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RE-EMERGING FROM THE CRISIS - MICROFINANCE IN ECA.

2010 EDITION

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

Re-emerging from the Crisis – Microfinance in ECA

2010 Edition

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List of Acronyms

ALL – Albanian lek
BAM – Bosnia-Herzegovina Convertible Mark
BGN – Bulgarian lev
BRU – Belarus, Russia and Ukraine
CA – Central Asia
CEE – Central and Eastern Europe
CGAP – Consultative Group to Assist the Poor
CIS – Commonwealth of Independent States
ECA – Eastern Europe and Central Asia
EAP – East Asia and Pacific
EBRD – European Bank for Reconstruction and Development
EFSE - European Fund for Southeast Europe
EU – European Union
EUR - Euro
FAO – Food and Agriculture Organization
GDP – Gross Domestic Product
GNI per capita – Gross National Income per capita
IMF – International Monetary Fund
KZT - Kazakhstan tenge
LAC – Latin American and Caribbean
MCI – Microfinance Confidence Index
MENA – Middle East and North Africa
MFC – Microfinance Centre
MFI – microfinance institution
NGO/NBFI – non-governmental organization/non-bank financial institution
OECD - Organisation for Economic Co-operation and Development
PAR>30 – Portfolio at Risk over 30 days
QAT – Quality Audit Tool
ROA – Return on Assets
SE Asia – Southeast Asia
SEE - Southeast Europe
SME – small and medium enterprise
SSA – Sub-Saharan Africa
US – United States of America
USD – United States dollar
WOCCU – World Council of Credit Unions

Chapter 1

Macroeconomic Conditions and Business Environment

The world economy is slowly emerging from a historically deep and widespread recession provoked by the bursting of a global financial bubble, although the recovery is challenged by the mounting government spending and global events like the recent social uprisings in the oil producing Middle East. And even if the overall economic indicators are improving, job creation and enterprise growth lag behind the recovery process. While growth rates have generally picked up, the depth of the recession was such that it will take years before unemployment and production capacity are absorbed.

Microfinance and the Crisis: Over the Hump?

Most microfinance institutions emerged from the crisis economically affected if not badly scathed: worsened repayment and increased risks, client indebtedness and low demand for credit is a typical story of most operators in the industry. There is little doubt that MFIs now have a more realistic and even a more pessimistic (see Chapter 2) view of the sector, and those which are more optimistic have also revised downwards their expectations for growth and market penetration opportunities.

The immediate impacts of the crisis (including freezing up of credit markets, a sharp reversal of capital flows, and the declines in exchange rates) are largely a thing of the past. Since March 2009, stock markets in high-income and emerging economies have recovered roughly half the value they lost, with developing economies rebounding somewhat more strongly than high income ones. Interbank lending rates have returned to normal levels, developing-country sovereign interest rate premiums have declined from a peak of more than 800 to around 300 basis points and stock market volatility has receded.

The real side of the global economy is also recovering, with industrial production at the global level growing at more than 12%-pace at the end of 2009. The recovery, which was initially concentrated in developing countries, has become more balanced recently as the drawdown of inventories in high-income countries slows and activity catches up to underlying demand trends. Nevertheless, the level of output remains depressed worldwide, with industrial production still 5% below pre-crisis peaks.

The microfinance performance in 2009 was still mixed, although there are reasons for some optimism as the performance slowly improves and the risks become more manageable (see Chapter 3). But for the first time microfinance has moved in the same direction as the whole real and financial sector, which indicates that the integration of microfinance in the ECA region has been successful to a large degree.

Break-up of the Myth

The consequences of the initial bubble and the crisis have been felt in virtually every economy directly or indirectly. Contrary to previous crisis however, in particular in contrast to the Asian crisis of the late 1990's which demonstrated the resilience of microfinance in comparison with the rest of the financial system[1], the current financial crisis penetrated deep into all nooks of financial markets, and microfinance was no exception.

One of the early culprits of the crisis was the sub-prime lending in the US, the high priced loans in the mortgage market to financially weaker borrowers, who did not have access to traditional banking credit. Sub-prime loans which bore a higher risk were quickly repackaged through financial engineering and sold off to the markets globally. The key to the US crisis was the marketing of loans that had a high chance to default as if they had a low chance of default. When the over-leveraged borrowers could not pay back their loans, the domino effect was set in motion.

Box 1.1. In Pursuit of the Impact: the Debate Continues

After years of impact studies of microfinance on the poor people's livelihoods, a new wave of assessments emerged using more sophisticated methods that look at the micro data as well as macroeconomic studies, but the results are far from conclusive. A string of studies using randomized trials have cast doubts on the positive outcomes claimed by the supporters of microfinance, pointing to no or weak effect on poverty, adding to the growing skepticism among academics. Yet these studies have recently been challenged by researchers taking a macroeconomic perspective and accounting for more than just direct effects of access to credit. Some studies show an unambigously positive impact for small-scale enterprise through the introduction of microfinance (thanks to the provision of non-collateralized loans and other features of micro-lending arrangements) with poverty and inequality reduced as a result. Other studies offer quantitative evaluations of the aggregate and distributional impacts of economy-wide microfinance or other credit programs to show that making the typical microfinance program more widely available may have a negligible impact on per-capita income. However, the welfare impacts may be still positive taking into account the general equilibrium adjustments of credit impacts throughout the economy. These recent results show that the debate is far from over and that better understanding would definitely help us reformulate microfinance towards a more sustainable role in economic growth and poverty reduction.

Source: Authors

While the initial reaction of the microfinance industry to the US sub-prime disaster was cautious (see Box 1.1.), it soon became clear that there are important similarities between the two. Sub-prime techniques boasted that finance has the power to eliminate risk as we know it, and microfinance has the power to eradicate poverty. The story of microfinance was premised on the belief that the poor are entrepreneurs whose business activities will allow them to get out of the poverty trap. Since they always seem to repay loans on time due to lack of choice (or because they are mostly women), and interest rate sensitivity is low,

1 See for example the discussion by M. Robinson in Microfinance Revolution, volume 2. The topic whether microfinance is pro-cyclical or not has since stirred considerable interest. One difference between the Asian crisis and the current one seems to be that in 1990's the amount of market based funding for microfinance was much smaller than now, and this may be one of the important channels of transmission of the global shocks into still mostly informal microfinance sector.

microfinance can be commercially viable. The simplicity of the solution to a very complex problem made everyone buy these ideas and the MFIs were generously rewarded with money for selling them.

It seems that the global financial crisis has exposed what has already been sensed for quite some time: that the dream of eradicating poverty through small scale entrepreneurship supported by access to credit is a dream. Low barriers to start a microenterprise and a relatively low start-up costs (however burdensome they may be for the poor entrepreneur) lead to an unsustainable number[2] of small entities which are highly vulnerable to external shocks, let alone a global financial crisis which has pushed hundreds of thousands of migrant workers to return to their home countries and the remittances to drop by significant amounts enough for many economies to experience a severe local crisis. Credit-led (or finance-led) poverty reduction has been put to test and calls for a radical change about the role of finance in poverty reduction for the near and longer term future.

Box 1.2. Meditating on the Microfinance Crisis

[...] In some respects, microfinance is the sub-prime market in most developing and emerging countries. Expanded financial options can offer valuable services to low-income and unbanked people, but bad practices, products and even players can enter the marketplace, harming consumers, legitimate lenders, and the broader financial system and economy. As we seek to innovate and compete with aggressive consumer lending, the microfinance industry needs to ask tough questions about the longer-term viability of our new products, practices, risk management techniques and financing strategies. We should anticipate credit cycles and periodic crises, especially in fast-moving emerging markets. We need to focus more attention on ensuring that clients understand their rights and obligations, in general, as well as the specific produce and all its features.

Source: CGAP/Kate MacKee, Meditations on the U.S. Sub-Prime Crisis. http://www.microfinance-gateway.org

Macroeconomic Performance of ECA Countries

Macroeconomic situation plays an important role in the growth and performance of microfinance in the economy (see Box 1.3.). More than ever before microfinance depends on the overall economic situation: its performance is closely correlated with the macroeconomic indicators which shows that microfinance has been integrated into the financial system and the transmission channels between microfinance and the economy are more direct than when microfinance remained a niche phenomenon of the informal markets.

The ECA countries have been heavily affected by the financial crisis but the macroeconomic performance varied substantially across the region. Aggregate GDP is estimated to have contracted 6.2% in 2009, nearly twice as much as the 3.3% estimated decline in high-income countries, and sharply more negative than the (2.2%) contraction for the remaining developing countries excluding China and India.

2 For example, in India which was severely hit by the microfinance crisis, 31% of the households in India run at least one small business (vs. OECD average of 12%). Of these, 9% of households run more than one business.

Box 1.3. Macroeconomy Matters for Microfinance Growth

A recent study by Ahlin and others showed that the success of microfinance institutions depends on the country level context: macroeconomic performance and institutional frameworks. In general, microfinance performance is complementary to the performance of the overall economy. General economic growth improves MFIs performance: defaults are lower and break-even is easier in richer countries.

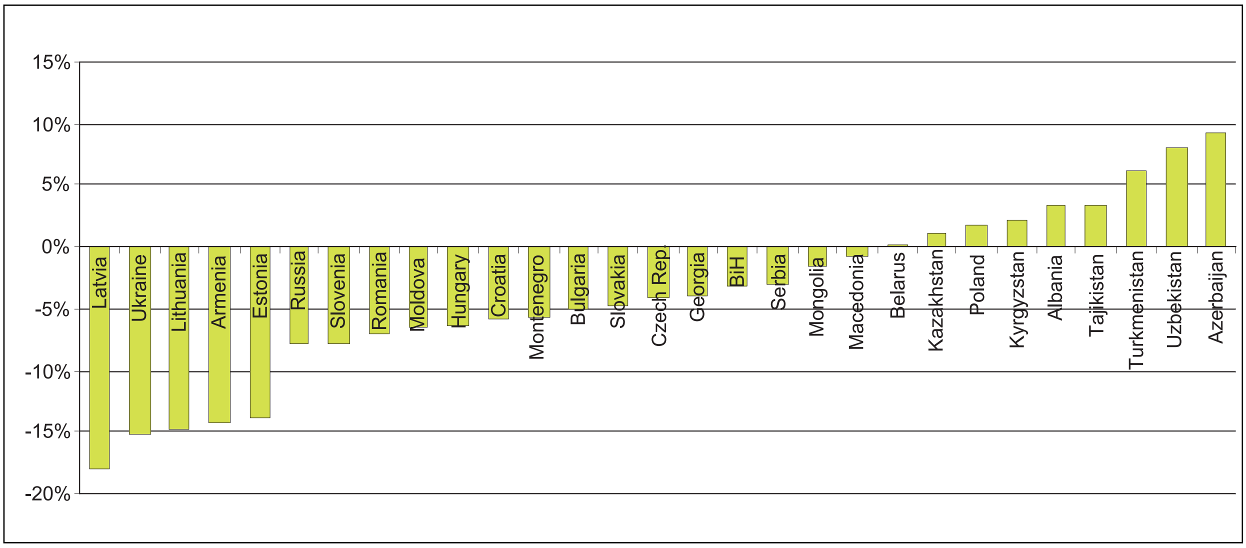
Deeper financial sector is associated with lower operating costs, lower interest rates, suggesting that broad financial competition benefits micro-entrepreneurs. At the same time there is evidence that there is competition between microfinance and industry-led growth. Workforce participation and the share of manufacturing output in GDP predicts slower growth of outreach of MFIs. Another interesting finding is that MFIs fare better in weaker institutional environments: where institutions are stronger, MFIs seem to be doing substantially worse. In short, national contexts in which microfinance is operating cannot be ignored.

As for the reverse causation, it is still doubtful that the microfinance sector in a country may be driving a significant portion of economic growth in the short run because the sector remains small.

Source: Ahlin, C., et al., Where does microfinance flourish? Microfinance institution performance in macroeconomic context, J. Dev. Econ (2010)

Figure 1.1. presents the GDP growth rates in 2009. Some countries largely escaped the crisis (for example Azerbaijan or Uzbekistan) while others were badly hit by the crisis and are far from recovery (e.g., Latvia or Ukraine).

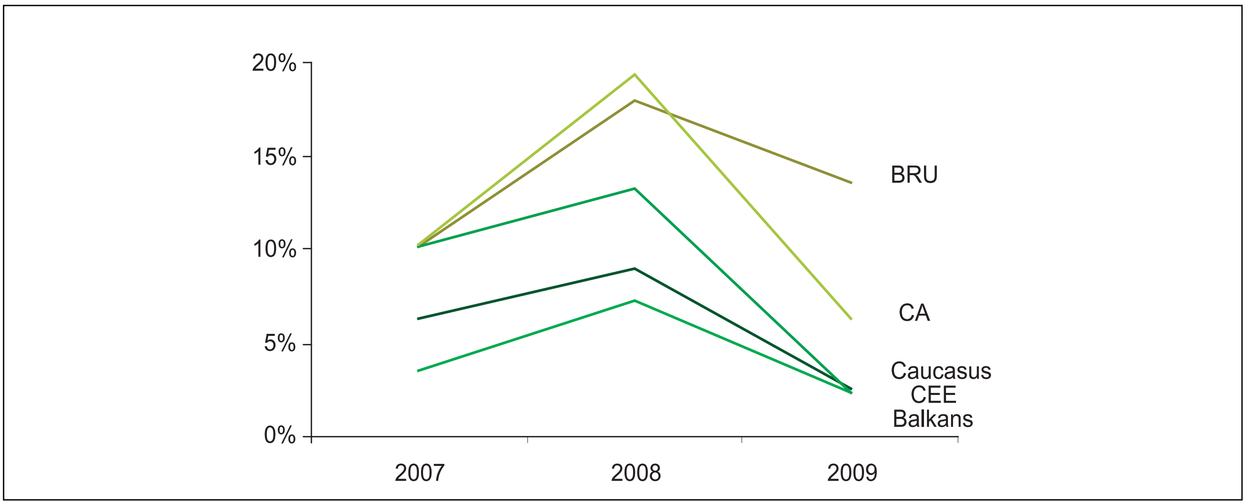
Figure 1.1. GDP growth in ECA in 2009 (year-to-year change)



Source: IMF EconStat

Consumer prices have peaked in 2008 when the global food prices have noted the all time historic high levels, and declined since then. The most recent reports from the FAO and the World Bank indicate that the prices of foodstuffs are on the rise again and are approaching the levels of 2008, which creates a very difficult situation for the low income people whose household budgets are largely allocated to the basic goods. The rising prices also pose problems for microfinance.

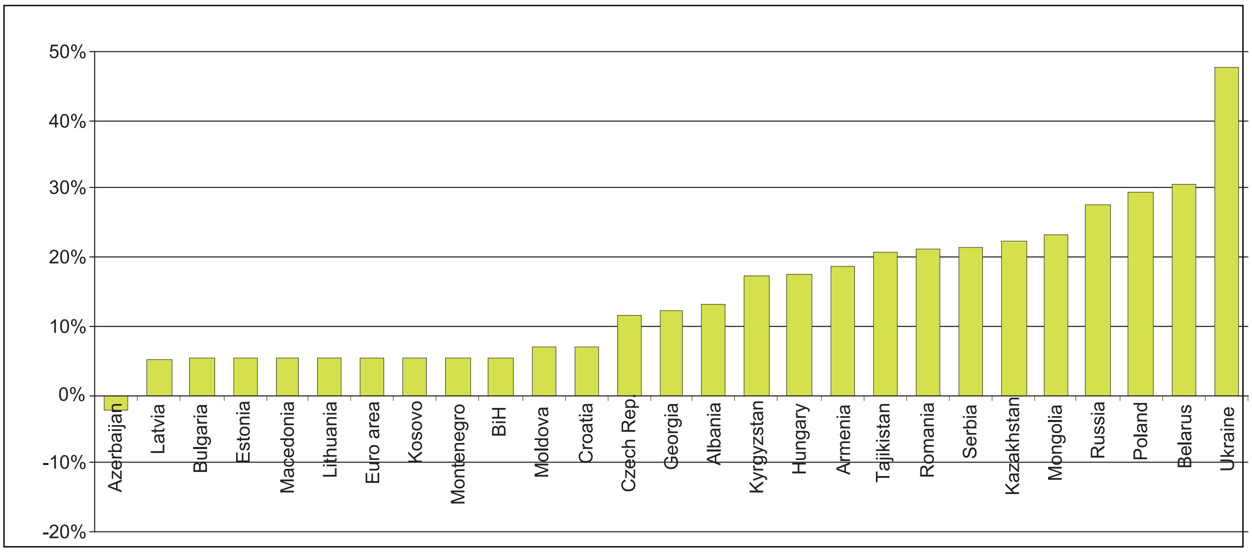
Figure 1.2. Consumer prices (annual percent change) in the ECA countries



Source: IMF World Economic Data (WEO)

The financial crisis has also impacted the exchange rates throughout the region (see Fig. 1.3). Weakening US dollar has been observed in most economies with a different impact in various countries.

