus falls into the “small” category of portfolio size, whereas in the Balkans and Russia/Ukraine/Belarus NGO MFIs are, on average, medium-sized.

NGO MFIs in Central Asia have the smallest average portfolio but are the most diversified in terms of size, ranging from \$3,000 to \$29 million. Also quite diversified were Eastern European NGO MFIs with loan portfolios ranging from \$10,000 to more than \$8 million. NGO MFIs in the Balkans and the Caucasus were more homogenous in terms of loan portfolio size.

⁴ MicroBanking Bulletin classes of loan portfolio size for ECA (Eastern Europe and Central Asia):
- small: below US\$ 2 million
- medium: between US\$2 million and 8 million
- large: over US\$8 million



* diversification index was calculated by dividing standard deviation by average value of the gross loan portfolio in the sample

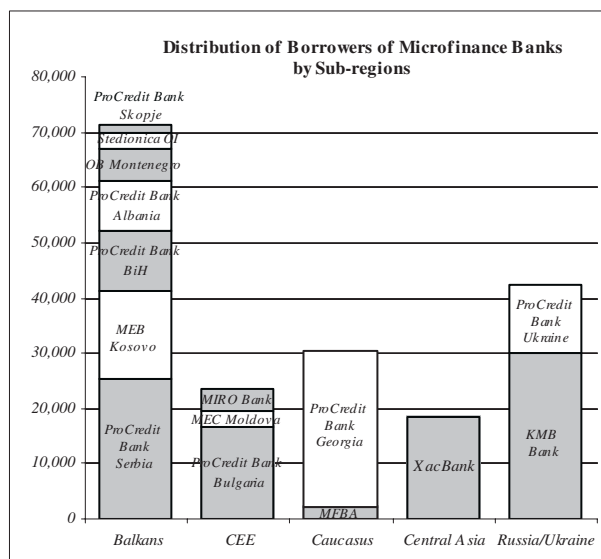
For all NGO MFIs the average value of the gross loan portfolio was US\$2.8 million but the median was only \$1.1 million. This shows that more than half of all NGO MFIs managed portfolios of only \$1 million.

In terms of achieving scale in reaching the biggest numbers of borrowers, NGO MFIs serve an average of 3,200 active borrowers. The median value was 1,400, however, there were a few examples of large NGO MFIs with more than 15,000 active borrowers.

NGO MFIs in the Balkans and in the Caucasus were in the lead. The average Balkan NGO MFI had 4,446 active borrowers and the Caucasian NGO MFI had 3,922.

Microfinance Banks

Microfinance banks are the second largest microcredit providers in terms of volume of gross loan portfolios. They are also the fastest growing institutions in the past two years. At the end of 2003 they reached \$780 million in outstanding loans.



In 2003 the total number of microfinance banks in the region grew to 15 with the creation of ProCredit Bank in Macedonia in June 2003. Nine of them are members of the IMI group of ProCredit Banks. Microfinance Banks are predominantly located in the European part of the region – seven of them operate in the Balkans and three in CEE.

The largest bank (KMB Bank) exceeded \$200 million in gross loan portfolio and the second largest – ProCredit Bank Bulgaria – \$100 million in outstanding loans. The average microfinance bank managed a loan portfolio of \$52 million.

Similarly to portfolio growth, the number of active borrowers of microfinance banks has increased quickly. By the end of 2003 these banks had nearly 190,000 active borrowers. The biggest numbers of borrowers were reached by KMB Bank in Russia and ProCredit Bank in



Georgia (29,000 and 28,000 respectively) but the average microfinance bank served 12,000 borrowers.

Microfinance banks offer micro and small loans ranging from \$100 to over \$50,000. The average microfinance bank has nearly 60% of its gross loan portfolio tied up in loans below \$10,000, which are utilized by 97% of borrowers.

Downscaling commercial banks

The downscaling process of commercial banks in the region has advanced significantly in the past year. By the end of 2003 the number of downscaling commercial banks increased to 45. New EBRD projects were started in Romania and Tajikistan and the existing downscaling projects of KfW and EBRD were further expanded. All downscaling commercial banks managed nearly the same value of loan portfolios as NGO MFIs (\$315 million and \$320 million respectively). Half of the total loan portfolio was allocated in Central Asia where the biggest EBRD program – Kazakhstan Small and Micro Lending Program – included seven banks managing a loan portfolio of \$150 million by the end of 2003.

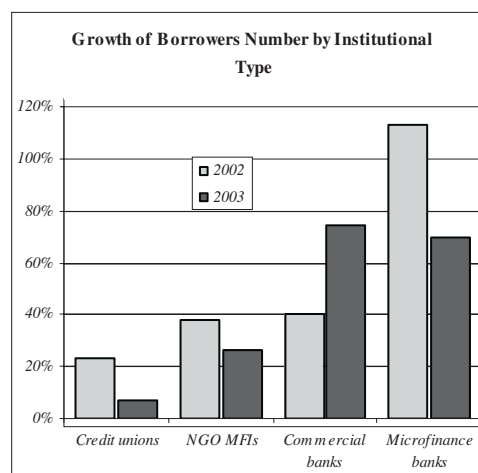
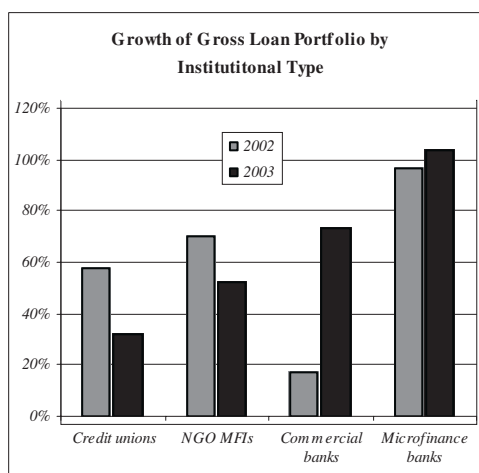
The biggest number of borrowers (50% of all downscaling bank borrowers) was also located in Central Asia, especially in Kazakhstan – over 32,000 – among them over 85% constituted micro borrowers with loans of less than \$10,000. Additionally, other downscaling banks predominantly serve this segment of borrowers (70-100% of the loan clients are borrowers with loans less than \$10,000).

Portfolio and Borrowers Growth Rates 2002-2003

In 2003 the growth rate of the gross loan portfolio of all institutions kept pace with 2002 (60% annual increase).

Significant differences were seen among institutional types. The fastest growing example was microfinance banks, which more than doubled their loan portfolio (up 104%) during 2003. This even surpassed 2002, when growth rate was 97%.

The largest portfolio increase was observed in ProCredit Bank Bulgaria and KMB Bank Russia.



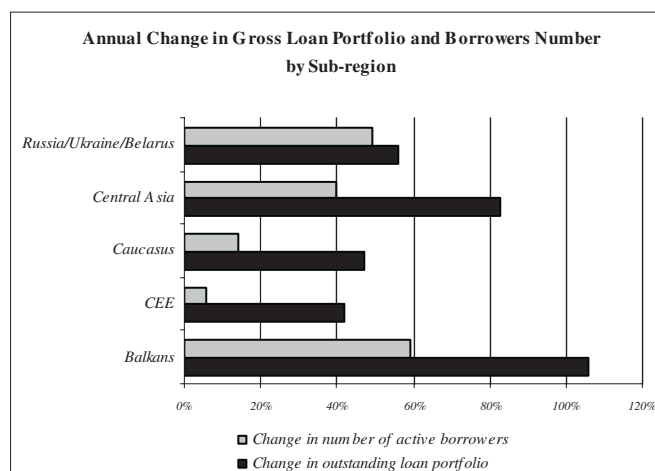
Downscaling commercial banks impressively grew their portfolio by 73%, especially in Kazakhstan under the EBRD Kazakhstan Small Business Project. Compared to 2002's growth rate of 16%, downscaling commercial banks significantly accelerated their growth in 2003.

The 70% growth rate of NGO MFI portfolio in 2002 slowed to 52% in 2003. Similarly, credit unions didn't grow as fast in 2003 as in the previous year.

Loan portfolio growth was coupled with an increase in the number of active borrowers. Unlike the loan portfolio, the overall growth in client numbers was modest in 2003 compared to 2002 rates (15% in 2003 vs. 32% in 2002). Commercial downscaling banks demonstrated the biggest growth. They were the only institutional type that grew faster than in 2002.



In the sub-regions, the biggest growth both of the portfolio and borrowers number was observed in the Balkans. This is the region where 7 out of 15 existing microfinance banks are present. The second highest portfolio growth occurred in Central Asia (83%) and the second biggest increase in the number of borrowers was observed in Russia/Ukraine/Belarus (49%).



Depth of Outreach – Average Outstanding Loan Balance

The average size of the outstanding loan significantly varied for different MFI types. NGO MFIs on average targeted a broad clientele, according to MicroBanking Bulletin classification⁵, with the average loan size of \$2,042 or 125% GNP per capita.

Table 2: Average Loan Balance by Institutional Type

	N	Avg. Outstanding Loan Balance US\$	ALB annual change %	Avg. Outstanding Loan Balance/GNP per capita	ALB/GNPpc annual change %
Credit Unions	4567	252	4%	15%	-6%
NGO MFIs	114	2,042	26%	125%	14%
Commercial Banks	45	4,455	-1%	509%	-14%
Microfinance Banks	15	4,076	15%	324%	-2%
microfinance banks – micro loans <US\$10,000	15	2,131	7%	176%	-10%

The average values indicate that the loans of microfinance banks and commercial banks fall into the category of “small business” according to classification of the MicroBanking Bulletin, as the average loan size in both cases exceeded 250% of GNP per capita. This is because both types of banks have a wide range of loan sizes offered starting from \$50 to \$600,000, so in order to better evaluate the average loan size in the micro sector, a portion of the loan portfolio allocated to loans below \$10,000 was further analyzed.

For the majority of microfinance banks, over 50% of the gross loan portfolio was allocated to loans below \$10,000. The average outstanding loan balance in this segment of the loan portfolio was \$2,131 or 176% of GNP per capita. In the course of the year the depth of outreach in this segment decreased by 10%.

In the case of downscaling commercial banks, the outstanding loan balance in the portfolio segment with loans below \$10,000 averaged \$1,770 or 295% GNP per capita.

⁵ The MicroBanking Bulletin classification of the depth of outreach:
 - low-end: depth of outreach <20% GNP per capita
 - broad clientele: depth of outreach 21% - 150% GNP per capita
 - high end clientele: depth of outreach 151% - 250% GNP per capita
 - small business: depth of outreach >250% GNP per capita



Compared to last year, the outstanding loan balance of an average NGO MFIs grew by 26% in nominal terms but the depth of outreach increased by 14% .

Commercial banks exhibited a real downscaling effect – their average loan size decreased by 1% in 2003. Their average depth of outreach decreased by even more – 14%.

Although the average loan size of microfinance banks increased in dollar terms, the relative size to GNP per capita decreased the depth of their outreach by 2%.

Despite the upscaling trend among the NGO MFIs, there were 30 institutions (38% of the sample) that decreased their depth of outreach, although only 13 of them actually lowered their average loan size in dollar terms. The largest number of downscalers was observed in the Caucasus (11 NGO MFIs or 61% of NGO MFIs surveyed there).

Among the microfinance banks, there were downscalers too. Seven microfinance banks lowered their depth of outreach, some by as much as 60%.

For the downscaling commercial banks the decrease in the depth of outreach occurred in seven country programs.

Despite an overall shallowness of outreach in the region, there are some MFIs that offer only small loans. The majority of them are located in the Asian part of the region – in the Caucasus and Central Asia.

Table 3: Top 20 MFIs by Depth of Outreach

Name	Country	Avg. Loan Balance/GNP per capita
MCA "Arysh-Kesh"	Kyrgyzstan	9%
MikroPlus	Croatia	11%
Local Women Organization	Romania	12%
Kharkiv Kassa Vzaemopomogy	Russia	13%
KS „Alternativa"	Russia	15%
MCA "Airan"	Kyrgyzstan	16%
MCA „Pokrovka-Kenchi"	Kyrgyzstan	17%
Azeri Star Microfinance	Azerbaijan	18%
ACTED	Uzbekistan	18%
NNO Daulet	Uzbekistan	18%
VOKA Slovakia	Slovakia	23%
FINCA Azerbaijan	Azerbaijan	24%
DEMOS	Croatia	25%
Constanta Foundation	Georgia	26%
MCI Barakot	Uzbekistan	26%
KLF	Kazakhstan	28%
USTOI – CRS Bulgaria	Bulgaria	29%
MDF Kamurj	Armenia	31%
Finance for Development	Azerbaijan	31%
FORA	Russia	31%

The depth of outreach of NGO MFIs correlated to the methodology of loan delivery. MFIs with a deeper outreach tended to commit more of its loan portfolio to group loans. The loan officers of NGO MFIs with a deeper outreach were also more productive.

MFI Performance

Operational Sustainability

Data on financial performance was not available for all MFI types. For NGO MFIs the average operational self-sufficiency was 117%, up from 109% in 2001. Among 86 surveyed NGO MFIs, 57 organizations were operationally self-sufficient. This is a steady increase from 30 MFIs in 2001 and 40 in 2002.

The biggest number of operationally sufficient NGO MFIs was present in Russia/Ukraine/Belarus (86% of MFIs in Russia/Ukraine) and in the Balkans (78% of Balkan NGO MFIs). The



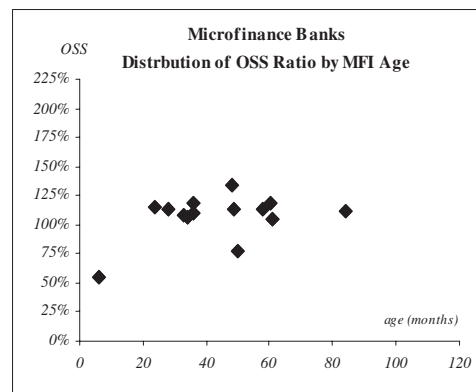
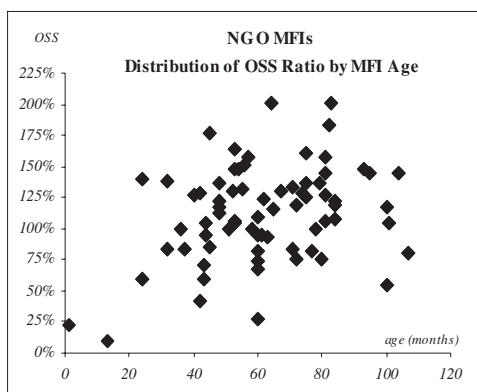
highest OSS levels were observed in Central Asia with an OSS ratio as high as 400% among some NGO MFIs.

Sustainability of NGO MFIs correlated significantly with age and the size of the institution (both portfolio size and number of borrowers). It was also found that more productive MFIs were more sustainable.