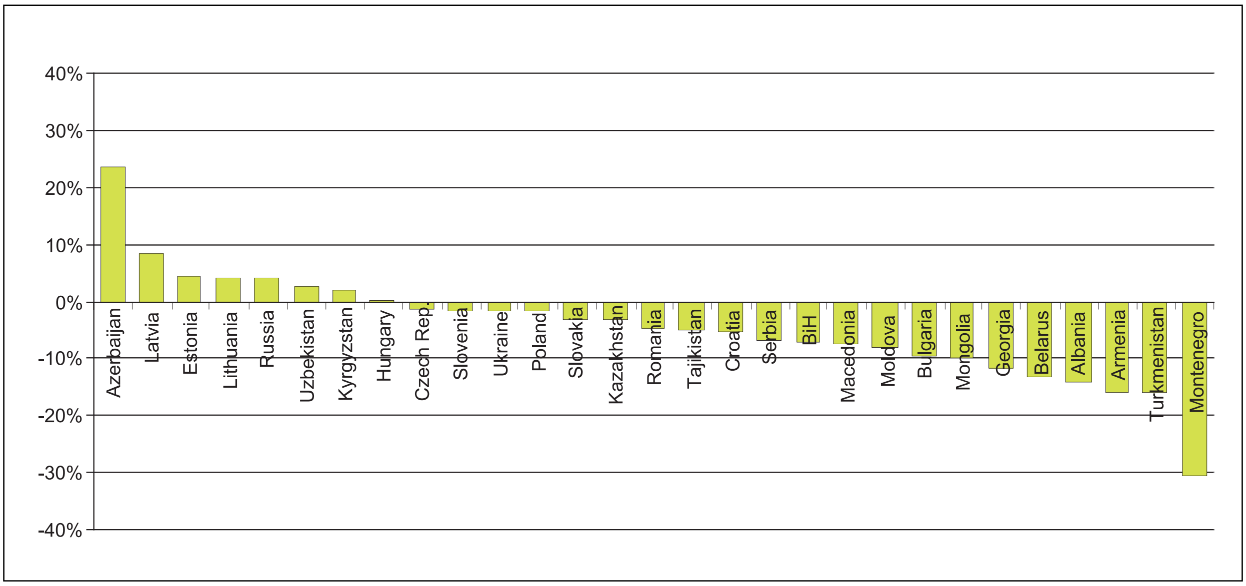
Figure 1.3. Currency exchange rates to USD (annual percent change) in the ECA countries



Source: IMF International Financial Statistics

With a few notable exceptions, such as Azerbaijan, Russia, the Baltics, and Uzbekistan, most countries experienced negative current account balances in 2009 and 2010 (see Fig.1.4). Reflecting the cut in capital inflows (and the associated cuts in domestic demand), regional current account deficits have narrowed, with Bulgaria, Latvia, and Lithuania posting double-digit improvements in current account positions measured as a share of GDP. As a result of the cuts in spending, the region's ex-post financing needs declined, while at the same time external assistance and moral suasion helped prevent access to external finance from declining as sharply as had been initially expected.

Figure 1.4. Current account balance/GDP in the ECA countries



Source: IMF World Economic Data (WEO)

Sharply reduced external demand for exports, a halving of foreign direct investment inflows, and falling remittances exacerbated the collapse in investor confidence and credit tightening, forcing a sharp contraction of 4.6% in regional private consumption, and a decline in gross fixed investment of 16.5% in 2009—down from expansions of 6.4% and 8.7%, respectively, in 2008. The impact of the crisis was most negative in countries where households and corporations held large foreign currency obligations (Armenia, Bulgaria, Croatia, Latvia, Lithuania, Romania, Turkey, and Ukraine), and where pre-crisis growth relied heavily on foreign capital inflows (Bulgaria, Georgia, Latvia, Lithuania, Macedonia, Moldova, Montenegro, and Romania are among the largest, with current account deficits equivalent to 10% or more of GDP in 2008). At the same time, petroleum exporters (Kazakhstan, the Russian Federation) were also hit hard by the plunge in international commodity prices.

Poverty

Overall, the number of poor or vulnerable people in the Europe and Central Asia region is estimated to have increased by some 10 million in 2009—compared with what might have been had the crisis not arisen (based on a $5-a-day poverty line). The contraction in economic activity has led to a 2.5 percentage point jump in the median unemployment rate of the 10 countries reporting data (compared with August 2008). Unemployment is expected to remain high for some time, curtailing household expenditures and contributing to higher poverty rates. Partly as a result of higher unemployment in destination countries (notably the European Union and Russia) for migrants, remittances are projected to decline by 15% in 2009—placing additional pressure on poor households. The macroeconomic impact from the decline in remittances will be largest in countries such as Albania, Armenia, Moldova, and Tajikistan, where remittances represent between 9% of GDP (Armenia) and as much as 50% of GDP (Tajikistan).

In Tajikistan an estimated 30-percent contraction in remittances may cause an additional 5% of the population to move into poverty.

Box 1.4. EBRD Transition Report: From Crisis to Recovery

Over the last year, most countries in the EBRD region have started to recover at varying speeds. In some central European countries, and most commodity-rich countries in Eastern Europe and Central Asia, the recovery has been solid, although growth remains significantly below its 2005-08 average. In a few cases, such as Armenia, Moldova, Poland and Turkey, capital inflows or renewed remittance inflows have contributed to growth in 2010. In contrast, the recovery in most south-eastern European countries is progressing slowly.

Three main factors contributed to these differences: the capacity of transition countries to take advantage of the incipient recovery of the world economy through higher exports; fiscal policies; and the unwinding of pre-crisis imbalances, which continue to weigh on credit growth in many countries. Commodity exporters, countries with export concentration in intermediate inputs such as machinery, and countries with large real exchange rate depreciations during the crisis are benefiting disproportionately from the recovery of global trade. In addition, the recoveries in Russia and Germany are contributing to a return of remittance flows to some of the smaller countries in the region. In contrast, capital inflows are generally recovering more slowly than in other emerging market countries, with the notable exception of Turkey and Poland.

Remittances

Nowhere has the crisis has been more visible than in the flows of remittances (see Fig. 1.5). In 2009 remittances dramatically decreased in all regions of the world although the drop in the flows seems to be most pronounced in the ECA region.

Figure 1.5. Remittances inflow (annual percent change) in the regions of the world

Source: World Bank Remittances Database

Remittance flows in the region are substantial, especially in CIS countries as would be expected in a region where 31 million people have left their countries of origin to work elsewhere. In all CIS countries, remittance flows exceed official development assistance (ODA) by several multiples and contribute significantly

Box 1.5. Migration and Remittances in Tajikistan during the Global Financial Crisis

[…] The global financial crisis further increased migration in a highly remittances dependent country, Tajikistan. The decline in the value of remittances coincides with the domestic economic slowdown in Tajikistan, so that households further expand the established migration system to cope with the domestic crisis. Despite the global financial crisis remittances remained a major source of finance for many households who have to bear most of the risk of Tajikistan's external dependence:

(1) The stock of Tajikistani migrants has increased during the period of economic crisis broadening the base but also the risks of remittance receipt. (1A) the increase in the stock of migrants was driven by a higher rate of Tajikistani migrants going abroad in 2009 compared to the pre-crisis period. In order to increase employment chances, many households started to send more than one migrant abroad during the crisis. (1B) simultaneously, the average migration duration declined slightly, increasing relative migration costs.

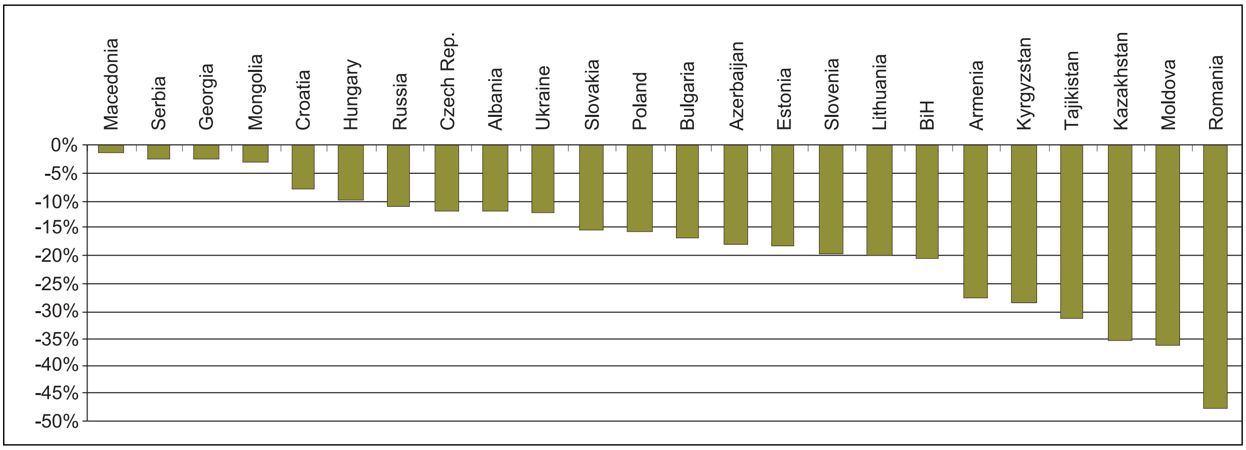
(2) The pattern of migration has become more "risky"—during the crisis the average migrant was significantly younger than before and found it harder to obtain legal residence permits. At the same time, the share of migrants with pre-arranged (before departure) jobs declined implying more involuntary returns to Tajikistan as push factors in the destination country pressurize more migrants to leave. Households respond to these risks by relying more on familiar destinations with existing support networks. This reduces scope for regional diversification, however, the recently increasing share of women migrants' points to increasing occupational diversification.

(3) Returns from migration fell as the average volume of real remittances per migrant declined by 30 per cent. This reduction is predominantly driven by precautionary savings of the migrants owing to increased risks.

Source: "Migration patterns in a remittances dependent economy: Evidence from Tajikistan during the global financial crisis." Migration Letters Vol. 7

to export financing. The share of remittances in GDP in the three top transfer dependent countries: Tajikistan, Moldova and Kyrgyzstan are 45.5%. 35.1% and 19.1%[3] respectively.

Figure 1.6. Change in remittances inflows 2008 - 2009 in the ECA region (annual percent change)



Several countries in the ECA region heavily depend on the remittance flows, and so do MFIs in those countries although it is hard to say to what extent reduction of remittances contributed to the microfinance crisis.

3 World Development Indicators, World Bank, 2009

Remittances to the ECA countries have fallen 20% percent since the global financial crisis hit, amounting to a loss of over USD 12 billion in 2009 reaching the total USD 50.3 billion, and since then there is slow growth of remittances (4%) in 2010. While the decline was very deep and sudden, the recovery is slow and mild.

Migrants are not returning to their countries of origin, preferring to remain abroad and cut their living costs. In their countries of origin, the households they left behind are facing more difficult times.

In the EU the biggest drop in money transfers have been noted in Romania which is not typically associated with remittances (they constitute about 4.5% of GDP) followed by Moldova and Central Asia. For some countries such as Tajikistan this drop means a major channel of economic crisis and slowdown (see Box 1.5).
Total outflows of workers' remittances from the EU reached 29.6 billion EUR in 2009 - an increase of 3% compared to 2004 - mainly due to a big increase in extra-EU remittances. While extra-EU remittances increased by 87%, from 11.5 billion EUR in 2004 to 21.5 billion EUR in 2009, intra-EU remittances in the same period increased by only 3%. The EU data on remittances show that the negative trend in overall remittances that began at the end of 2007 was over by the second half of 2009 in most EU countries.

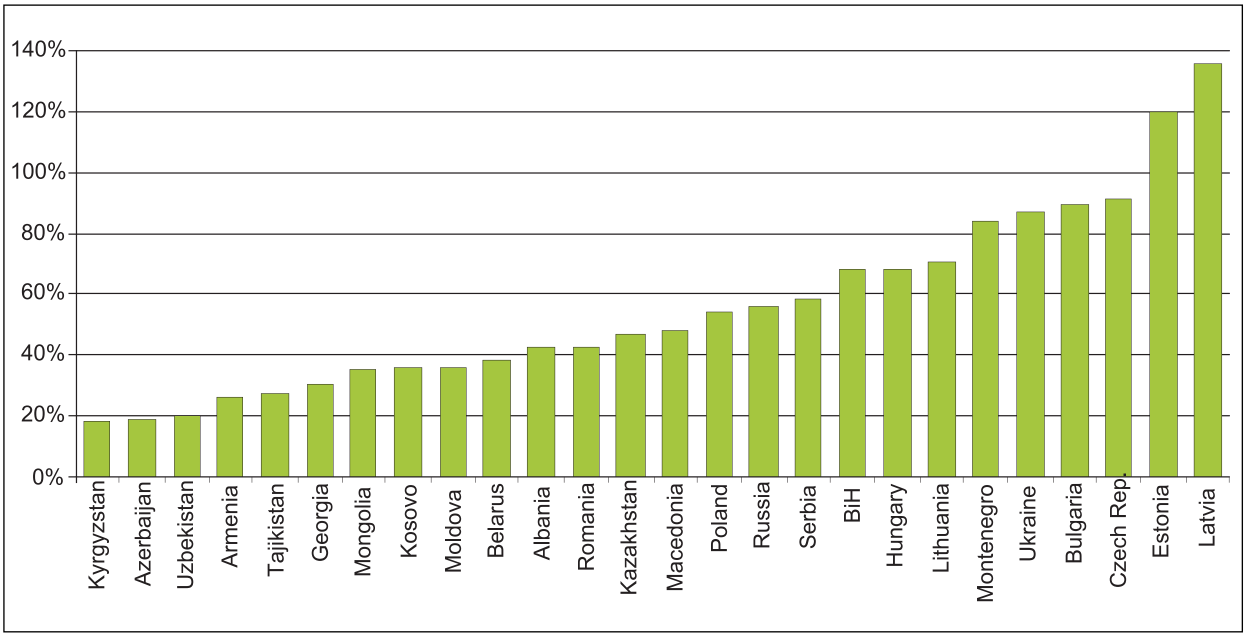
Banking Sector and Lending

Banks in Eastern Europe and CIS 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 became overdue. Even the loss of just one of these loans could lead to the state bankruptcy of some countries.

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.

One of the salient features of the current crisis is the impact of financial integration on the spread of the crisis. The better financially integrated, the stronger the crisis was felt, but not all ECA countries have been equally hit by the crisis. There are notable examples. The year-on-year fall in Latvia's GDP during 2009 of about 20% compared with the Czech Republic's 4%. Both countries are deeply integrated into the global financial system and depend heavily on economic growth in Europe. 85% of the Czech banking sector is foreign-owned, compared with 65% of the Latvian banking sector. But the loan-to-deposit ratio at end-2008 was 280% in Latvia compared with 80% in the Czech Republic, implying that an extraordinarily large proportion of loan growth in Latvia was funded from abroad. This difference is due in part to the credible monetary policy in the Czech Republic and continued tight fiscal policy which kept interest rates lower than those in the euro area. Despite real exchange rate appreciation due to productivity growth, borrowing in local currency was more attractive than borrowing internationally. This removed a source of potential instability.

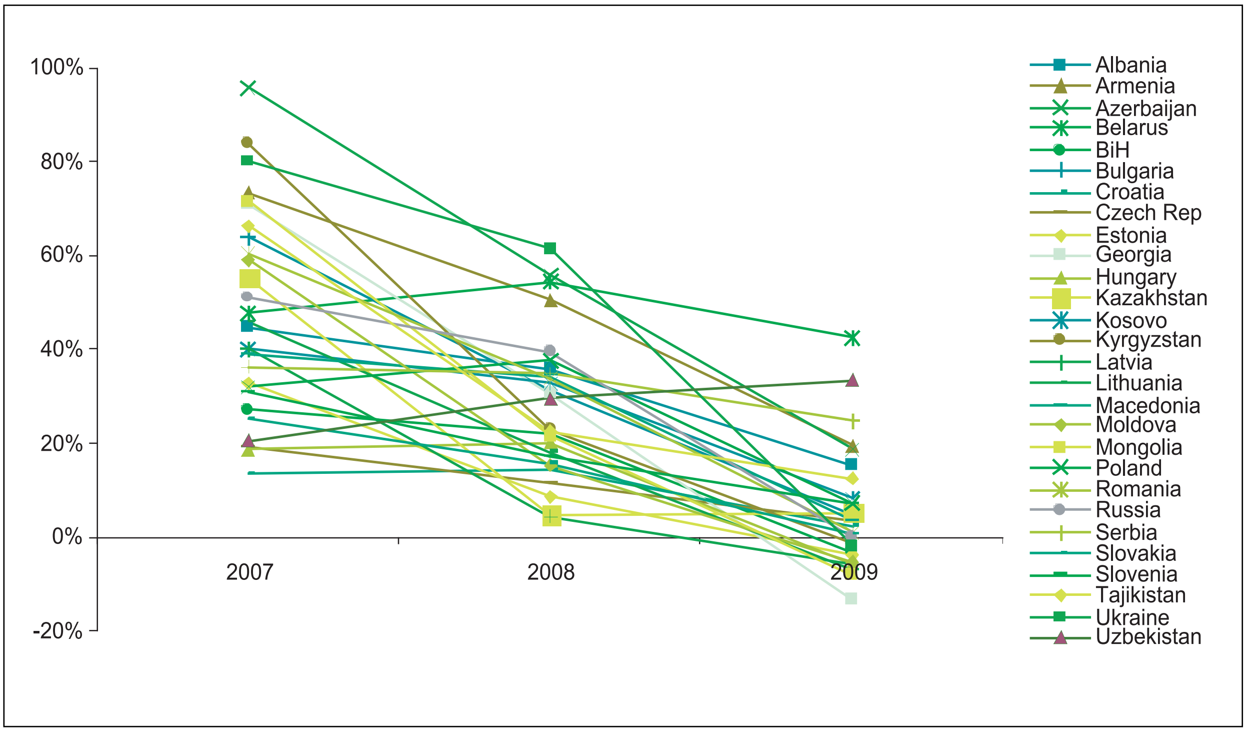
Figure 1.7. Bank loans to GDP in 2009 (percent)



Source: IMF Financial Access Statistics 2010

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 (see Fig 1.7. and 1.8.).