Table 4: Operational Self-Sufficiency of NGO MFIs

	N	Operational Self-Sufficiency %
Balkans	28	119%
CEE	11	79%
Caucasus	19	117%
Central Asia	21	135%
Russia/Ukraine/Belarus	7	115%

Microfinance banks had a slightly lower average level of operational self-sufficiency – 107%. All microfinance banks in operation for more than two years were operationally self-sufficient. Microfinance banks have to assume the market interest rates on borrowed funds (both loans and savings) while NGO MFIs continue to benefit from grant funds and social loans for on-lending.



Productivity

Loan officers of different institutional types had varying workload. Downscaling commercial banks had the smallest numbers of clients per loan officer. Microfinance banks were quite productive given that they disburse individual loans only. The most productive microfinance banks operated in the Balkans and the Caucasus.

In one year, microfinance banks improved loan officer productivity from 119 to 144.

Table 5: Loan Officer Productivity by Institutional Type

	N	Number of Active Borrowers/ Number of Loan Officers
Commercial Banks	21	46
Microfinance Banks	14	144
NGOs	97	158

NGO MFIs were the most productive type of institution. Unlike the banks their productivity has increased since December 2002 when the average loan officer served 152 borrowers. Among NGO MFIs the most productive were on average MFIs in the Caucasus followed by the Balkans. Productivity was correlated with the size of the loan portfolio as well as with the number of active borrowers – bigger NGO MFIs were more productive.

Table 6: Loan Officer Productivity among NGO MFIs by Sub-region

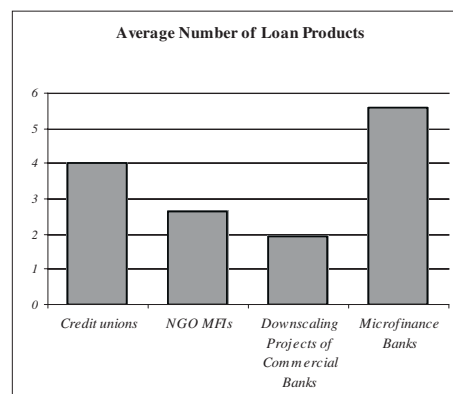
	N	Number of Active Borrowers/ Number of Loan Officers as of Dec 2003	Number of Active Borrowers/ Number of Loan Officers as of Sept 2001
Balkans	27	206	177
CEE	14	73	78
Caucasus	18	219	219
Central Asia	28	123	128
Russia, Ukraine, Belarus	8	101	102

Loan Products

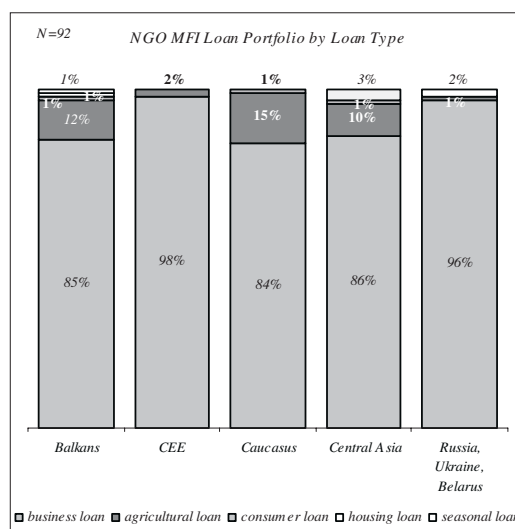
Number of loan products⁶

At the end of 2003 the average MFI in ECA offered 4 loan products. The largest variety was offered by microfinance banks (the average of 5.7 loan products), ranging from 2 to as many as 12. For NGO MFIs an average number of loan products was 2.6, ranging from 1 to 7. Downscaling programs of commercial banks offered on average 1.9 types of loans. It should be noted that most commercial banks also offer other loan products that can be used by micro-entrepreneurs although not directly targeted at them through downscaling projects.

The average for credit unions was skewed by Romanian credit unions, which constitute the majority of institutions. They offer 4 types of credit that differ in the loan size. The biggest



number of loan products was offered by Polish credit unions – some had as many as 11-15 different types of loans.



Among NGO MFIs the biggest number of loan products was offered in the Balkans – on average 3.1, closely followed by Russia/Ukraine – 3, and the Caucasus – 2.9. The most limited loan product offer was observed in Central Asia and CEE (2.2). The number of products was correlated with the outreach – the more borrowers an MFI served and the larger portfolio it managed, the bigger number of loan products it offered.

Apart from various business loans, which are offered by almost all MFIs, some institutions also offer agricultural, consumer, housing and seasonal loans.

Again, differences are seen among institutional types.

Half of the microfinance banks provide consumer loans, 43% provides agricultural loans and nearly one-third housing loans.

NGO MFIs predominantly offer business loans (95% of NGO MFIs) for working capital and investment in trade, services and production, but also agricultural loans (42% of NGO MFIs), consumer loans (16%), seasonal loans (12%) and housing loans (3%).

⁶ there is no one definition used by MFIs what counts as a separate product



Despite the variety of loan products offered, the majority of NGO's loan portfolio is in business loans. Agricultural loans also have in some sub-regions a significant share, for example, NGO MFIs in the Caucasus had 15% of the portfolio engaged in agriculture.

This can be attributed to the following two reasons: product diversification is a new trend observed in the past two years (see below) and has not yet achieved scale, and loan products other than business and agricultural loans are meant to be supplementary for MFI clients to better fulfil diversified financial needs and will never take a significant portfolio share.

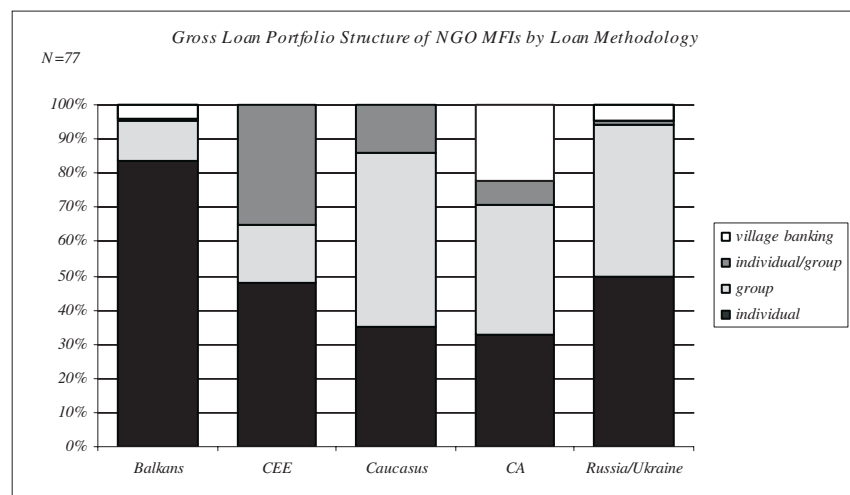
New loan products

In the last year, 37% of surveyed NGO MFIs⁷ introduced new products. Among them 36% introduced new types of enterprise loans while 20% started offering agricultural loans. Other types of new products were consumer loans (17%) and seasonal loans (7%).

Loan Methodology

Both downscaling commercial banks and microfinance banks – as well as the majority of credit unions – offer only individual loans, while NGO MFIs provide individual, group and village banking loans.

In the sub-regions individual loans constituted the majority of the loan portfolio of an average NGO MFI in the Balkans. As for the Caucasus and Russia/Ukraine, half of the total loan portfolio constituted group loans. A significant portion of the total loan portfolio in Central Asia was involved in village banking.



Non-credit Financial Products

Commercial banks as well as microfinance banks offer a wide variety of non-credit products such as current and savings accounts, payment services, monetary transfers, and debit cards. On average, microfinance banks offer 2.5 types of savings products. The most common savings products are demand and term deposits in local and foreign currencies, housing savings and children's deposits.