Figure 1.8 Annual percent change in the volume of bank loans 2007 – 2009



Source: IMF Financial Access Statistics 2010

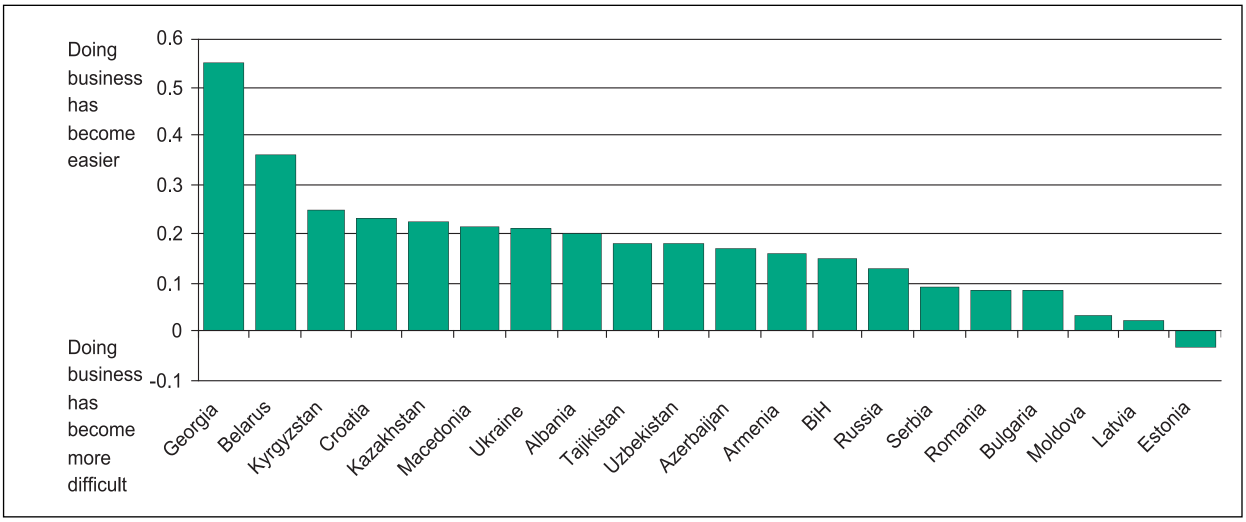
The dynamics of annual changes in credit supply in the past three years is particularly telling. Overall, there is a clear tendency downwards indicating substantial decelerating of the speed at which domestic credit was growing recently with one notable exception of Uzbekistan where the volume of credit was on the increase during the crisis times (which may have not been felt that strong there). The country that placed the highest in 2009 was Belarus which showed a modest slow down yet overall a strong tendency in crediting in 2008 and 2009. This may be due to a low starting point of credit activities and the gradual opening of the Belarus economy for private entrepreneurship. Some countries registered dramatic changes in their credit activities: the fast growing Azerbaijan experienced sharp slow down and did Ukraine, Georgia and Moldova. Other countries, for example Tajikistan, also slowed down their credit activities but not as drastically.

Business Environment in the ECA Region

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.

Some countries have made substantial progress in making the local environment more friendly towards businesses. Georgia and Belarus are two notable examples of such positive changes. In general, the CIS countries have made more progress than the European countries which have already reformed their business environments. In countries which have suffered most from the crisis such as Estonia, Lithuania and Latvia doing business has become more difficult or has not changed at all.

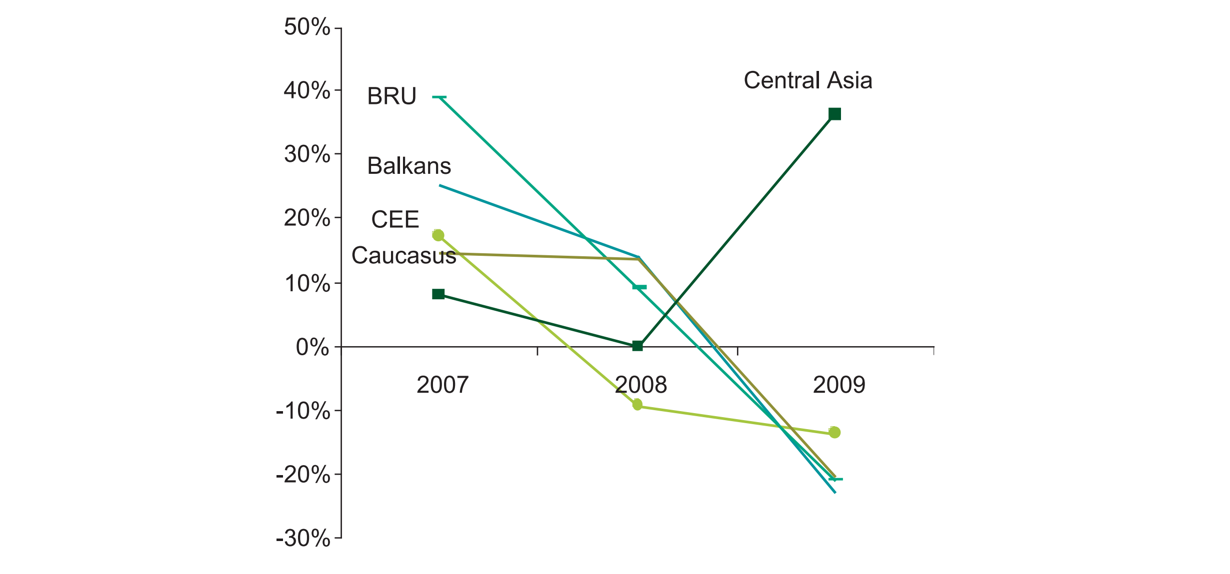
Figure 1.9. Doing Business cumulative change across 9 indicators between Doing Business 2006 and Doing Business 2011



These are important developments which have direct impact on the ability of the entrepreneurs to start and manage their business, which in turn is correlated with the demand for microfinance services.

The number of new businesses created during the year 2009 is also indicative of the crisis. With the exception for Central Asia, the start-up rates slowed down considerably reversing the entrepreneurship gains of the previous years. The rate of new business creation in Central Asia is quite interesting: the increase is taking place in the environment that is fairly difficult as most of the countries in the region rank low on the Doing Business Index.

Figure 1.10. Changes in the number of new businesses created during the period 2007 -2009



Source: IFC Business Creation 2010

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.

The region is slowly emerging from the crisis and so is microfinance but also at an uneven pace. One of the interesting characteristics of the crisis was that credit contraction between the banking sector and non-banking microfinance segment were closely correlated which is to show that the policies of integrating microfinance sector into the mainstream banking and finance has been fairly successful, but the side effect of this convergence is the loss of microfinance its counter-cyclical behavior in bad times, also strengthened by the reduction of the size of the informal sector in most of the ECA countries.

Chapter 2

Microfinance Confidence Index

The recent financial crisis shook up the microfinance landscape throughout the region leaving MFIs with challenges on a scale unknown to the industry before. Many MFIs now face low portfolio quality, increased indebtedness of their clients and difficulty in accessing funding, while the low end market conditions for microfinance services seriously deteriorated. The prospects for fast growth in the sector have been stalled: the return to a sustainable growth path may be difficult undermining the confidence of managers and investors in future performance. In 2010 MFC launched the Microfinance Confidence Index (MCI) to measure the perceptions of microfinance lenders and their outlook for the future.

Microfinance Confidence Index

The purpose of the Index is to gauge MFIs managers' assessment of the performance of their organizations in the previous year and to test their confidence about the prospects for the upcoming year. The survey, conducted in February - May 2010 among MFI managers, asked questions about the year 2009 as well as the expectations for 2010.

The MCI is based on five key aspects of MFI operations: (i) loan portfolio size, (ii) loan portfolio quality, (iii) employment outlook for the organization, (iv) new capacity of the organization, and (v) access to funding. Additionally, information about business contacts and change factors that have an impact on the MFI's performance was used to describe the business environment.

For each section of the index a pair of questions about the past and about the expectation for the future were asked (for example: Was the past period better, same or worse than the same period one year ago? Do you expect the coming period to be better, same or worse than the period one year age?).

The index value[4] is an aggregate of each section's score with the weights reflecting the relative importance of each component of an MFI performance. Each component of the index was assumed to have the same importance therefore the weights were equal as shown in Figure 2.1.

4 The value of the MCI index was calculated using the same methodology for the calculation of a diffusion index. The diffusion index takes values between 0 and 100: values above 50 denote a positive change and below 50 – negative. The higher the index is above 50, the greater the change.

Figure 2.1. MF Confidence Index Components

Index Components	Weights
Loan portfolio size	20%
Loan portfolio quality (PAR)	20%
Employment outlook	20%
Capacity expansion	20%
Access to funding	20%
Total	100%

The index measures perceptions of microfinance leaders about the future

Sample Structure and Data

53 MFIs responded to the MCI questions. The majority of them were NGOs/NBFIs from Central Asia. Half of the respondents were mature MFIs who have been operating in microfinance for more than 10 years. A quarter of the respondents were members of international microfinance networks[5].

General Results

The overall MCI Index of 40.8 – a score below 50 - points to the downward trend in confidence of the microfinance sector in 2009. The low value of the index was driven mostly by the major deterioration of the portfolio quality (20.8 points on a scale of 100 for this category) and access to funding (43.8 points). Loan portfolio growth and operational capacity (55.1 and 54.3 respectively) and the level of employment (50.9 points) were assessed slightly more positively by MFI managers.

Figure 2.2. Microfinance Confidence Index Scores for 2009

Index Components	Weights	2009
Loan portfolio	20%	55.1
Loan portfolio quality (PAR)	20%	20.8
Employment outlook	20%	50.9
Capacity expansion	20%	54.3
Access to funding	20%	43.8
Overall score for ECA region	100%	40.8

Loan portfolio quality deterioration ranks lowest among the Index scores

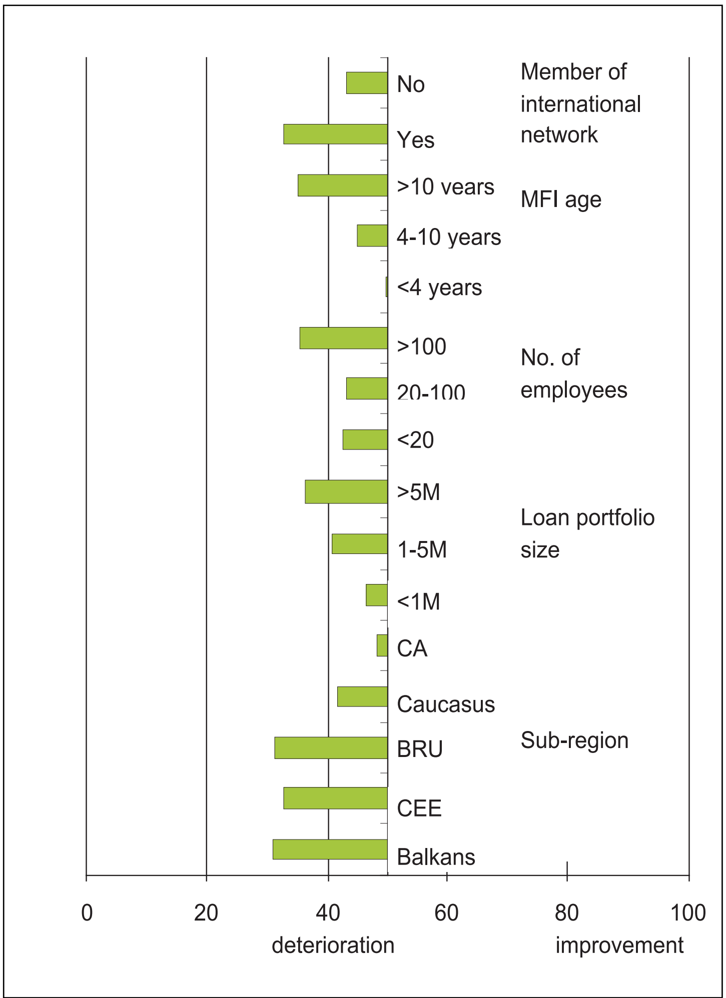
In order to capture the differences in business confidence among different types of MFIs the scores were analyzed separately for MFIs operating in Asia (Caucasus and Central Asia) and Europe (Balkans, CEE, the BRU sub-region), for MFIs with small, medium and large loan portfolios, for young, mature and old MFIs, as well as MFIs belonging to international microfinance networks.

The results show (see Fig. 2.3.) that for MFIs in the European part of the ECA region (in particular those located in the Balkans and in BRU), mature MFIs with large portfolios and a large staff, MFIs affiliated with international microfinance networks, the confidence in microfinance industry decreased far more as compared with the younger and smaller MFIs operating in Central Asia.

5 A category of network members differentiated between MFIs which are affiliated or not with the following international institutions: Access Holding, CHF, FINCA International, Hope International, Mercy Corps, Opportunity International, and World Vision International.

More importantly, none of the groups exceeded the threshold of 50 which indicates the decline in the level of confidence in 2009 among various types of MFIs.

Figure 2.3. MCI 2009 Scores by Categories and by Location



Confidence was the lowest among MFIs in the Balkans and in Russia/Ukraine, among mature MFIs with large portfolios and a large staff, and MFIs affiliated with international networks.

Box 2.1. MFIs Look Vulnerable to the Global Crisis

[…] The economic crisis has completely transformed perceptions of the microfinance risk landscape: risks that were thought minor in the 2008 survey have been propelled to the top of the rankings, edging out risks that were previously seen as crucial to the prospects for microfinance. Broadly, these new risks fall into three "clusters" of vulnerability for MFIs: the worsening business environment; threats to funding and liquidity, and potential damage to the reputation of microfinance. […] Contrary to the hope expressed by many people in the earlier survey that MFIs would be insulated from shocks in the "real economy", they are now seen to be vulnerable to shocks through financial markets, credit conditions and the fortunes of their customers.

Source: Microfinance Banana Skins 2009

In the outlook for 2010 (see Fig 2.5. and Fig 2.6.) the biggest positive change was anticipated in the loan portfolio components of the index: both the size of the portfolio and the quality were expected to improve substantially, with the biggest change in quality (PAR) where the index moved from 20.8 to 70.2. This clearly reflected the hopes for improved portfolio quality which could then be followed by portfolio growth and expansion of capacity. Conversely, very little improvement was expected in terms of access to funding, which may indicate that the financial crisis is far from over and in particular that microfinance investors may not be yet ready to allocate more financial resources to the troubled industry.

Figure 2.4. Microfinance Confidence Index: Scores for 2009 and 2010

Index Components	MCI 2009	MCI outlook for 2010
Loan portfolio	55.1	81.1
Loan portfolio quality (PAR)	20.8	70.2
Employment outlook	50.9	73.9
Capacity expansion	54.3	74.5
Access to funding	43.8	52.4
Overall score for ECA region	**40.8**	**56.4**

The expectations towards 2010 developments were more optimistic in Central Asia than in Europe (see Fig. 2.4.). Only access to funding is similarly forecast to remain almost unchanged in both parts of the ECA region, which again confirms that risk perceptions about the industry remain a serious challenge in the years to come.

Figure 2.5. MCI total scores for 2009 and 2010

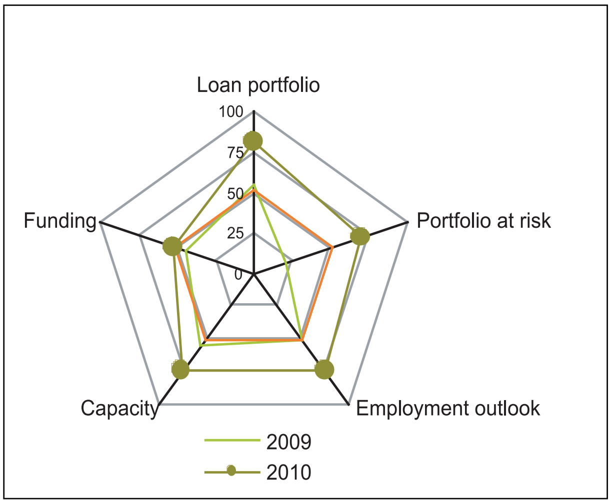
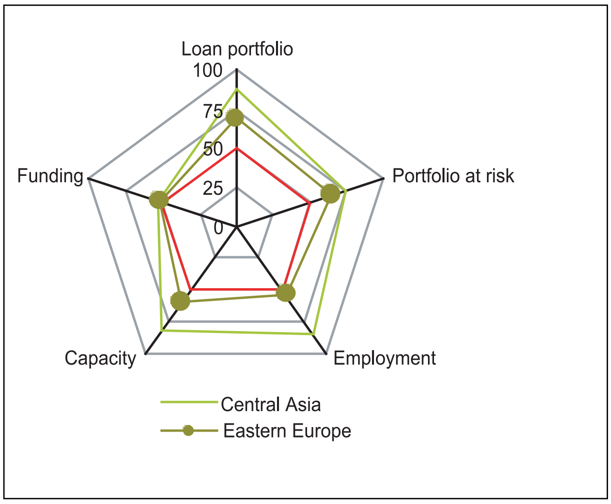


Figure 2.6. MCI 2010 scores by ECA sub-regions



Overall, the increase in confidence is a positive sign that microfinance in the ECA region is slowly emerging from the financial crisis, but there are many differences across confidence categories and regions which indicate a varied impact of the crisis on MFIs and therefore different outlook for the future.

Loan Portfolio

The figures show that the overall volume of activities decreased in 2009. Many MFIs reported negative loan portfolio growth, fewer loans disbursed with smaller amounts per client. MFIs in Asia were doing better than others. Changes for the worse were reported mainly by institutions in the Balkans, CEE and BRU sub-regions. Smaller and younger MFIs, including the smallest ones, with portfolios below USD 1 million managed through the crisis much better than large and mature institutions.