As it is not legal for NGO MFIs to collect savings, no NGO MFI offers deposit services. However, 10% of NGO MFIs provide savings opportunities for clients either in the form of mandatory or voluntary savings that are held and managed by the client group.

Non-financial Products

Non-financial products are offered by 17% of surveyed NGO MFIs and six credit unions. These are business development services such as training and consulting in managing a private business, marketing, business planning, and legal issues. Three of the NGO MFIs provide insurance. Services are provided either directly by MFI staff or by joining forces with an outside service provider.

⁷ data on other institutional types was unavailable

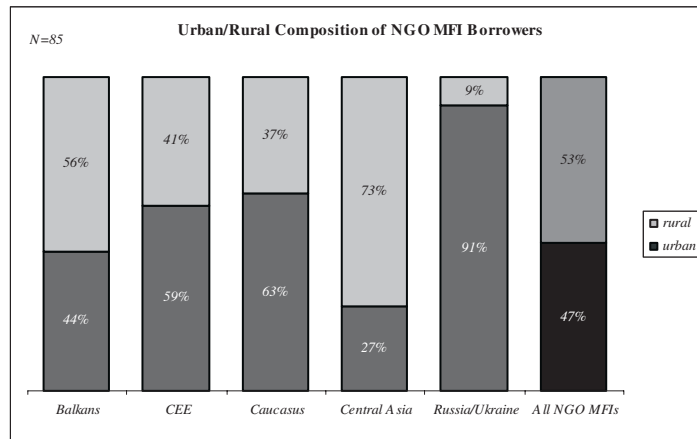


Analysis of NGO MFIs

Due to limited access to detailed information, the following findings are from NGO MFIs only.

Client Characteristics

At the end of 2003 NGO MFIs served more rural borrowers than entrepreneurs in towns and cities. This is a change compared to 2001 when more than 60% of MFI borrowers were located in urban areas.



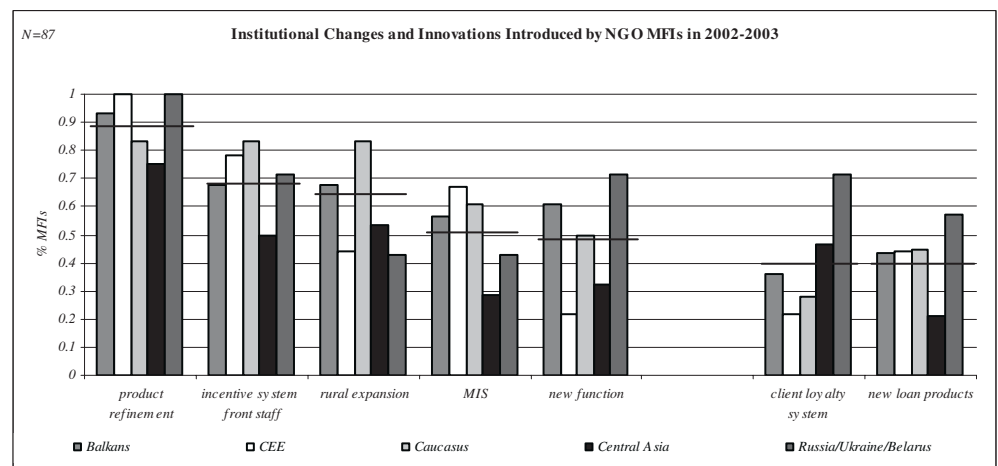
Institutional Changes and Innovations

In the past two years, the most frequently introduced innovation was to refine existing products (86% of surveyed NGO MFIs), introduce incentive systems for frontline staff (67%) and expand to rural areas (63%), all of which were backed up by institutional changes such as introducing new MIS systems (48%) and creating a new function or department in the institution (47%).

For all sub-regions refining products to better address client needs was the most common change. Also, incentive systems for frontline staff were introduced by the majority of MFIs in every sub-region.

Rural expansion was most strongly seen in the Caucasus where 83% of the NGO MFIs extended their operations into rural areas.

In the Russia/Ukraine sub-region, client loyalty systems (71% of MFIs) and new loan products (57%) were introduced more often than in the other sub-regions.



Although only 39% of NGO MFIs introduced new products in the past two years the vast majority (86%) plans to develop new products and improve existing ones (80%) in the next three years (2004-2006). This suggests the growing recognition of the need to better address the

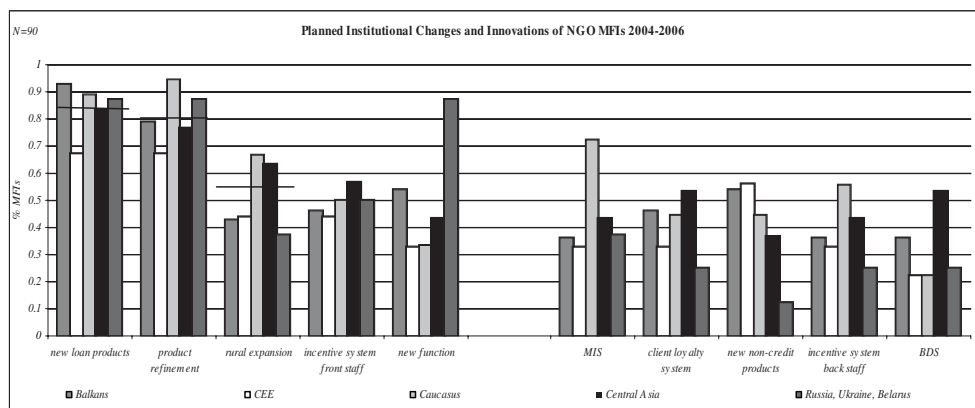


demand for microfinance services of both existing and potential clients. Therefore, over half of the MFIs will increase their presence in rural areas (56%).

The expected growth of the institution will also be coupled with internal improvements in staff productivity through incentive schemes for frontline staff (50%) and new functions and departments like HR department or marketing (49% of NGO MFIs). Many MFIs will install new MIS systems (46%) and develop client loyalty systems (46%).

Many MFIs, particularly in CEE and in the Balkans, plan to extend their product offerings by adding new non-credit financial products (63% of CEE NGO MFIs and 50% of Balkan NGO MFIs) and non-financial products (business development services) – 63% of Central Asian NGO MFIs.

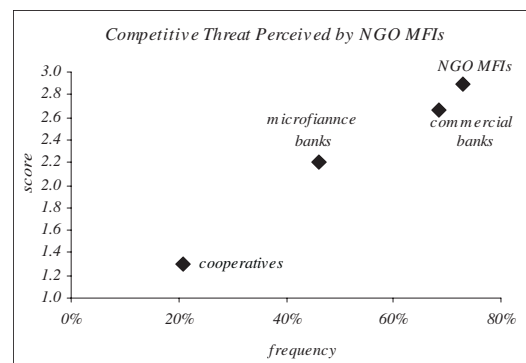
Over half of the NGO MFIs in the Caucasus (56%) will also introduce incentive schemes for back office staff.



Competition

Competitive pressure is felt by the majority of the NGO MFIs (94%) but only less than 40% perceive it as a big problem. On average, competition was not evaluated as a very strong threat (2.07)⁸ on a 1 to 5 scale. This suggests that competition is becoming an issue in the region but is not yet fierce enough to pose a major threat.

A competitive threat is most often imposed by other NGO MFIs. This is felt by 72% of the NGO MFIs and therefore assessed as a somewhat competitive threat (2.9).