Figure 2.7. MCI Loan Portfolio

		Number of MFIs	MCI 2009	MCI outlook for 2010
Location	Asia	34	64.9	87.9
	Europe	19	37.7	69.3
No. of employees	<20	22	56.0	83.0
	20-100	14	63.6	77.4
	>100	17	43.1	81.8
Loan portfolio size (USD)	<1M	15	70.0	83.0
	1-5M	19	56.1	81.8
	>5M	19	42.0	78.9
Age	<4 years	7	78.6	95.2
	4-10 years	19	57.9	84.3
	>10 years	25	43.9	73.3
Member of international network	yes	13	34.6	80.8
	no	40	61.8	81.2
Sub-region	Balkans	7	33.3	57.1
	CEE	4	33.3	66.7
	BRU	8	43.8	81.3
	Caucasus	11	53.0	93.9
	Central Asia	23	70.7	84.9
	Total	**53**	**55.1**	**81.1**

The outlook for 2010 showed more optimism among the MFIs. The majority of MFIs planned to increase the size of their loan portfolio. Asian MFIs, in particular, were very positive about the future growth opportunities. The most cautious predictions of the development were seen among institutions located in the Balkans.

Portfolio at Risk

The quality of the loan portfolio was the weakest area of performance. The most difficult situation was felt by MFIs in Europe where all institutions saw the deterioration in the repayment timeliness. This region was also cautious in the assessment of the 2010 outlook, as Balkan MFIs foresaw a continued deterioration in portfolio quality. Only the MFIs in the BRU sub-region were very optimistic about the recovery of their portfolio health.

Figure 2.8. MCI Portfolio at Risk

		MFI MCI 2009	MFI MCI outlook for 2010
Location	Asia	26.5	74.2
	Europe	10.5	63.2
No. of employees	<20	28.6	66.7
	20-100	22.7	67.9
	>100	11.8	76.5
Loan portfolio size (USD)	<1M	10.0	71.4
	1-5M	39.5	65.8
	>5M	10.5	73.7
Age	<4 years	21.4	71.4
	4-10 years	23.7	77.8
	>10 years	18.0	66.0
Member of international network	yes	7.7	80.8
	no	25.0	66.7
Sub-region	Balkans	0.0	42.9
	CEE	0.0	62.5
	BRU	25.0	81.3
	Caucasus	31.8	77.3
	Central Asia	23.9	72.7
	Total	**20.8**	**70.2**

The difficulty with repayment discipline was experienced not only by the largest MFIs but also by the ones with the smallest loan portfolios, but both types were the most optimistic about the quality improvements in 2010.

Box 2.2. Stabilization of PAR despite Regional Disparities

After a severe deterioration in portfolio quality last year, PAR>30 (including restructured loans) stabilized around 6% in 2010, except in Central America and Eastern Europe, where it is now over 12%. The situation of countries with high PAR has deteriorated through the first semester of 2010, leading to repayment difficulties for some MFIs and new work-out negotiations. They endured both worsening macro-economic factors and weakening industry practices (rapid growth, multiple borrowing, lack of regulation, institutional capacity and/or lending discipline). However, the crisis in these markets seems to have reached its peak and the situation has been stabilizing for the past few months.

Source: Symbiotics Quarterly Corporate Newsletter, Q1 2011

Employment

Despite the decrease of credit activity no major change was observed in the area of employment. Only a third of MFIs reported falling staff numbers, the other third employed more staff and a third retained the same number of employees.

Figure 2.9. MCI Employment

		MFI MCI 2009	MFI MCI outlook for 2010
Location	Asia	61.8	85.0
	Europe	31.6	54.3
No. of employees	<20	54.6	86.2
	20-100	53.6	73.9
	>100	44.1	60.9
Loan portfolio size (USD)	<1M	60.0	91.7
	1-5M	50.0	75.2
	>5M	44.7	61.0
Age	<4 years	71.4	92.9
	4-10 years	60.5	81.1
	>10 years	38.0	61.6
Member of international network	yes	46.2	59.9
	no	52.5	79.0
Sub-region	Balkans	35.7	46.4
	CEE	37.5	75.0
	BRU	25.0	48.1
	Caucasus	54.6	82.1
	Central Asia	65.2	86.5
	Total	**50.9**	**73.9**

Lower employment was seen among MFIs in Europe, larger institutions with over 100 employees, with larger loan portfolios over USD 5 million and with over 10 years in business. MFIs which reduced staff numbers were more often members of international microfinance networks.

The optimistic outlook for 2010 was shared by MFIs which managed better in 2009. Those which reported staff reductions were more cautious and restrained in their forecasts. While the employment index for 2010 went as high as 85 for Central Asian MFIs, it reached only 54.3 for European MFIs – only 4.3 points above the score of 50 denoting no change.

Capacity Expansion

Capacity refers to the ability of an MFI to scale up the operations – making capital investments, increasing the number of products, opening new outlets, improving technology and other capacity growth options.

MFIs performed in this area relatively well (see Fig 2.10.), with slight overall improvement (capacity index of 54.3). Similarly to what has been observed in earlier sections, the results show that MFIs in Europe decreased their capacity and they remain more skeptical about growth in 2010. Again, Balkan MFIs are most pessimistic about expansion in 2010 (42.4) as their level of operations slowed down considerably and they may now have excess capacity.

Figure 2.10. MCI Capacity Expansion

		MFI MCI 2009	MFI MCI outlook for 2010
Location	Asia	59.6	81.7
	Europe	45.0	59.8
No. of employees	<20	54.2	74.9
	20-100	50.9	71.2
	>100	57.4	78.8
Loan portfolio size (USD)	<1M	53.8	77.7
	1-5M	52.9	72.1
	>5M	56.4	75.7
Age	<4 years	58.9	77.1
	4-10 years	59.2	80.0
	>10 years	50.8	69.0
Member of international network	yes	56.4	72.8
	no	53.7	75.2
Sub-region	Balkans	43.5	42.4
	CEE	50.0	70.0
	BRU	43.8	68.6
	Caucasus	61.4	81.5
	Central Asia	58.7	82.3
	Total	**54.3**	**74.5**

The outlook for 2010 was more positive in Central Asia (82.3) followed by Caucasus (81.5). There were no major differences in the level of confidence between smaller and larger institutions, however older organizations in existence for over 10 years are more reserved about growing their capacity.

Access to Funding

Funding was the second weakest area after the portfolio quality. The overall score of 43.8 demonstrates the overall decrease of the amount of funding obtained by the MFIs in 2009. Institutions from Central Asia, smaller ones and those which were not part of any international network performed relatively better, although still below the 50-points threshold.

Figure 2.11. MCI Access to Funding

		MFI MCI 2009	MFI MCI outlook for 2010
Location	Asia	44.3	53.0
	Europe	43.1	51.3
No. of employees	<20	48.9	59.5
	20-100	49.0	46.4
	>100	32.4	48.5
Loan portfolio size (USD)	<1M	48.3	58.9
	1-5M	45.5	54.0
	>5M	38.2	46.1

		MFI MCI 2009	MFI MCI outlook for 2010
Age	<4 years	39.3	53.6
	4-10 years	47.9	52.8
	>10 years	42.7	52.0
Member of international network	yes	27.2	40.4
	no	48.9	56.4
Sub-region	Balkans	42.9	46.4
	CEE	43.8	37.5
	BRU	44.2	62.5
	Caucasus	38.6	52.3
	Central Asia	46.9	53.4
	Total	**43.8**	**52.4**

The outlook for 2010 was not very optimistic – although a slight improvement was expected (overall score of 52.4), it was mainly posted by small MFIs which did better in 2009. Institutions located in the BRU sub-region believed more strongly that access to funding would ease in 2010 (the highest score of 62.5) while MFIs in the Balkans and CEE presumed further constraints in their funding inflow. MFIs in CEE were the most pessimistic about funding and their confidence even lowered in comparison to their perceptions in 2009 (down to 37.5). This is the only deterioration of confidence noted in this category despite the fact that CEE countries can now access funds from the EU.

For those MFIs which belong to international microfinance networks, the confidence in accessing additional lending capital increased but still remained well below the 50 points benchmark (40.4) leaving these institutions skeptical about access to resources. This is a somewhat surprising result as one of the benefits from being a part of a larger network is better access to finance.

Business Contacts

The business contacts section of the index asked questions related to new relations of a MFI with investors, donors, networks, and other similar business contacts.

The overall score in the area of business contacts of 48.3 in 2009 indicates deterioration in the development of connections with financiers, networks or support organizations and with other local institutions which could better support outreach to clients. MFIs in CEE (72.2, the highest score in the category) are an exception which may be attributed to new interest on the part of the EU in microfinance in Europe. The score of 36.3 was recorded for the BRU sub-region indicating that this sub-region is of smaller interest to international business partners and investors.

The weak score showed that most of the institutions did not enter into any new alliances, partnerships, business relations on which they could improve their position on the market and outreach to clients. This is particularly true for smaller and younger institutions which may have fared better than others during the crisis but because of their small size and early stage, they may be of smaller interest to investors and lenders.

Figure 2.12. Business Contacts

		2009
Location	Asia	47.6
	Europe	48.1
No. of employees	<20	39.6
	20-100	64.5
	>100	46.8
Loan portfolio size (USD)	<1M	37.5
	1-5M	54.1
	>5M	50.2
Age	<4 years	30.2
	4-10 years	54.2
	>10 years	46.3
Member of international network	yes	61.6
	no	43.5
Sub-region	Balkans	47.6
	CEE	72.2
	BRU	36.3
	Caucasus	51.4
	Central Asia	45.6
	Total	**48.3**

Change Factors

The change factors show how different aspects of MFI operations affect the decisions taken by MFI managers measured on a scale from 0 for 'not important', 50 for 'important' to 100 for 'very important'.

The most important aspect for business decisions appeared to be the demand for financial products among clients, availability of qualified staff and the country's economic situation (see Fig 2.13.).

Figure 2.13. Change Factors

	Total	Region		Gross loan portfolio (USD)		
		Asia	Europe	<1M	1-5M	>5M
Demand for financial products	84.0	85.3	81.6	83.3	84.2	84.2
Availability of qualified personnel	82.1	82.4	81.6	86.7	79.0	81.6
Economy	82.1	79.4	86.8	86.7	71.1	89.5
Changed level of business activity	73.6	72.1	76.3	76.7	71.1	73.7
Change in regulation	63.2	61.8	65.8	63.3	50.0	76.3
Change in operational costs	63.2	60.3	68.4	66.7	50.0	73.7
Taxation	56.7	60.6	50.0	67.9	52.6	52.6
Red-tape and corruption	45.2	50.0	36.8	57.1	31.6	50.0

Professional staff was found to be the most important aspect among the smallest MFIs with loan portfolios of less than USD 1 million while the economy was far more important in Europe and among the largest MFIs than in any other group.

Bureaucracy and corruption were considered as the least important factor, especially by European MFIs. Interestingly, changes in operating costs were not considered to be overly important and they mattered less for Asian MFIs than for the ones located in Europe.

Summary

Microfinance confidence has been undermined by the recent crisis in several important areas, in particular in the quality of the loan portfolio which has been one of the key features of microfinance. The deterioration in economic conditions showed that the sector is also vulnerable to external microeconomic shocks, contrary to the widespread belief that microfinance is shielded from macro shocks because of the more informal/semi-formal nature of the borrowers and the granularity of the portfolios. Pessimism is particularly strong among the European MFIs which have experienced major contractions and losses.

At the same time, it is interesting to note that optimism is on the rise and that most MFIs see a brighter future, although not immediately and not in all areas of business performance. This may be partly due to the measures taken by MFIs to improve their portfolio quality on the one hand, and the overall economic recovery on the other. Also, contracted bank lending to the micro and SME sector has loosened the competitive pressures on MFIs in most markets, opening a temporary window of opportunity for MFIs to expand their lending activity while banks re-think their strategies for this segment of the market. However, one should not expect a major jump in the scale of microfinance as most MFIs face strong budget constraints due to more difficult (and overall more expensive) access to funding.

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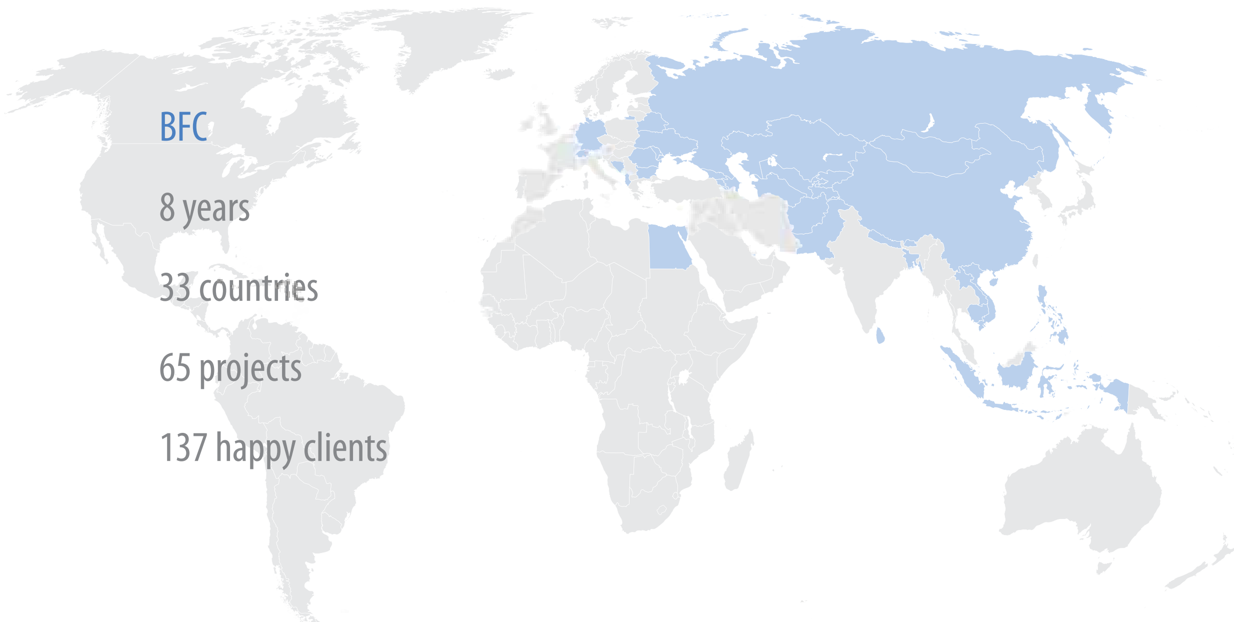

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Chapter 3

Portfolio Quality and Financial Performance

2009 was the first year in the history of microfinance in the ECA region when the size of credit operations, both in terms of the volume of loan portfolio and the number of active borrowers, decreased during the year. The total size of the gross loan portfolio of all types of microfinance providers was 7% smaller in December 2009 compared to December 2008. The opposite development was observed in the deposit-taking activity: the total amount of savings collected by deposit taking microcredit providers grew by 15%, although there were significant differences among the sub-regions and deposit-taking institutions.

Scale of Outreach: Microcredit

At the end of 2009 the total gross loan portfolio of microcredit providers in ECA reached USD 16.6 billion. Credit unions dominated the microcredit market with a 41% market share, followed by microfinance banks (30%). The other types of microfinance providers - microfinance banks and NGO/NBFIs – accounted for less than 29% of the total volume of credit in the region.

As credit unions are mostly active in CEE this sub-region was the largest in terms of the volume of micro-credit. Credit unions provide 80% of credit in CEE while non-deposit taking MFIs account only for a little over 5%. The second largest sub-region – the Balkans – was dominated by microfinance banks, where 7 out of 21 such banks were present. Downscaling banks operated predominantly in the BRU sub-region where they account for almost 60% of microcredit activities followed by Credit unions (27%). Central Asia and the Caucasus are the two smallest sub-regions representing respectively 8.8% and 10.2% of the total supply of ECA microcredit (see Figure 3.1).

Figure 3.1. Total value of gross loan portfolio of microcredit providers in ECA (USD billion)

	Downscaling banks	Credit unions	Microfinance banks	NGOs/NBFIs	ECA total
Balkans	0.3	0.1	2.2	1.0	3.6
CEE	0.1	5.6	0.9	0.4	7.0
BRU	1.7	0.8	0.3	0.1	3.0
Caucasus	0.4	0.0	0.9	0.3	1.7
CA	0.3	0.2	0.6	0.3	1.4
ECA total	**2.9**	**6.7**	**5.0**	**2.1**	**16.6**

The total value of gross loan portfolio recalculated in USD decreased by 7.3%, which is comparable to the - 6% change of the volume of commercial bank credit in the respective countries. Strong correlations were found between commercial bank credit growth rates[6] and microfinance portfolio development, not only for microfinance banks and downscaling banks which are part of the banking sector but also for NGOs/NBFIs and credit unions. This shows that microfinance mirrors the trends of the mainstream banking sector (see Fig 3.2.).

Figure 3.2. Growth rates of the total loan portfolio of mainstream commercial banks and microcredit providers in the ECA region

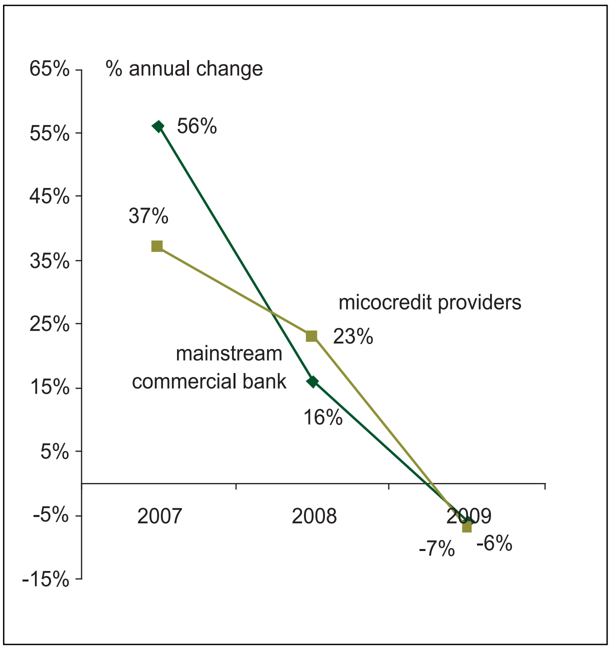
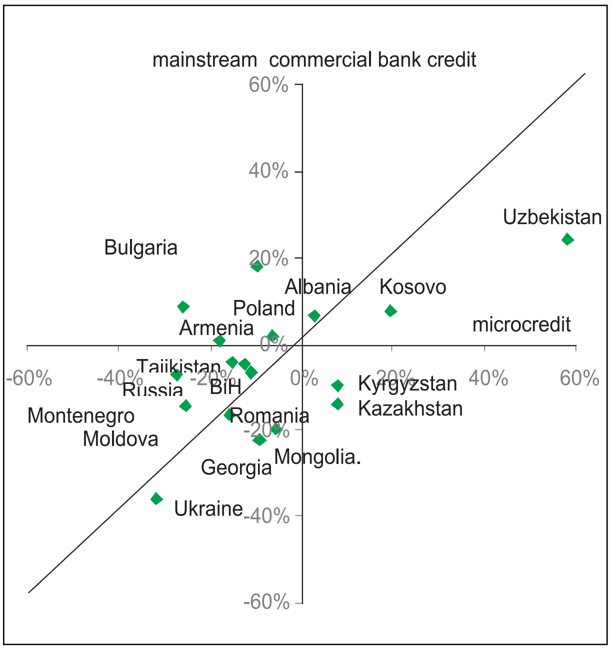


Figure 3.3. Correlation between the changes in the total value of loan portfolio of mainstream commercial banks and NGOs/NBFIs by country



In some countries NGOs/NBFIs showed some resilience as their portfolios grew despite the declines in the banking sector. This was seen in Kazakhstan and Kyrgyzstan (see Fig. 3.3.). In several other countries either the growth rates of microcredit portfolios exceeded growth in the commercial sector (Kosovo and Uzbekistan) or the declines were lower than in the mainstream banks (Georgia, Mongolia, Romania, Ukraine).

Among microcredit providers, the largest decrease in the size of the total loan portfolio was seen among downscaling banks – almost half of the funds engaged in microlending in 2008 were withdrawn from the microcredit portfolio in 2009. This strongly affected the BRU sub-region where the total size of the loan portfolio fell by 45% (Fig 3.4.).

At the other end of the spectrum were credit unions, which were the strongest growers in 2009 posting a 21% increase in the outstanding loan portfolio. Operating chiefly in the CEE they drove the growth making CEE the most dynamically growing sub-region in 2009. Networks of credit unions in Poland and Hungary (the largest in the whole ECA region) grew by 26% although the fastest grower was the credit union movement in Uzbekistan: while still relatively small it was the fastest grower of all the WOCCU members worldwide (see Box 3.1.).

6 IMF FAS 2010 statistics were used to calculate changes in the value of credit from commercial banks, except for Tajikistan for which data of the National Bank of Tajikistan were used

Box 3.1. Downscaling Banks and Credit Unions

Russian Small Business Fund

The Russia Small Business Fund (RSBF) was established by the European Bank for Reconstruction and Development (EBRD) in 1994 to provide financial support to the Russian small business sector. In 2009 banks in Russia experienced a stagnation as the volume of disbursed loans in the micro loans segment fell by 44% - back to the level of operations observed before 2001.

Source: www.microcredit.ru

Credit Unions in Uzbekistan

The credit union movement in Uzbekistan began in 2002 when the credit union law was passed with the assistance of WOCCU. There are over 100 credit unions which at the end of 2009 provided services to over 150,000 members. The loan portfolio of over USD 120 million grew by 66% in 2009 making the credit union movement of Uzbekistan one of the fastest-growing in the world.

Much of the success of Uzbekistan's credit unions appears to be in their ability to address the growing public demand for affordable, easily accessible financial services. They developed their own market, paying higher interest on savings and providing more immediate access to loans.

The biggest challenges currently facing Uzbekistan's credit unions are similar to those in other developing countries. The lack of credit union access to deposit insurance, the clearing and settlement system, card networks and liquidity sources will make further growth challenging. Despite their existing strengths, the country's credit unions will need greater liquidity in order for the system to expand.

Source: www.woccu.org

Figure 3.4. Annual changes in the value of gross loan portfolio by institutional type

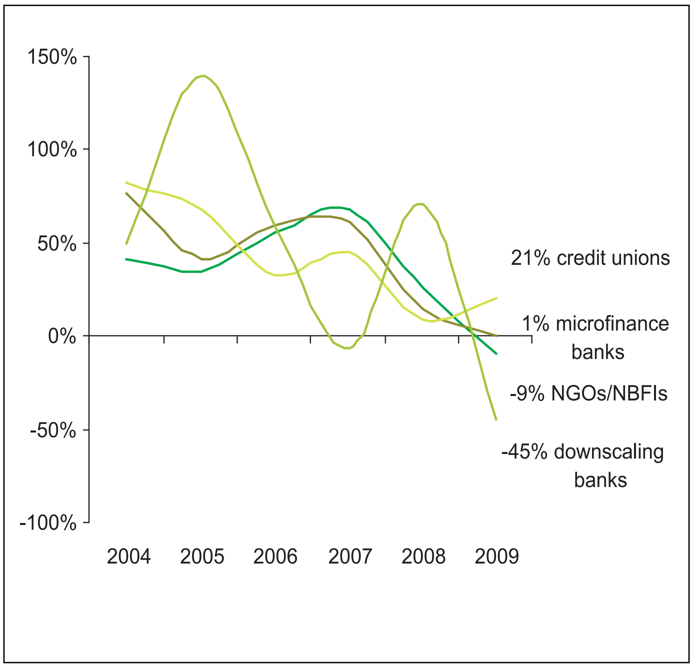
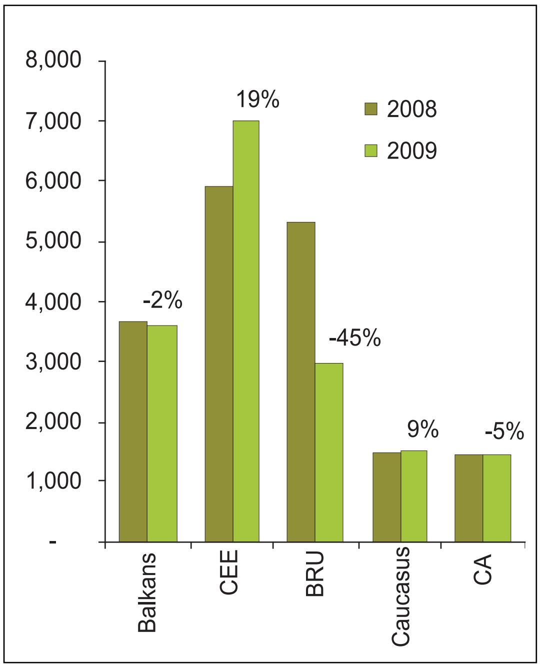


Figure 3.5. Annual changes in the value of gross loan portfolio by sub-regions (all institutional types)



Quality of the Loan Portfolio

Portfolio at Risk

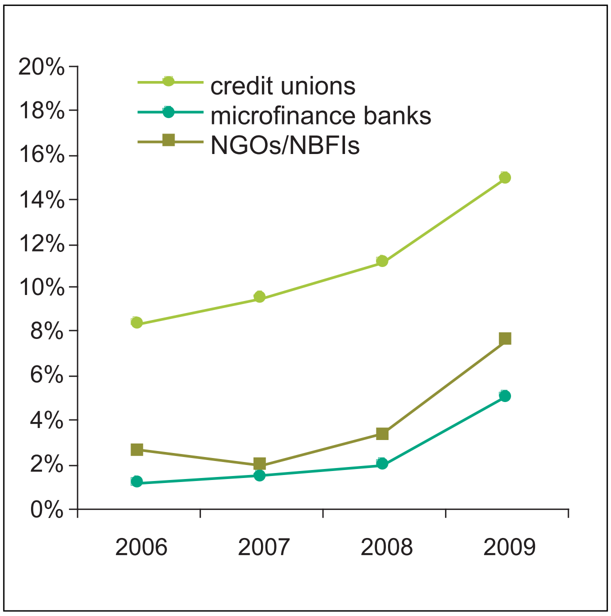
The total value of the loan portfolio affected by overdue loans for more than 30 days was higher than a year earlier for all institutional types.

Microfinance banks showed the best loan portfolio quality (5.1% PAR>30 weighted by the total loan portfolio), although the deterioration was more than twofold. The value of the portfolio at risk over 30 days of all NGOs/NBFIs was 7.6% of the total portfolio, up from 4.7% in 2008. Credit unions showed an even higher ratio of problematic loans but the exact measure of PAR>30 was difficult to obtain given different reporting methodologies for credit unions in different countries[7].
The deterioration of the repayment discipline had already started in 2008. While in 2007 half of the institutions improved their portfolio quality and the other half experienced deterioration, in 2008 already over 70% of institutions observed higher values of the portfolio at risk over 30 days. The trend continued throughout 2009. With the closing of the books at the end of the year 80% of the institutions noted higher PAR>30.

The most difficult situation was observed in the BRU sub-region, where 23% of the total outstanding loan portfolio of NGOs/NBFIs and 25% of the credit union portfolio was engaged in risky loans.

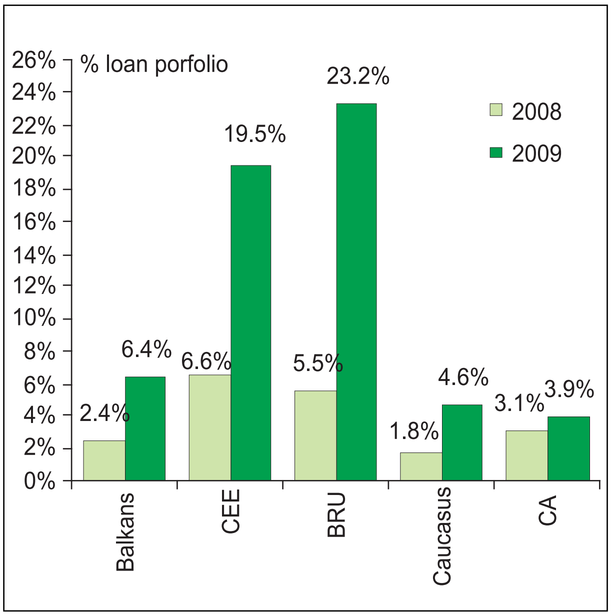
Additionally, almost 20% of the loan portfolio of NGOs/NBFIs in the CEE was affected by repayment delays of more than 30 days. The problem was seen in most of the NGOs/NBFIs there, while microfinance banks performed quite well.

Figure 3.6. Portfolio at risk over 30 days* (PAR>30) by institutional type



*weighted by the gross loan portfolio

Figure 3.7. Portfolio at risk over 30 days* (PAR>30) of NGOs/NBFIs by sub-region



*weighted by the gross loan portfolio

7 Credit union data in several countries did not specify the loan portfolio classification methodology. For the purpose of the analysis the following portfolio classes were included into the portfolio at risk: sub-standard, doubtful, bad (loss).

Box 3.2. Quality of the Loan portfolio of the Commercial Banking Sector in ECA Countries

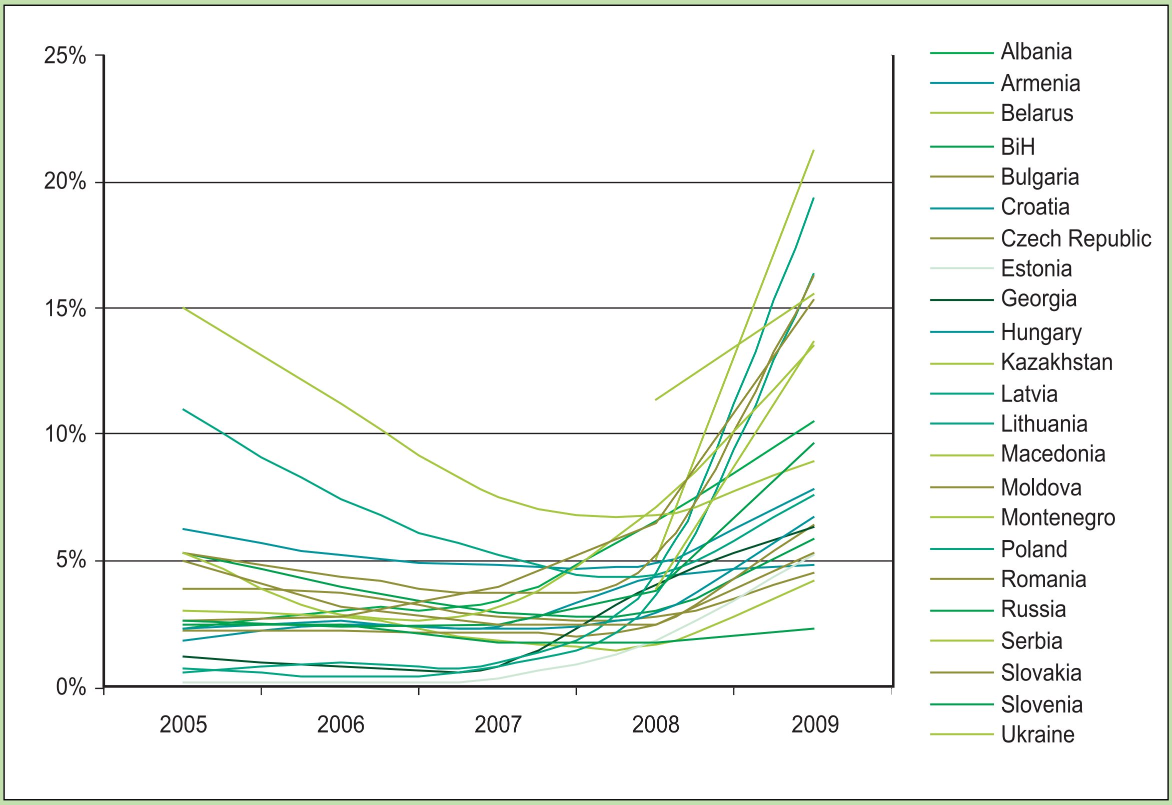
According to the IMF statistics the quality of the loan portfolio in the majority of ECA countries has been gradually deteriorating for the last 3 years. While in 2007 almost all countries, with the exception of Macedonia and Poland, managed to keep less than 5% of non-performing loans (NPL), in 2009 the share of non-performing loans went up in almost all countries to between 2.3% and 21% of the outstanding loan portfolio. Only two countries managed to keep the delinquency below 5% (Armenia, Belarus) while in 6 countries the NPL ratio exceeded 15% (Kazakhstan, Latvia, Lithuania, Moldova, Romania, Serbia).

Non-performing loans (NPL)

According to the Financial Soundness Indicators guide loans should be classified as NPL when payments of principal and interest are past their due date by three months (90 days) or more, or interest payments equaling three or more month's interest have been capitalized (reinvested into the principal amount), refinanced, or rolled over. In addition, NPLs should also include those loans with payments less than 90 days past their due date that are recognized as nonperforming under national supervisory guidance— that is, evidence exists to classify a loan as non-performing even in the absence of a 90-day past due date payment, such as when the debtor files for bankruptcy.

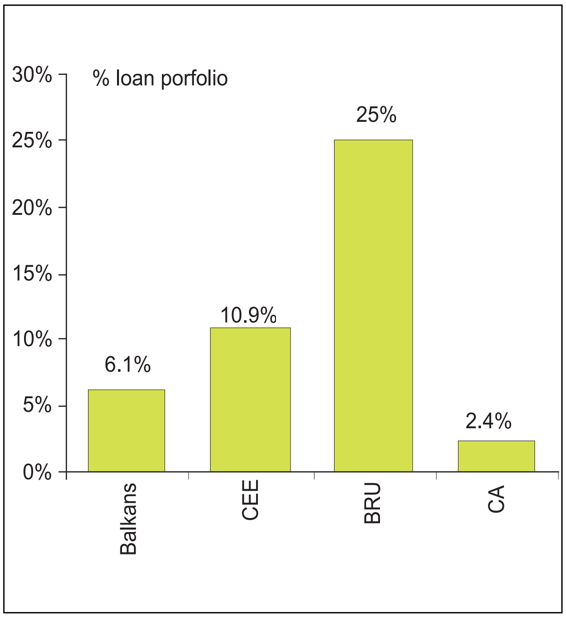
However, adherence to this definition varies from country to country, therefore precise analytical results could not be obtained, although data shed some light on the general trends.

Non-performing loans to total loans of commercial banks in ECA countries



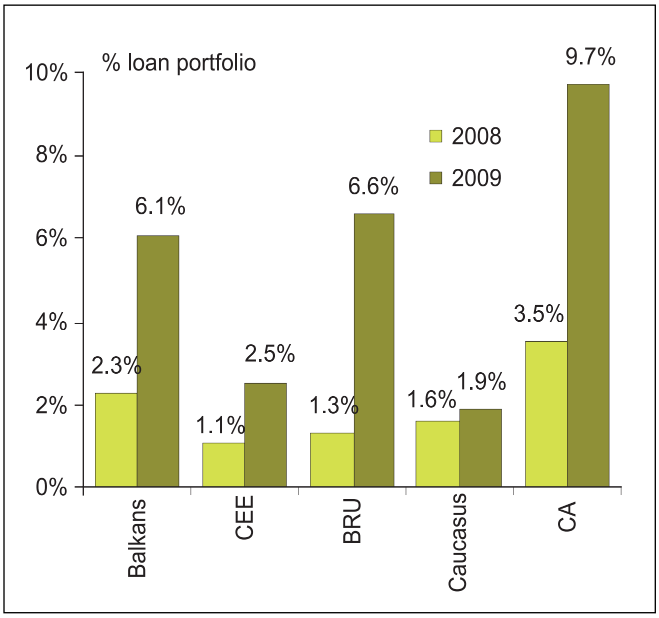
Source: IMF Global Financial Stability Report, October 2010, Financial Soundness Indicators

Figure 3.8. Portfolio at risk over 30 days* (PAR>30) of credit unions by sub-region



*weighted by the gross loan portfolio

Figure 3.9. Portfolio at risk over 30 days* (PAR>30) of microfinance banks by sub-region



*weighted by the gross loan portfolio

The Central Asian sub-region presented a different situation. NGOs/NBFIs and credit unions there exhibited very good control over the quality of their portfolios while microfinance banks had quite high PAR>30 (9.7%) driven by the largest institutions.