Sub-regional analysis shows that perception of overall competitive pressure is most strongly felt by the NGO MFIs in the Caucasus (overall competitive threat 2.4). It was most strongly felt by microfinance banks (ProCredit Bank Georgia and the Microfinance Bank of Azerbaijan). This was considered a threat by 71% of NGO MFIs and on average rated 3.5. Also, the competition from other NGO MFIs was felt (although somewhat weaker) in the Caucasus. This suggests that the microfinance market is becoming crowded there.

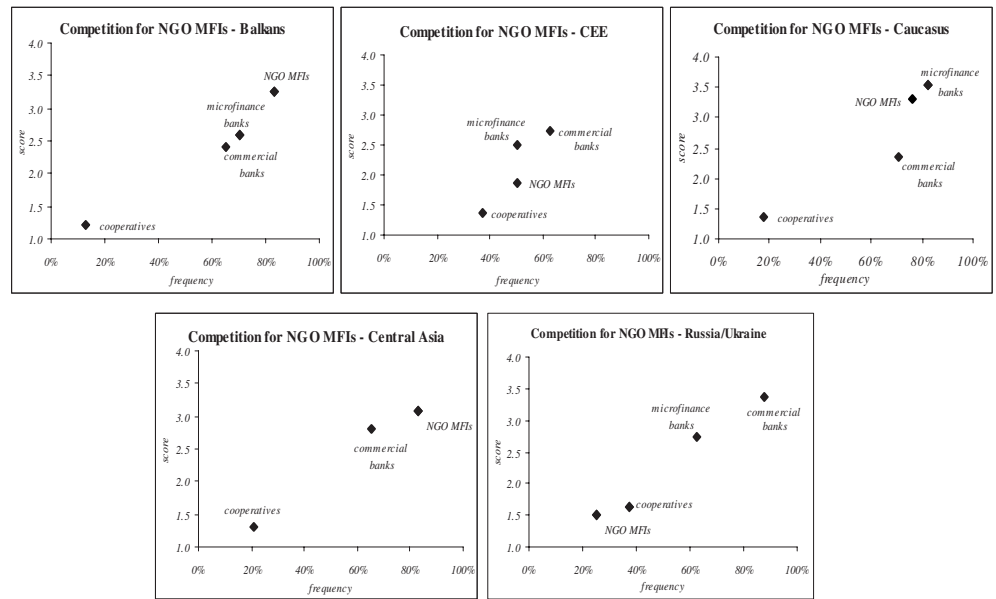
In Russia/Ukraine competitive pressure was the strongest from commercial banks (3.4). In the two other sub-regions – the Balkans and Central Asia – competition from other NGO MFIs was feared by over 80% of the NGO MFIs, which suggests that these MFIs offer similar products in the same geographic areas.

Other fears of a competitive nature were unfair competition from heavily subsidized projects.

⁸ The 1 to 5 scale ranged from 1 - "no competitive threat", through 3 - "somewhat a competitive threat" to 5 - "major competitive threat"



NGO MFI competitive Threat by Sub-Region



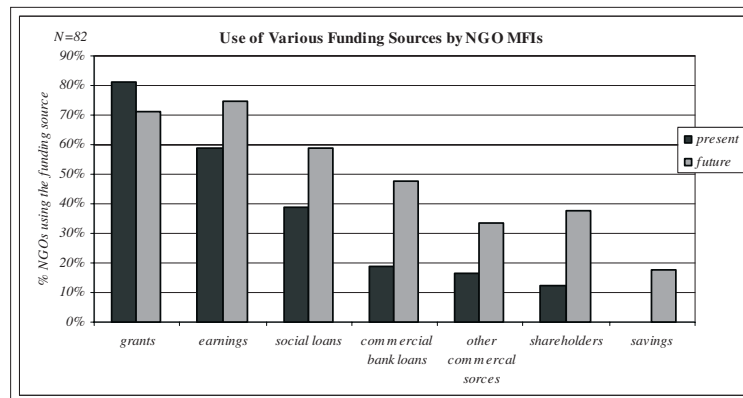
Sources of funding

NGO MFIs in CEE use diverse sources of financing to fund their assets. These include both the equity owned by the MFI, coming from shareholders, donors or earned from operations, and liabilities – subsidized funds borrowed from donors or socially responsible investors – or fully priced from commercial banks or private companies, as well as savings collected among the clients.

Donor grants remain the most common funding source for NGO MFIs. At the end of 2003 over 80% of NGO MFIs utilized donor grants. Nearly 60% of NGO MFIs generated positive earnings, increasing their capital base. Only a limited number of these institutions were financed by their shareholders. Among liabilities, subsidized loans were most often in use (40% of NGO MFIs) but already 35% of NGO MFIs accessed commercial sources of funds from banks or other institutions.

In the next three years, at least 10% of surveyed NGO MFIs plan to move away from donor grants. More NGO MFIs will rely on their own funds either from generated earnings (75% of NGO MFIs) or from shareholder capital (38%).

Over 15% of NGO MFIs will collect savings. All types of loans will also be more frequently used among NGO MFIs, both social loans as well as commercially priced.

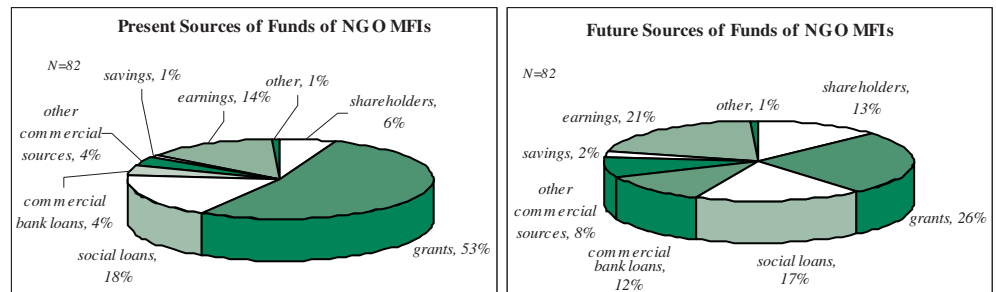


An analysis of the equity and liabilities structure showed that the assets of an average NGO MFI were funded in 74% from equity and 26% from liabilities.

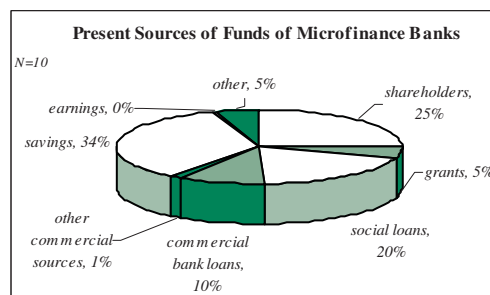


For an average NGO MFI, donor grants accounted for 53% of the total funds. An important share of the sources had own earnings – 14% of all funding. Among liabilities, social loans had the biggest share of the borrowed funds.

Plans for the future (end of 2006) show a more balanced funding structure with an increase in the liability portion (59% of equity and 41% of liabilities). The share of earnings, shareholder capital and commercial loans will also significantly increase.



As a comparison, an average microfinance bank finances its operations predominantly from liabilities (34% equity, 66% liabilities), and chiefly from savings, which constitute 34% of total assets.



Problems

There are three major categories of external problems perceived by NGO MFIs:

- legal and regulatory obstacles faced by 71% of MFIs
- access to funding (62%)
- competition (39%)

Among internal problems the most important ones appear to be:

- staff skills and capacity (53%)
- MIS (40% of MFIs)

Legal and regulatory problems were linked to a lack of microfinance legislation, prohibitive regulations, and ambiguous regulations (especially those related to tax issues), which endanger the normal operations of MFIs.

A lack of funding was also a major issue. MFIs are constrained by insufficiency of funds for increasing the loan portfolio to satisfy the demand. Subsidized funds are often not available because of the donor shift to other countries. Commercially priced funds are in turn either too expensive or the MFIs are excluded because of a lack of sufficient collateral.

The most common internal constraint was the problem with staff capacity, especially at the middle managerial level. This concerned not only the personnel employed at the MFI but also the general workforce on the market.



Sub-regional Outlook

Capacity of other staff was also a concern. MFIs are faced with the difficulty of finding skilled personnel in microfinance issues. Training staff is often unaffordable, but even in that situation there are no mechanisms for retaining trained personnel. As an organization grows, human resources management becomes an issue.

Problems with the MIS system included the need for the integration of operational and accounting software, and the need for a more efficient system that could keep up with MFI growth.

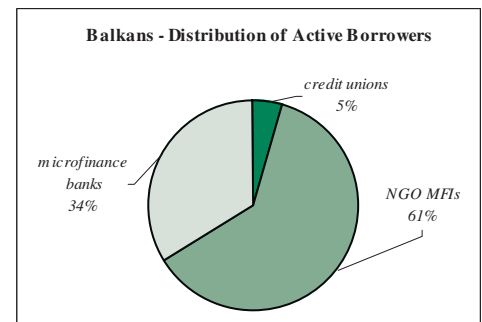
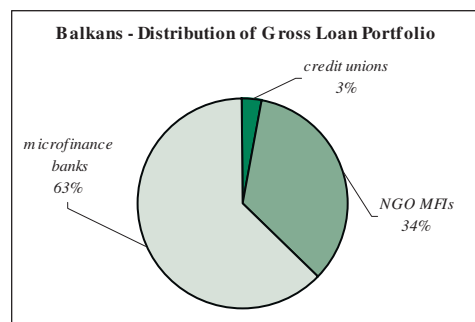
The Balkans

The Balkan sub-region is dominated by microfinance banks and NGO MFIs. Seven out of 15 microfinance banks are located there. Although fewer in number than NGO MFIs, they managed 60% of the Balkan region's gross loan portfolio. The average microfinance bank in the Balkans had a gross loan portfolio of \$46 million and 10,000 borrowers. The majority of borrowers of microfinance banks (93%) had loans below \$10,000.

NGO MFIs reached the majority of borrowers in the region (61% of all microfinance borrowers). The average institution served 4,400 borrowers and was the highest average client base of an NGO MFI among all sub-regions.

Balkan NGO MFIs had, on average, a much larger gross loan portfolio than NGO MFIs in other sub-regions. The average gross loan portfolio of a Balkan NGO MFI was \$6 million – 10 times more than the average portfolio of an NGO MFI in Central Asia.

Credit unions had a modest share in microfinance volumes.



The Balkans were also the fastest growing sub-region in 2003. All MFIs included, the Balkan loan portfolio grew by 106% compared to 60% for all sub-regions. Also, the number of active borrowers grew most dynamically in the Balkans (59% compared to 15% for all sub-regions). All three institutional types grew faster in the Balkans than elsewhere.

Microfinance banks in the Balkans are also big savings collectors. Contrary to other sub-regions, the total volume of savings exceeded the volume of outstanding loans.

Balkan NGO MFIs possess the biggest variety of loan products. An average NGO MFI had 3.1 credit products on offer. Among new products introduced were business loans, agricultural loans and consumer loans. The outstanding loan portfolio is still dominated by enterprise loans but already 12% of the gross portfolio is involved in agricultural loans.

NGO MFIs are very productive – an average loan officer served 206 borrowers. This is a very good result considering that the majority of loans disbursed in the Balkans are individual credits.



The perception of competition was not very strong in the Balkans, but it was recognized by 96% of NGO MFIs and was evaluated for 2.1,⁹ which can be interpreted as little competitive pressure. The highest threat was perceived to emanate from other NGO MFIs (3.3).

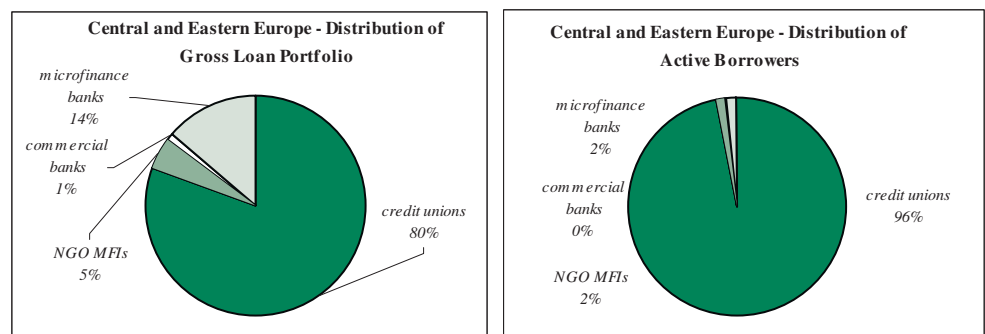
Central and Eastern Europe (CEE)

This sub-region is dominated by credit unions. With its tradition rooted in the 19th century, Raiffeisen cooperative movement credit unions are active in almost all countries of the sub-region.

The majority of loans as well as borrowers are with those credit unions. Other types of MFIs had weaker representation there.

Among three microfinance banks the biggest one was in Bulgaria.

NGO MFIs had on average small portfolios of \$1.97 million and 1,023 borrowers. They provided the biggest loans compared to other sub-regions. The average depth of outreach of an NGO MFI was 208%.



The NGO MFIs offered on average 2.2 loan products (all business loans). Only 1% of the total loan portfolio was used for agricultural loans.

The financial performance of the NGO MFIs in this sub-region was worse than in the other parts of ECA, the average institution has not reached operational self-sufficiency (OSS ratio 79%). They are also less productive with only 73 borrowers served by one loan officer.

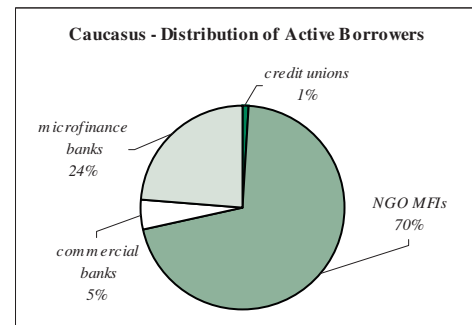
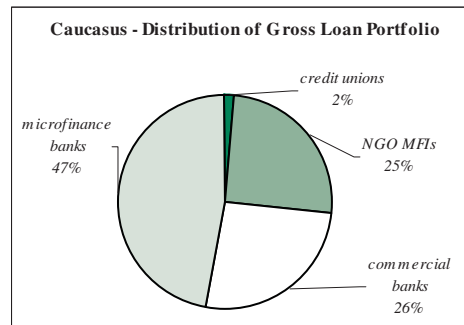
Among institutional changes introduced in the past two years all NGO MFIs refined their products, 75% introduced incentive systems for front staff and 63% installed new MS systems. In the coming years, as in the Balkans, more than half of the institutions plan to start offering new non-credit products.

The Caucasus

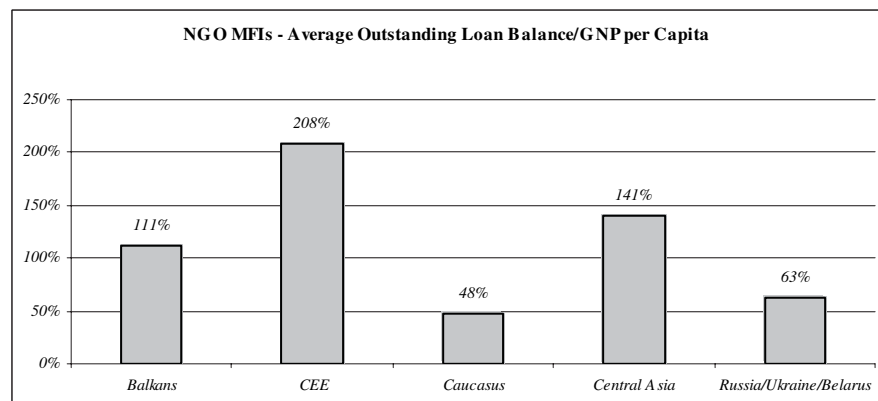
The Caucasus is geographically the smallest of sub-regions as it spans three countries with a total population of 16.5 million.