Due to the lack of common definitions for portfolio risk classification of banks and MFI loans it was not possible to compare the credit performance of the microfinance sector versus the commercial banking sector. However, a similar trend was observed in the two sectors. The Box 3.2. presents data on credit repayment performance in the banking sector in ECA countries. Similar trends in credit repayment can be seen in the microfinance industry as in the commercial banking sector: after several years of a relatively low and stable share of non-performing loans their proportion in credit portfolio increased in 2009.

Cost of Risk

Institutions with higher portfolio at risk and those experiencing large PAR increases during the year incurred higher impairment loss expenses which led to lower return on assets: the higher the PAR, the larger portion of the financial income had to be allocated to the creation of the reserves for potential losses. In total, 22% of all financial revenues[8] generated by NGOs/NBFIs in the ECA region was spent on increasing the loan impairment allowance (cost of risk ratio[9]) or 5.2% of the total assets (provision for loan impairment ratio[10]).

In the extreme cases the NGO/NBFI would spend up to 75% of its revenues or 19% of its assets on building up the loan loss allowance. Although only 7 institutions spent more that 50% of the financial revenues

8 Financial revenue = total income from interest and fees on loans
9 Cost of risk ratio = Impairment losses on loans/Financial revenue
10 Provision for loan impairment ratio = Impairment losses on loans/Average total assets

on the creation of loss reserves, these were predominantly the largest institutions in the region.
Even though microfinance banks had lower amounts of risky loans in their portfolios, the total expense connected with impairment losses on loans reached 10% of their total financial revenues. The weighted provision for loan impairment ratio was also lower (1.5%) than in the case of NGOs/NBFIs.

Figure 3.10. Weighted loan loss provision expense of NGOs/NBFIs and microfinance banks by sub-regions

	NGOs/NBFIs		Microfinance banks	
	Cost of risk	Provision for loan impairment ratio	Cost of risk	Provision for loan impairment ratio
Balkans	36%	7.4%	9%	1.1%
CEE	26%	5.7%	12%	1.6%
BRU	7%	2.2%	28%	4.8%
Caucasus	7%	2.1%	4%	1.0%
Central Asia	8%	2.1%	9%	1.3%
ECA total	**22%**	**5.2%**	**10%**	**1.5%**

Uncovered Risk

Although in some institutions the percentage of the portfolio in overdue loans (PAR>30) may not seem overly high, some of the risks remained uncovered.

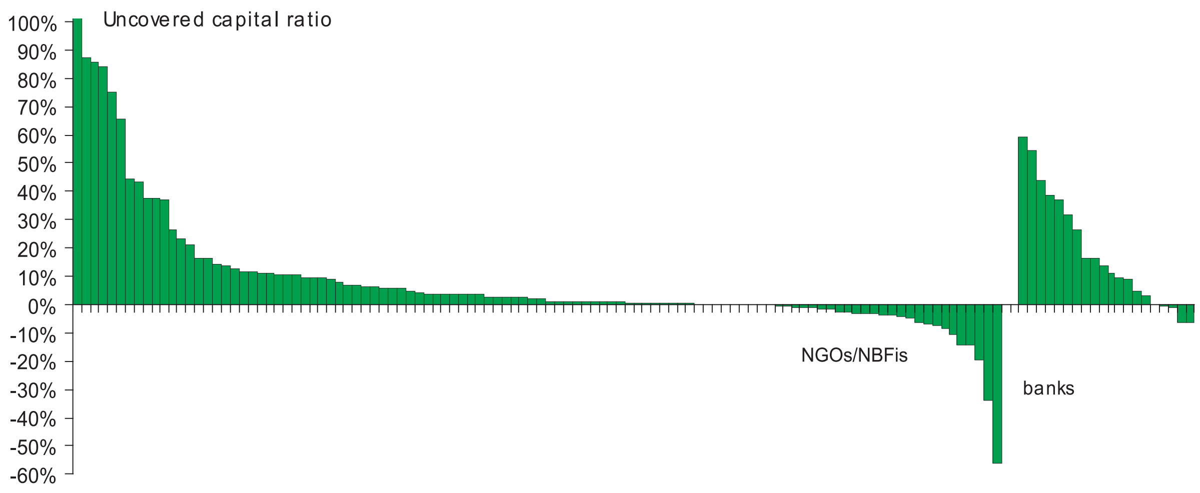
The ratio of the value of the PAR>30 days above the loan impairment allowance to total capital (uncovered capital ratio)[11] shows the degree of vulnerability to unexpected, and therefore not provisioned for, losses. Higher values of the ratio indicate higher potential capital losses in case of unanticipated delinquency for which reserves were not created. Lower values show that only a small fraction of the MFI capital is susceptible to losses, while negative scores are characteristic for institutions with a provision above the total value of loans overdue for more than 30 days.

The uncovered capital ratio for NGOs/NBFIs weighted by the total equity was 9%, indicating that only 9% of the value of equity of all NGOs/NBFIs was in loans overdue for more than 30 days not provisioned for. However, the situation varied from institution to institution. 11% stood out as a group with rather high uncovered capital ratio – the value of potential losses exceeded 25% of their equity.

Microfinance banks had a larger risk exposure on their capital as 18% of their equity had open exposure to the potential loan losses uncovered by provisions. A larger number of microfinance banks (35%) than NGOs/NBFIs were exposed to the risk of losing more than a quarter of equity. Even though their portfolios were generally healthier in comparison with NGOs/NBFIs, the majority provisioned less for potential losses. This might be explained by the higher share of secured loans in the portfolios of microfinance banks.

11 Uncovered capital ratio = (PAR>30 – Impairment loss allowance)/Total capital
This is a new ratio proposed by the MFI Reporting Standards Initiative hosted by the SEEP Network. The detailed description of the ratio is available at www.seepnetwork.org.
Because the value of total capital (calculated according to the Basel II principles) was not available from MFIs it was substituted with the value of total equity.

Figure 3.11. Distribution of NGOs/NBFIs and microfinance banks by the value of uncovered capital ratio



Scale: Savings and Deposit Services

The total value of deposits with microcredit providers was almost USD 10 billion, posting a 15% growth rate compared to the end of 2008. This is a reflection of consumer changes in attitudes during the financial crisis when people became more cautious in spending and tried to build financial reserves.

Figure 3.12. Total value of deposits (USD billion) collected by microcredit providers in ECA

	NGOs/NBFIs	Credit unions	Microfinance banks	ECA total
Balkans	0.0	0.0	2.3	2.3
CEE	0.0	5.0	0.7	5.7
BRU	0.0	0.5	0.1	0.6
Caucasus	0.0	0.0	0.4	0.4
Central Asia	0.001	0.1	0.7	0.8
ECA total	**0.001**	**5.6**	**4.2**	**9.8**

Credit unions remain the largest provider of saving services in the whole ECA region but their operations are concentrated in CEE and the BRU sub-regions. Credit unions continued their growth at the same pace as in the previous years driven chiefly by the growth of Polish and Czech credit union networks which managed to attract respectively 30% and 43% more deposits than a year earlier.

In other countries, with significant credit union deposit activities, such as Ukraine and Russia, the trend was the opposite – a 28% decrease in the value of deposits at the end of 2009. The financial crisis was particularly harsh for those credit unions which experienced severe liquidity problems caused by withdrawing of savings. This created a major challenge for the system (see Box 3.3.).

Microfinance banks attracted the highest volume of deposits in the Balkans. After a year of a very slow growth microfinance banks managed to increase their deposit growth rate to 6% per year. The highest growth rate was seen in the Caucasus, where Access Bank in Azerbaijan and ProCredit Bank in Armenia more than doubled their client deposits.

Box 3.3. Credit Unions in Ukraine

Ukrainian Credit Unions

The credit union movement in Ukraine significantly reduced its operations in 2009 – the number of credit unions fell by 10% and the value of capital decreased by 55%. After lifting the moratorium on the early termination of deposit contracts in March 2009 credit union members started closing their deposit accounts. Depositor's loss of confidence resulted in a 25% decrease in the value of client savings and 30% fall in the value of the outstanding loan portfolio. As many as 100 credit unions faced liquidation in 2009 and until mid-2010 almost 200 required state refinancing and transitional administration.

Source: http://news.finance.ua/ua

The growth of the deposit market was in line with the trend in the commercial banking sector in ECA, although microcredit providers managed to retain higher growth rates in 2008 and 2009.

Figure 3.13. Annual changes in the volume of deposits attracted by mainstream commercial banks and microcredit providers

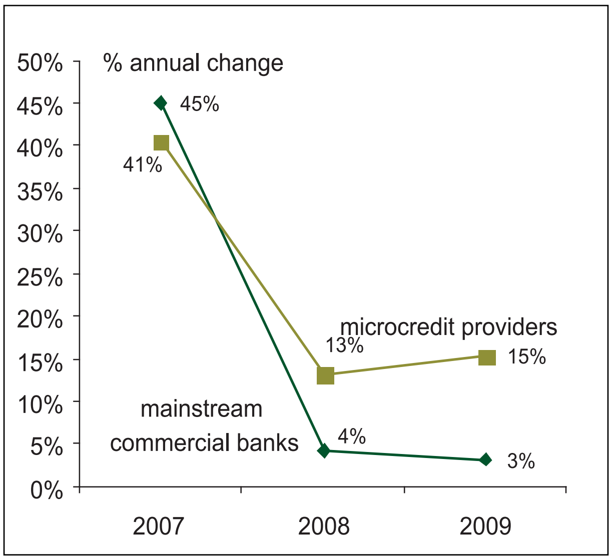


Figure 3.14. Annual changes in the value of savings collected by credit unions and microfinance banks

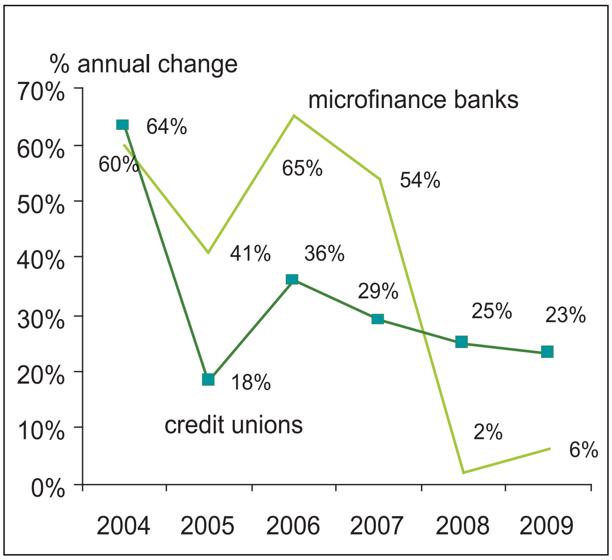


Figure 3.15. Annual change in the total value of deposits of credit unions by sub-region

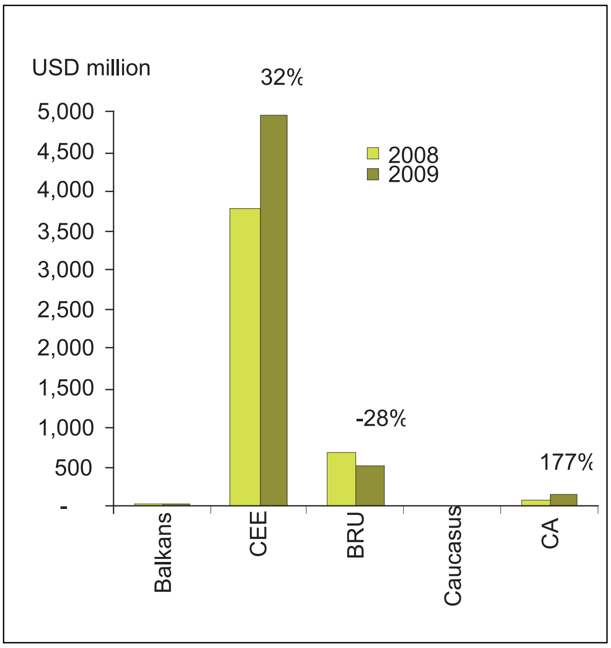
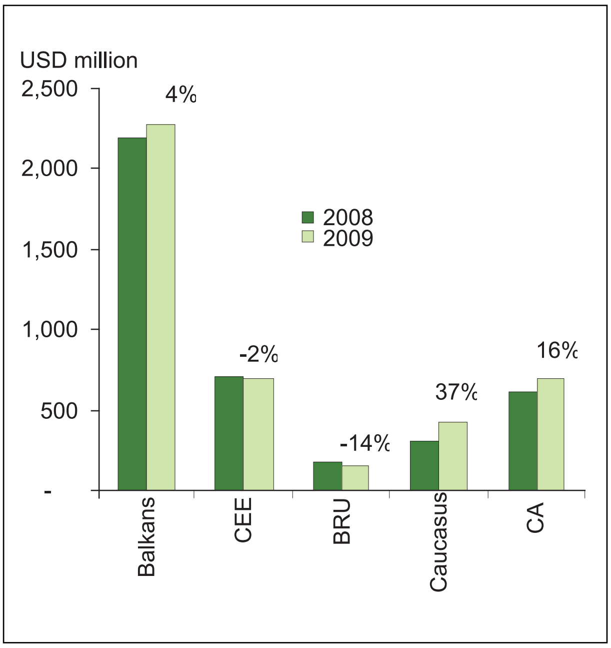


Figure 3.16. Annual change in the total value of deposits of microfinance banks by sub-region

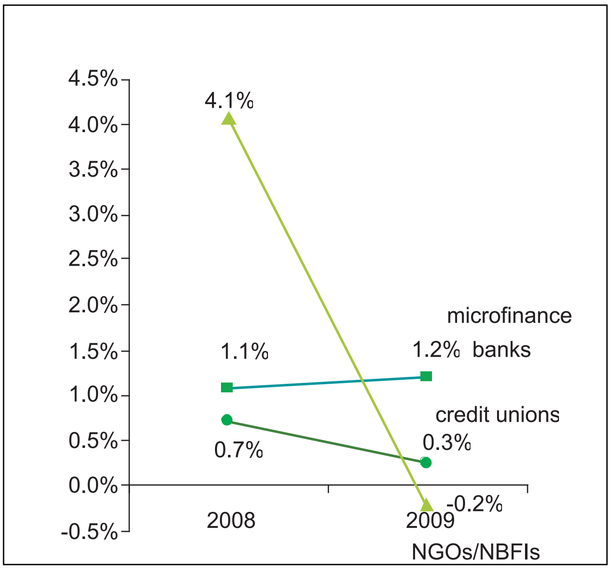


Profitability and Cost Structure

In 2009 NGOs/NBFIs were the only type of institutions which experienced a sharp fall in returns. NGOs/NBFIs became unprofitable while microfinance banks and credit unions continued to generate modest profits.

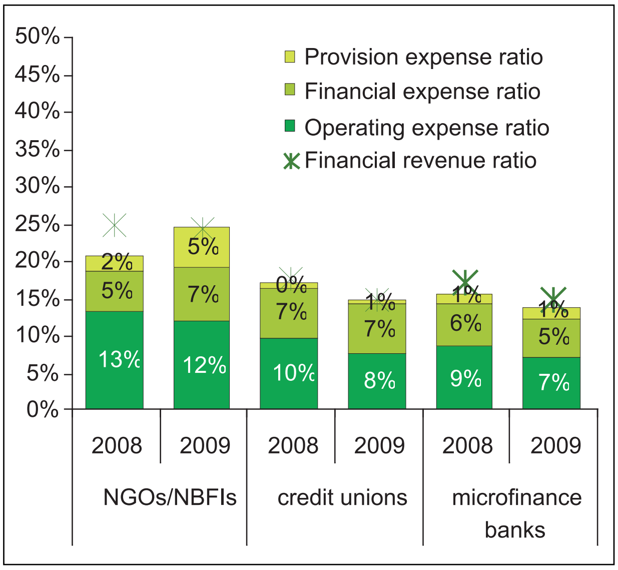
All types of institutions earned lower revenues but only NGOs/NBFIs did not manage to reduce their expenses in order to maintain a positive net result. Although the operating expenses were lower, their financial expenses increased by 2 percentage points, and the loan impairment provision expense by 3 percentage points.

Figure 3.17. Return on assets* (ROA) of microcredit providers



*weighted by total assets

Figure 3.18. Revenue and cost structure* of microcredit providers



*weighted by total assets

NGOs/NBFIs

During 2009 profitability decreased to -0.2% from 4.1% in 2008. However, institutions from the Asian part of the ECA region managed to generate positive returns. The ones located in the BRU sub-region only managed to break even while in the other 2 sub-regions (Balkans and CEE) institutions suffered from losses. Two reasons contributed to the decreased profitability – lower revenues and higher provisioning expenses. Operating expenses fell in most locations, financial expenses remained the same or slightly fell, but the provision for loan impairment expense increased significantly in the Balkans, CEE and the BRU sub-region.