Microfinance is dominated there by NGO MFIs in terms of the number of institutions (23 NGO MFIs) as well as the volume of borrowers served.

⁹ The 1 to 5 scale ranged from 1 - "no competitive threat", through 3 - "somewhat a competitive threat" to 5 - "major competitive threat"



The average Caucasian NGO MFI has a loan portfolio of \$1.2 million, which is the second smallest among the sub-regions. The largest NGO MFI didn't exceed \$4 million in outstanding loans. Despite a seemingly limited scale, Caucasian NGO MFIs reach a vast clientele. The average number of borrowers of 3,900 was comparable to other sub-regions. Two of the NGO MFIs were among the 15 largest MFIs in ECA in terms of number of borrowers. The average outstanding loan balance is quite small – \$358 or 48% of GNP per capita. It shows that NGO MFIs in this region penetrate much further than in the other sub-regions. Moreover, the Caucasus was the leading sub-region in the downscaling of operations in 2003. Despite an already deep outreach, 11 NGO MFIs further decreased their average loan balance of GNP per capita.



Although there are only two microfinance banks in the Caucasus they account for an important share of the activity. They serve a quarter of microfinance borrowers in this sub-region and manage nearly half of the total loan portfolio.

With more than 28,000 microfinance borrowers ProCredit Bank Georgia is the leader not only in this sub-region but it is also the third biggest MFI in the whole ECA region. In both microfinance banks nearly all borrowers had loans of less than \$10,000.

Downscaling commercial banks operate in each of the countries under EBRD, KfW, IPC downscaling projects. Similarly to NGO MFIs, some commercial banks decreased their average loan balance to GNP per capita.

NGO MFIs offered mainly business loans to urban entrepreneurs (63%). However, 15% of the total loan portfolio was used for agricultural loans. Half of the gross loan portfolio in the Caucasus was involved in solidarity group loans. Caucasian NGO MFIs were also the most productive among all sub-regions in terms of the number of borrowers served by one loan officer.

Regarding institutional changes and innovations, the Caucasian NGO MFIs followed the pattern of focusing on the refinement of products, rural expansion and front office staff incentive systems. In the future, however, unlike the majority of NGO MFIs in other sub-regions the important share of MFIs (70%) will introduce changes in MIS systems. The Caucasus also had the highest percentage of MFIs that decentralized their operations.



Central Asia

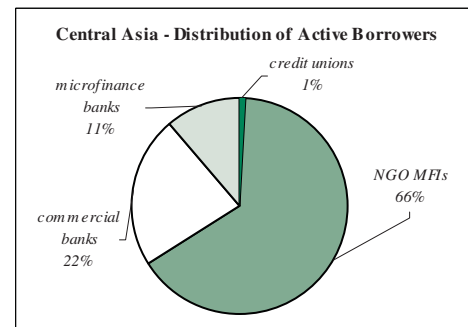
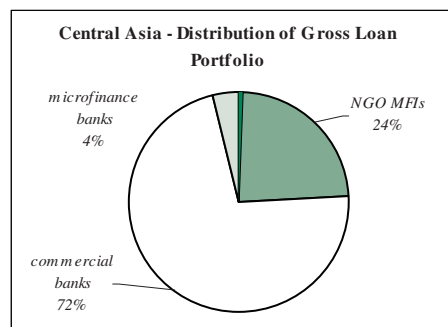
In Central Asia the microfinance scene is dominated by downscaling commercial banks and NGO MFIs.

Seventeen commercial banks realizing EBRD's micro and small business projects were present in Kazakhstan, Kyrgyzstan, Uzbekistan and Tajikistan.

NGO MFIs served the majority of Central Asia micro entrepreneurs. The average NGO MFI in Central Asia had 3,300 active borrowers but the smallest NGO MFIs served less than 100 and the largest over to 32,000 loan clients. Therefore, a more meaningful measure of the median value of 484 indicates that half of the NGO MFIs had fewer than 500 borrowers. As Central Asian NGO MFIs are the youngest among all sub-regions (average of three years, eight months) they have yet to grow their client base. On the other end of the spectrum there were several institutions that served more than 10,000 borrowers.

Central Asian NGO MFIs have on average the smallest and most diversified size of loan portfolio compared to other sub-regions.

Compared to other sub-regions, Central Asia was the second largest sub-region after the Balkans in terms of the volume of outstanding portfolio and client numbers. It had the second biggest growing portfolio volume among all sub-regions.



Although the average loan size of the Central Asian NGO MFIs was not high, the depth of outreach was shallow – 148% (the average depth of outreach in the whole region of the ECA was 116%).

Again, the depth of outreach was most diversified in Central Asia among the sub-regions. For 11 NGO MFIs, the depth of outreach was more than 100%, reaching as high as 620%. But for 10 MFIs it did not exceed 50%.

The only microfinance bank in this sub-region – XAC Bank – had an important share of the market serving 11% of the borrowers.

While commercial banks mainly served borrowers in urban areas, NGO MFIs predominantly serve rural clients – 73% of borrowers lived outside towns. 10% of the gross loan portfolio of NGO MFIs was involved in agricultural loan products.

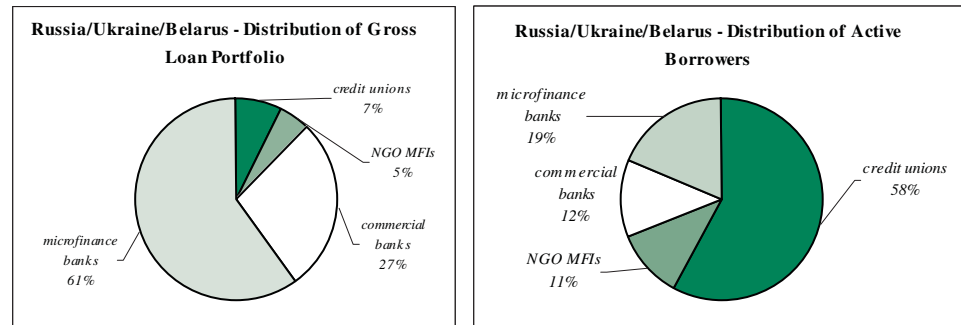
Central Asian NGO MFIs fall behind MFIs in other sub-regions in regard to the institutional changes introduced in the past two years in almost all categories. In nearly every category surveyed, they had the lowest percentage of MFIs introducing changes. This situation will change in the next years. The majority of Central Asian MFIs plans to introduce new loan products. In addition, a significant number of MFIs is considering introducing business development services.



Russia/Ukraine/Belarus

In Russia/Ukraine/Belarus all types of institutions had their share of the microfinance market but they were mostly active in Russia and Ukraine. In Belarus only commercial banks operated. Credit unions and cooperatives led in terms of number of clients served, but microfinance banks managed 60% of the portfolio. The two of them – KMB Bank in Russia and ProCredit Bank Ukraine – were among the biggest MFIs in the whole ECA region. Downscaling programs of commercial banks operated in all three countries including 17 banks, managing 27% of the total gross loan portfolio.

This sub-region was the second fastest growing by borrower numbers, where Ukrainian credit unions predominantly contributed to this growth.



Although NGO MFIs were the least numerous compared to the other sub-regions, on average they managed portfolios of \$2.5 million and served an average of 2,800 active borrowers each. The largest NGO MFI – FORA Fund – served more than 12,000 active borrowers. The average depth of outreach of 63% was lower than in other sub-regions.

Unlike in the other sub-regions, 70% of NGO MFIs in Russia/Ukraine/Belarus introduced new functions or departments and did not pursue rural expansion. NGO MFIs continue to target predominantly urban clientele – over 90% of borrowers resided in cities and towns. In the next three years only 38% of the institutions plan to expand outside towns. Contrary to other sub-regions, client loyalty systems were introduced in 70% of organizations.

The competition for NGO MFIs in Russia and Ukraine emanated from commercial banks. Nearly 90% of NGO MFIs perceived commercial banks as competition and rated its strength at 3.4. Other institutional types were not seen as a competitive threat.

List of Microfinance Institutions Participating in the Study

Balkans

Country	NGO MFIs	Microfinance banks	Commercial banks	Credit unions and cooperatives
Albania	BESA Foundation PSHM For the Future Foundation Mountain Areas Finance Fund	ProCredit Bank Albania		ASC Union SCA-Jehona
Bosnia&Herzegovina	BosVita EKI LOKmicro MI-BOSPO Mikra Mikrofin NGO SINERGIIAplus Banja Luka Partner Prizma Rez-Fond Sunrise Women for Women	ProCredit Bank BiH		
Croatia	CRS - MikroPlus Program			DEMOS NOA
Kosovo	Agency for Finance in Kosovo Beselidhja/Zavet MicroFinance Kosovo Enterprise Program Kosovo Grameen Missione Arcobaleno Microcredit Fund KRK Ltd. FINCA Kosovo	ProCredit Bank Kosovo		
Macedonia	Horizonti	ProCredit Bank Skopje		
Serbia and Montenegro	AGROINVEST Alter Modus Micro Development Fund MicroFinS Integra Serbia	Opportunity Bank Montenegro ProCredit Bank Serbia Stedionica Opportunity International		

Central and Eastern Europe

Country	NGO MFIs	Microfinance banks	Commercial banks	Credit unions and cooperatives
Bulgaria	CRS/USTOI	ProCredit Bank Bulgaria		Nachala Cooperative
Lithuania				Association of Lithuanian Credit Unions
Moldova		MEC Moldova		MMA RFC
Poland	Fundusz Mikro Sp. z o.o. Inicjatywa Mikro Sp. z o.o. Rural Development Foundation			SKOK
Romania	CAPA Finance CHF Romania Economic Development Center (CDE) FAER HIRO - Asociatia Help Integra Romania LAM Local Women Organization OMRO Romcom	MIRO Bank Romania	Banca Romanesca S.A.	Caselor de Ajutor Reciproc (CAR)
Slovakia	BIC2 Spis Nova Wes Integra Foundation RAIC Presov RPIC Komarno RPIC Martin RPIC Povazska Bystrica RPIC Trebisov RPIC Zvolen Seed Capital Company VOKA Slovakia			

Caucasus

Country	NGO MFIs	Microfinance banks	Commercial banks	Credit unions and cooperatives
Armenia	ECLOF Armenia FINCA Armenia Horizon Fund MDF „KAMURJ” SEF International UMCOR/AREGAK		ACBA Anelik Bank Armeconombank Converse Bank Ineco Bank	
Azerbaijan	ADRA Kredit Azeri Star Microfinance Cred-Agro Finance for Development FINCA Azerbaijan IOM MADAD Credit Normicro Viator Microcredit Fund WV AzerCredit	Microfinance Bank of Azerbaijan		CU Agroinvest CU Alinazarli CU Amin CU Komak CU Nijat CU Nurana CU Uch Gardash
Georgia	Constanta Foundation Crystal Fund FINCA Georgia Small Business Development Fund (SBDF) Social Fund for Development Society Development Association WV GEF	Procredit Bank of Georgia	Bank of Georgia Tbiluniversbank	

Central Asia

Country	NGO MFIs	Microfinance banks	Commercial banks	Credit unions and cooperatives
Kazakhstan	Almaty Credit Asian Credit Fund Kazakhstan Fund for Support of Entrepreneurs Kazakhstan Loan Fund ORDA Credit PF for Assistance to Farmers of South Kazakhstan (Shymkent)		Almaty Merchant Bank Bank TuranAlem Halyk Savings Bank (Narodny Bank) KazakhCenterCredit Kazkommertzbank Temirbank Tsesna Bank	
Kyrgyzstan	Bai Tushum Financial Fund Citizens' Microcredit Fund FINCA Kyrgyzstan KAFC MCA „Arysh-Kesh” MCA „Pokrovka-Kenchi” MCA „Airan” MCI Women's Microcredit Programme MFI „Keshikesh” Microcredit Agency “Ai-Ken” NGO Tynchyk		AKB Kyrgyzstan Kyrgyz Demirbank Kyrgyz Ineximbank Kyrgyzstan Kazkommertbank	CU „Paritet Credit” Ictus
Mongolia		XAC Bank		
Tajikistan	Association „Woman and Community” CARE International Development Fund Supporting Farmship and Entrepreneurship Fund „Oila” Gender and Development MDTM Millennium Development Partners NABWT NGO Sitoraj Najot Orion		Orienbank	
Uzbekistan	ACTED FINCA Uzbekistan FV MARD (ACDI/VOCA) MCI Barakot NNO Daulet PAD		Ipak Yuli Bank Hamkorbank Pakhta Bank Uzjilsberbank	CU Ishnoch CU Lastochka CU Sherdor CU Tayanch CU Umid



Russia/Belarus/Ukraine

Country	NGO MFIs	Microfinance banks	Commercial banks	Credit unions and cooperatives
Russia	Counterpart Enterprise Fund Financial Fund „Development” FINCA Samara FINCA Tomsk FORA Russian Women’s Microfinance Network Sakhalin Regional Micro- Credit Program	KMB Bank	Chelindbank Far East Bank NBD Bank Sberbank Sibacadembank UralSib Bank Uraltansbank	KS Alternativa
Belarus			Belorussian-Russian Belgazprombank PriorBank	
Ukraine	Fund for Support of Entrepreneurs „Mezhgorye- Carpathia” Hope-Ukraine	ProCredit Bank Ukraine	Agiobank AVAL Bank CreditProm Bank Forum Bank Nadra Bank Privat Bank	CU Kasa Vzaimopomogy National Association of Ukrainian Credit Unions



Methodology

In May 2004 a survey was conducted among MFIs in ECA by circulating a questionnaire via e-mail. The questionnaire contained 17 questions that covered two main areas of interest:

Part 1 – general information about MFIs regarding their size, outreach, products, financial structure and performance

Part 2 – perception of the external environment (competition, opportunities, threats, problems) and MFI responses to it (changes on an institutional level)

In total, the questionnaire reached 187 NGO MFIs, 15 microfinance banks, 45 downscaling commercial banks and 6,010 credit unions. The organizations were contacted individually but local networks and projects working with MFIs were also asked for support. As for credit unions, the data was obtained chiefly from national associations. In addition, secondary, publicly available information was used.

The coverage rate obtained for the first part of the questionnaire (general information) was: NGO MFIs – 63%, credit unions – 77%, downscaling commercial banks – 100%, microfinance banks – 100%. The second part of the questionnaire was mainly answered by NGO MFIs. Therefore, its analysis was narrowed to this institutional type only.

All information received from respondents was self-reported and no verification was conducted by MFC.



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