Figure 3.19. Return on assets of NGOs/NBFIs by sub-region

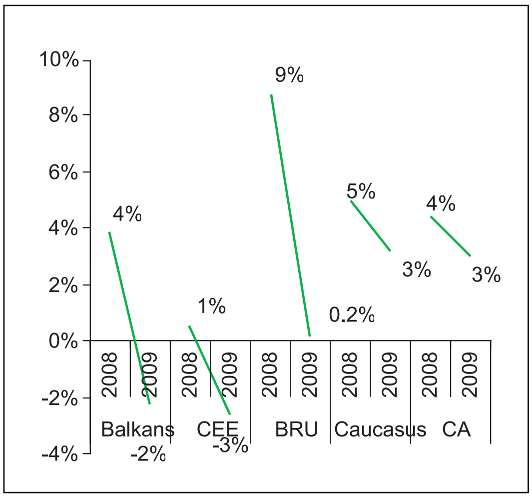
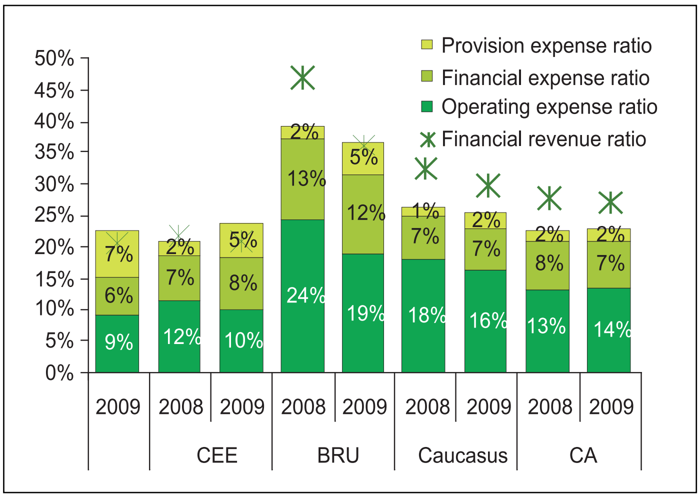


Figure 3.20. Revenue and cost structure of NGOs/NBFIs by sub-region



Microfinance Banks

The situation among microfinance banks was more diverse. In some sub-regions profitability remained positive while in other sub-regions (CEE and BRU) it remained negative. Revenues were lower in 2009 in all sub-regions and expenses decreased as well. It was only in the BRU and the CEE sub-regions that the provision expense increased.

Figure 3.21. Return on assets of microfinance banks by sub-region

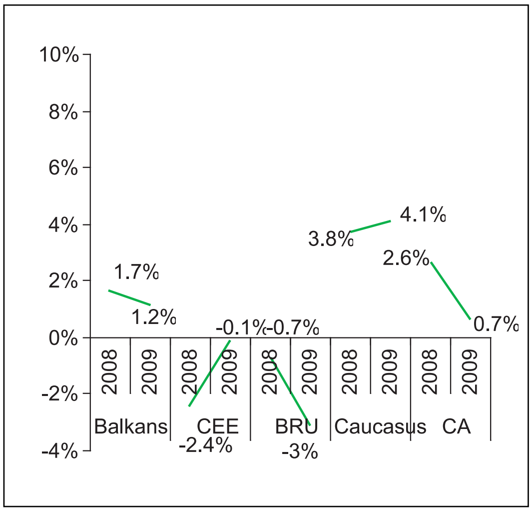
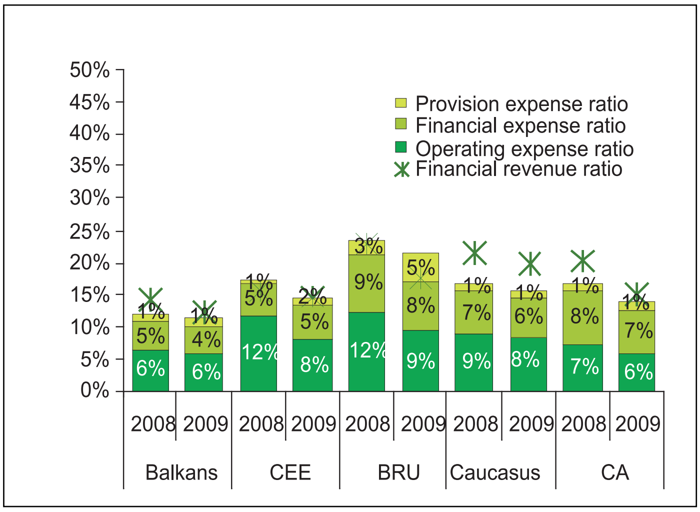


Figure 3.22. Revenue and cost structure of microfinance banks by sub-region



Credit Unions

Despite lower returns on assets than a year earlier credit unions remained profitable. The largest change in profitability was seen in the BRU sub-region where expenses did not change but revenues decreased.

Figure 3.23. Return on assets of credit unions by sub-region

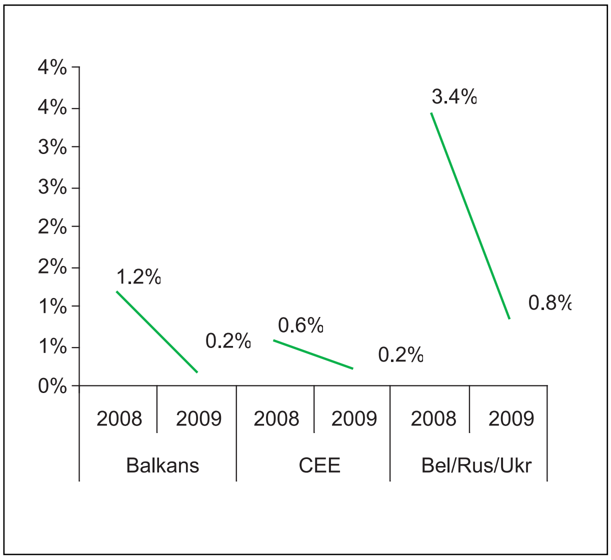
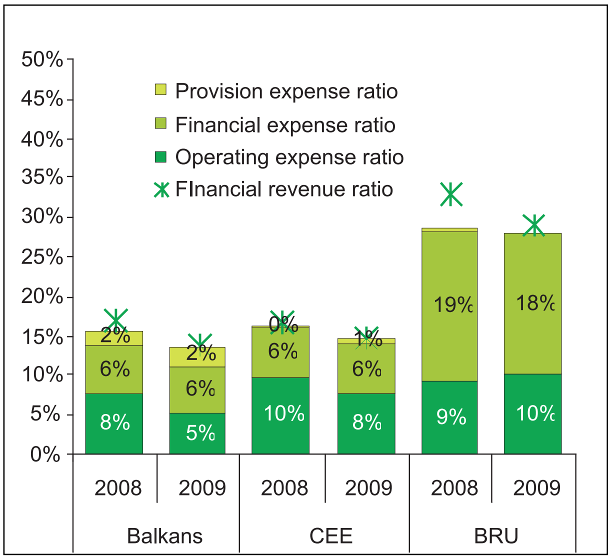


Figure 3.24. Revenue and cost structure of credit unions by sub-region



Among all institutional types microcredit providers in the Balkans had the lowest total expenses while the highest were seen in the BRU sub-region. In the BRU sub-region, the cost of funds was particularly high for those institutions which obtained local currency funding. The operating expense ratio in this sub-region was also among the highest compared to other sub-regions.

Summary

The microfinance industry in ECA followed the same growth trends as the commercial banking sector. In countries where sharp declines in the volume of bank lending were observed MFIs also experienced a decrease in the value of their loan portfolio. Credit unions managed to grow better than other types of microcredit providers. Due to the prevalence of credit unions in Central and Eastern Europe this region was the fastest grower in ECA.

The decline of microcredit activities was seen among downscaling commercial banks which decreased their total microcredit volume in ECA by 45%. This affected the BRU sub-region the most, which noted the largest fall in the value of total loan portfolio.

Apart from the negative growth of the total portfolio its quality deteriorated for all types of microcredit providers following the general tendency of the mainstream banking sector. Although the total portfolio at risk may not seem overly high (7.6% for NGOs/NBFIs and 5.1% for microfinance banks) it was quite high in some sub-regions (BRU). Sharp increases in the portfolio at risk entailed higher expenditures connected with provisioning. NGOs/NBFIs spent in total 25% of their financial revenue on increasing loan loss allowance which was equivalent to 5.2% of the total assets. Microfinance banks, given the better loan portfolio quality, spent less than half of it on building up reserves.

Despite the increase of loan loss reserves several institutions remain exposed to loan loss risk. For 11% of NGOs/NBFIs and 35% microfinance banks the value of the PAR>30 days which was not covered by impairment allowances exceeded 25% of the total equity of the institution.

The volume of deposits collected by credit unions and microfinance banks grew during the year which was also characteristic for mainstream commercial banks in ECA. Credit unions continued their deposit growth with a stable 23% rate, with the highest increase in the deposit value in their main sub-region of operations – CEE. The BRU sub-region turned out to be the most difficult sub-region for deposit-collection activities of credit unions and microfinance banks alike.

Despite the declines in lending operations microfinance providers continued to report positive financial returns. Microfinance banks and credit unions managed to remain profitable unlike NGOs/NBFIs for which ROA fell sharply and was negative at the end of the year. All types of institutions observed lower revenues but only NGOs/NBFIs did not manage to decrease their expenses accordingly; although their operating expenses decreased the financial expenses and provision expenses were higher than in 2008.

Social performance management in Vision Fund AzerCredit

First steps regarding social performance management were introduced into AzerCredit's daily performance since World Vision Azerbaijan started its activities in Azerbaijan in 1996. Initially the organization provided financial services to internally displaced persons and then, later, to the ordinary people who were not able to access conventional banking system. By rendering our loans to owners of micro and small businesses and farmers we do ensure that those people can take control over their own lives and livelihoods. Among main roots in social performance area embedded into the organization since start up were: keeping gender balance, female clients, as a minimum of 40%; monitoring number of jobs created and sustained through our credits; tracking the number of children positively impacted by our operations.

In May 2008 staff members of Marketing Department of VF AzerCredit attended training organized by Microfinance Center of Poland (MFC) and Azerbaijan Micro Finance Association (AMFA) "Social Performance Management in Microfinance: Translating Your Mission into Practice". Here main conceptions and indicators were explained and some tasks were given to all participants to distribute information about SPM to their organizations.

Further, in July 2008, VF AzerCredit was able to secure the first social audit in Azerbaijan, with the assistance of AMFA and MFC. As a result of the social audit we were expecting positive changes both in terms of the social performance and in terms of the company development: strengths and weaknesses within and toward outside stakeholders were found out and some of the weaknesses/gaps have been covered up till now due to our strategy to become more social oriented in the local market. Among them are: customer and staff grievances system; awareness of staff about social component of our operations - our mission; poverty measurement tool; and, social indicators incentive system, which is being developed for field staff at the time being.

In 2008:

- We received recognition certificate from Azerbaijan Microfinance Association as acknowledgement for pioneering participation in Advancing Social Performance Management in Azerbaijan, which included undergoing the process of Social Audit.
- Perfect results helped us to receive a VFI Green "Good Performance" Rating for the year 2008.
- In September, 2008 VF AzerCredit was awarder "The Best Community Impact provider in Azerbaijan" award by Azerbaijan Microfinance Association, being recognized as the MFI with the best community impact on the market

In 2009:

- VF AzerCredit was recognized as a leader in transparent pricing in the Azerbaijani microfinance industry by MF Transparency
- Silver award was received from CGAP, Ford Foundation and Michael & Susan Dell Foundation for reporting on Social Indicators to MIX
- Social rating was conducted by MicroFinanza in autumn 2009
- We developed and tested a poverty measurement tool, which is a very strong tool of poverty outreach and social impact measurement

In 2010:

- Social Performance Reporting Awards committee awarded a Gold Social Performance Reporting Award at the MFC conference in Astana, Kazakhstan in May 26, 2010.

VF AzerCredit will continue sustaining its fast growth to maintain its status of a leading MFI on the market, as the microfinance sector in Azerbaijan is intensively developing. We have now: 7 branches; 15 sub-branches; more than $27 000000 outstanding portfolio; 280 staff members; and more than 35000 clients. Our PAR for more than 30 days is 0,3%; and we have 104% outstanding self sustainability. So, reaching those numbers we are expanding our services and becoming more and more community impact oriented with the very active approach to the social performance management.

Chapter 4

Microfinance Outreach and Social Performance

The reduction of the scale of lending operations was coupled with an unprecedented decrease in outreach. The client base of microcredit providers was 9% smaller than a year earlier. The deposit-taking operations were more successful in attracting clients, but the total number of depositors grew by only 2%.

Breadth of Outreach

Borrowers

At the end of 2009 microcredit providers in ECA served 5 million borrowers out of 276 million adults living in the ECA region.

The largest number of clients was located in the CEE sub-region, where credit union networks operated on a large scale. In other sub-regions microfinance banks and NGOs/NBFIs were the main providers of microcredit, except for the BRU sub-region where credit unions and cooperatives were the main microlenders.

Figure 4.1. Number of active borrowers by institutional type and sub-region

	Downscaling banks	Microfinance banks	NGOs/NBFIs	Credit unions	Total
Balkans	19,072	338,755	478,882	38,658	**875,367**
CEE	21,930	95,058	64,870	1,637,416	**1,819,273**
BRU	129,251	35,504	50,627	554,803	**770,185**
Caucasus	99,989	273,294	322,858	13,371	**709,512**
CA	68,699	427,268	439,957	175,611	**1,111,535**
ECA total	**338,940**	**1,169,879**	**1,357,194**	**2,419,860**	**5,285,872**

In 2009 the total number of borrowers fell by 9%. The dramatic decrease in the lending volume of the downscaling banks was also seen in the falling number of active clients (– 46%). Other types of institutions, even those whose loan portfolios grew (credit unions increased their outstanding loan portfolio by 21% and microfinance banks by 1%) noted the fall in the number of active borrowers by 12% and 3% respectively. Only NGOs/NBFIs managed to slightly increase their client base, despite a decreased loan portfolio.

In the majority of sub-regions the number of borrowers fell except for Central Asia where the number increased during the year, specifically in Kyrgyzstan and Mongolia.

Figure 4.2. Active borrowers growth rate by institutional type

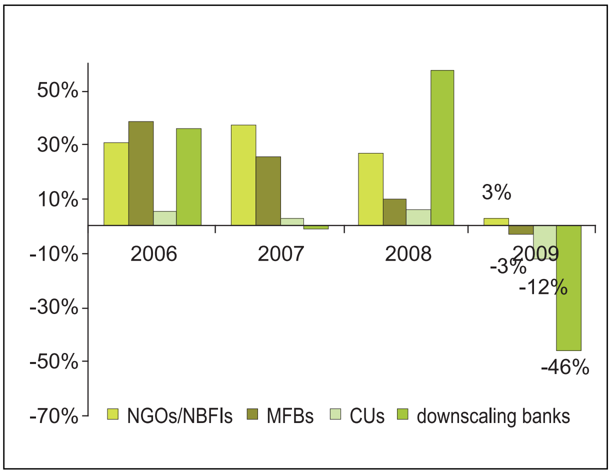
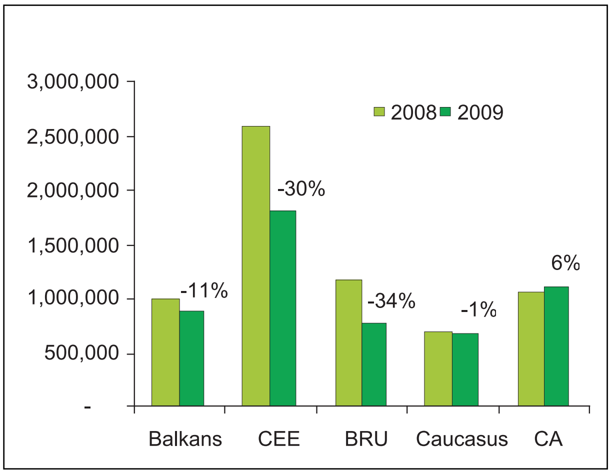


Figure 4.3. Active borrowers growth rate by sub-region (all institutional types)

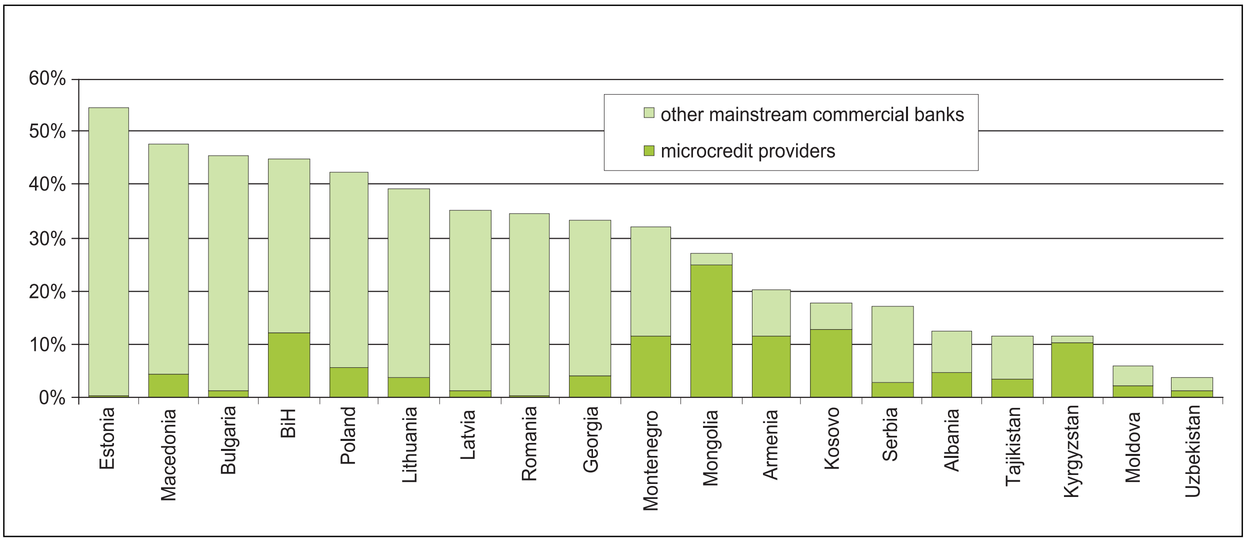


Statistics on financial access in the mainstream commercial banking sector[12] of ECA show that the number of bank borrowers fell by 0.2%, but data was only available for a small sample of countries, so they are not representative for the whole region.

Nevertheless, the comparison of the development of the client base in the mainstream banking sector and among microcredit providers reveals that only microfinance banks and credit unions followed the commercial bank trends in their countries, while changes in the outreach of NGOs/NBFIs and downscaling banks did not coincide with the banking sector movements.

In the majority of countries microborrowers constitute a small fraction of credit users. Only in countries such as Mongolia, Kyrgyzstan, Kosovo or Armenia are microlenders the primary source of credit, as they serve more than half of all borrowers in the country.

Figure 4.4. Penetration rate of microfinance providers and mainstream commercial banks[13] among adults in the economically active age group[14]



12 IMF Financial Access Statistics (FAS) and CGAP Financial Access 2010 provided information on the number of borrowers from commercial banks for 17 countries. Two year data were available for 11 countries from IMF FAS. Additionally, data for two more countries were obtained from the statistics of central banks.

13 Microfinance providers include downscaling commercial banks, microfinance banks, credit unions and NGOs/NBFIs. Penetration rates of mainstream commercial banks, excluding microfinance banks and bank downscaling programs were calculated from the IMF FAS 09 data.

14 Penetration rate: number of active borrowers per population of the working age group (16-65 years old)

Depositors

The total number of savers with microfinance providers was over 6 million people. The largest number of depositors was located in Central Asia, in Mongolia, where they were clients of Khan Bank. Apart from that, large numbers of savers were seen in the CEE, where they were served by credit unions, and in the Balkans, where they were clients of microfinance banks.

In total, depositors outnumbered borrowers. The average microfinance bank attracted 3.1 times more savers than borrowers while an average credit union had 1.3 times more depositors than credit users. In the sub-regions, Central Asian institutions served twice as many borrowers as savers, while the opposite was seen in the BRU sub-region.
The start of collecting voluntary deposits by NGOs/NBFIs was seen in Tajikistan where more and more microcredit-deposit institutions (MDO) started offering saving products.

Figure 4.5. Number of savers by institutional type and sub-region

	NGOs/NBFIs	Credit unions	Microfinance banks	Total depositors	Total depositors/ Total borrowers
Balkans		24,904	1,290,396	1,315,300	1.5
CEE		1,000,580	386,333	1,386,913	
BRU		331,192	121,865	453,057	0.6
Caucasus		8,008	678,703	686,711	1.0
Central Asia	416	195,897	2,339,027	2,535,340	2.3
ECA total	416	1,560,581	4,816,324	6,377,321	

The ratio of depositors to savers was not calculated for CEE because of the missing data from Hungarian cooperative credit institutions.

During the year the number of depositors increased by 2%. Credit unions managed to increase their depositors base more dynamically than microfinance banks, as after one year of a slow-down they returned to a double-digit growth rate. The highest increases in depositor numbers were seen in the CEE (Poland, Czech Republic) and Central Asia (Uzbekistan).

Microfinance banks, on the other hand, continued the slowing down trend. Growth was driven mainly by Access Bank in Azerbaijan and Khan Bank in Mongolia which contributed 18% to the total growth. In the sub-regions, Caucasus and BRU showed the highest growth dynamics.

Figure 4.6. Growth of depositor numbers of credit unions and microfinance banks

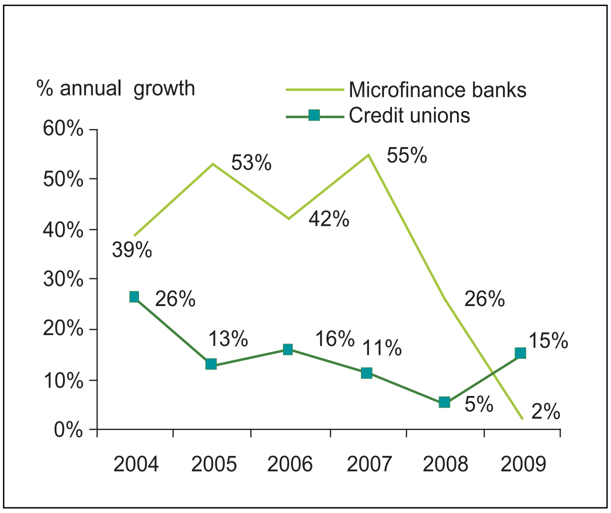
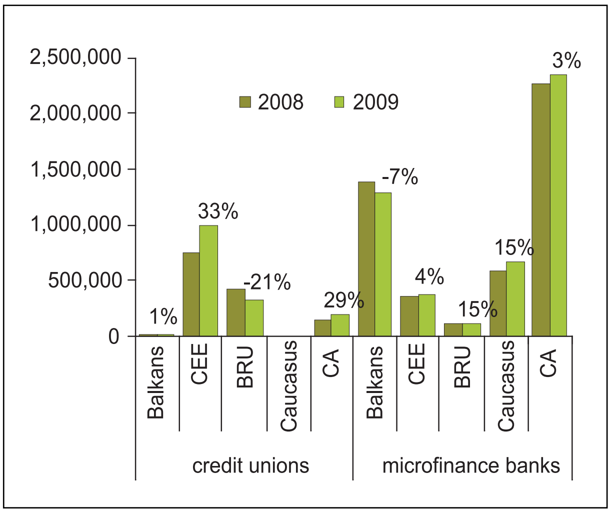


Figure 4.7. Changes in the number of savers of microfinance banks by sub-region



The comparison of the trends among microfinance providers and mainstream commercial banks[15] showed the same change direction – an increase in the number of depositors - although the banking sector was successful in attracting a larger number of savers. The number of bank depositors in the selected countries increased by 14% while the number of microfinance depositors grew by only 3% in the same group of countries.

Social Performance

Depth of Credit Outreach

The depth of outreach was measured as an average loan size to country's per capita GNI[16] weighted by the number of borrowers in each sub-region.

Credit unions had the deepest outreach, although this was mainly in Central and Eastern Europe. In other sub-regions they usually provided loans of a similar size or larger than NGOs/NBFIs. Downscaling commercial banks traditionally served the higher-end market.

During the year the total depth of outreach remained at 70%, but there were some movements in the target clientele of different types of institutions. NGOs/NBFIs and microfinance banks decreased the average loan size relative to a country's GNI per capita while credit unions and downscaling commercial banks moved slightly up market.

However, the causes and consequences of the depth of outreach changes remain ambiguous. It was observed that among NGOs/NBFIs which decreased the loan size to GNI per capita the majority did not grow, indicating that the decrease of the size of an outstanding loan may be the result of more clients being in the last stages of loan repayment and therefore holding smaller loans. The deeper outreach of NGOs/NBFIs

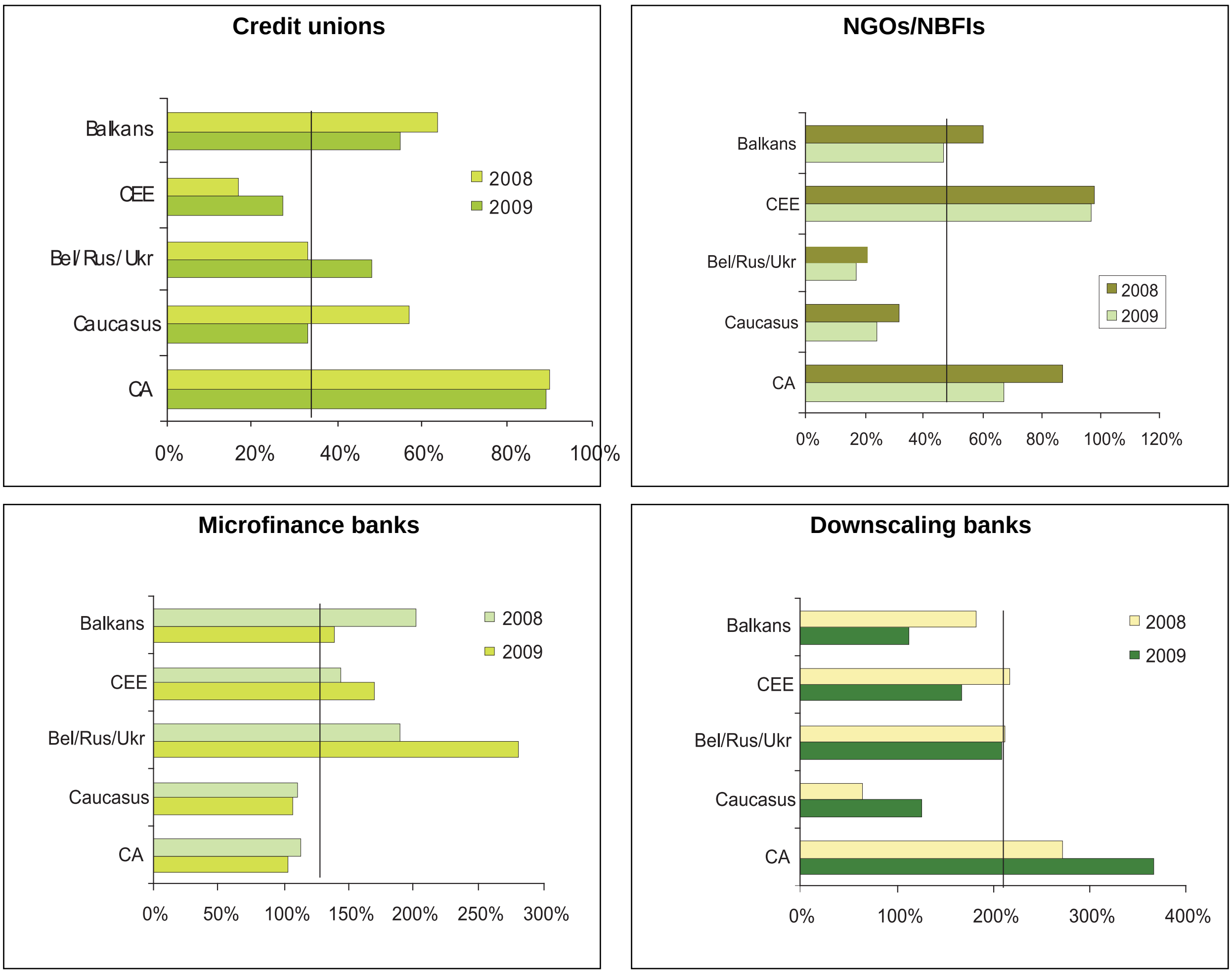
15 IMF Financial Access Statistics (FAS) and CGAP Financial Access 2010 provided information on the number of savers with commercial banks for 13 countries. Two year data was available for 11 countries from IMF FAS.
16 Source: World Development Indicators database, World Bank

and microfinance banks could, therefore, result from the change in the portfolio composition, where loans with shorter term to maturity and smaller relative balances prevailed over newly disbursed loans.

Figure 4.8. Depth of outreach (weighted by the number of borrowers) by institutional type

	Depth of outreach 2008	Depth of outreach 2009
Credit unions	25%	37%
NGOs/NBFIs	59%	49%
Microfinance banks	147%	125%
Downscaling commercial banks	188%	210%

Figure 4.9. Depth of outreach (weighted by the number of borrowers) of clients by institutional type and sub-region



Deposit Size

The average deposit size per saver reached 31% of GNI per capita. The size of deposits collected by credit unions and microfinance banks varied widely from one sub-region to another. In Central Asia credit unions collected much larger deposits than microfinance banks, in fact the largest among credit unions in all sub-regions. In the Balkans and Caucasus the opposite was seen – credit unions collected much smaller deposits than microfinance banks.

In 2009 deposit size decreased from 36% to 31%, but mainly among microfinance banks.

Figure 4.10. Average deposit size weighted by depositors

	Credit unions		Microfinance banks	
	2008	2009	2008	2009
Balkans	21%	9%	68%	41%
CEE	41%	39%	33%	31%
BRU	43%	44%	52%	44%
Caucasus	22%	12%	19%	21%
CA	61%	65%	16%	19%
ECA total	**43%**	**43%**	**34%**	**26%**

Female Clients of NGOs/NBFIs

Outreach to women did not seem to be affected by the financial crisis as women continued to constitute over half (54%) of the clientele of NGOs/NBFIs, although regional differences were seen. The smallest number of women borrowers was in the Caucasus and Central and Eastern Europe.

Women were predominantly served by institutions which provided smaller loans (deeper outreach) but changes in the depth of outreach did not lead to any significant changes in the number of women served. Women were more often among microcredit clients in countries with a higher development of the banking sector which was a result of the fact that microfinance in these countries had deeper outreach.

Figure 4.11. Distribution of borrowers of NGOs/NBFIs by gender and sub-region

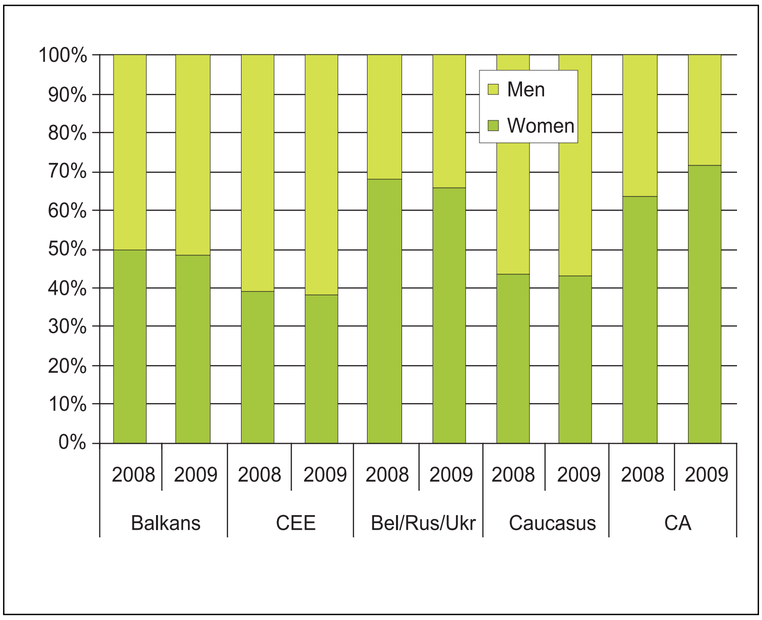
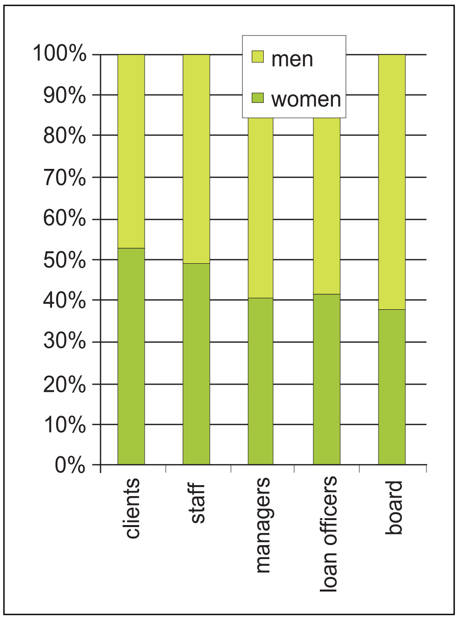
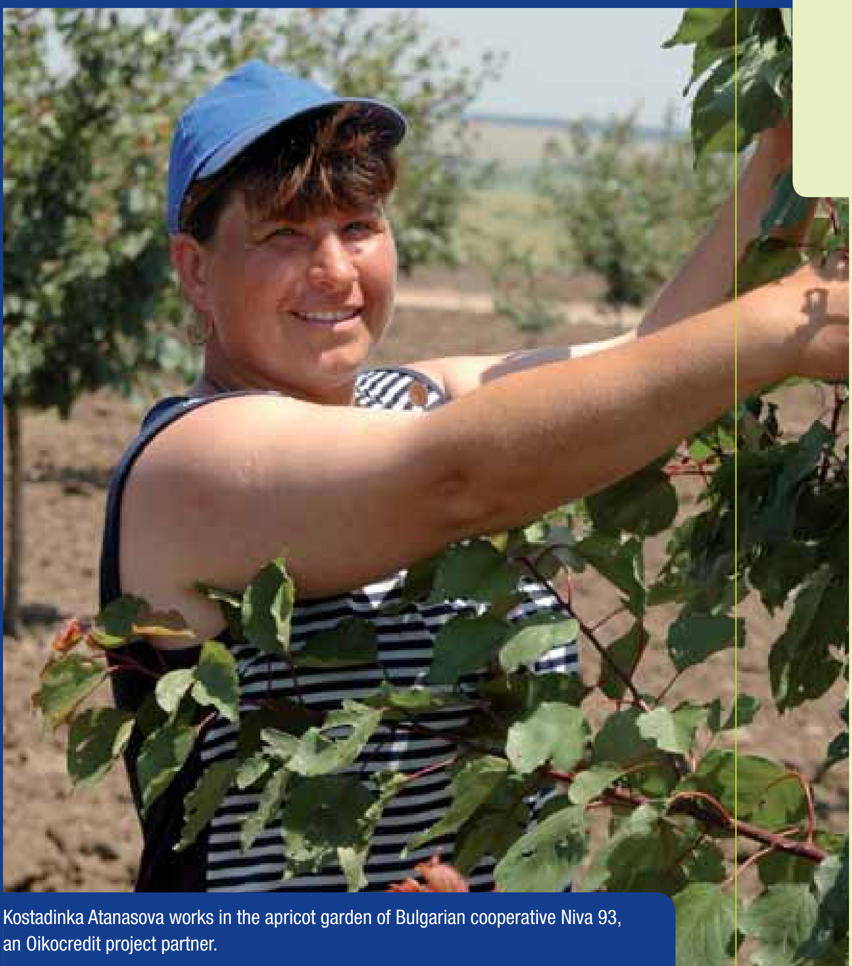


Figure 4.12. Distribution of borrowers and staff of NGOs/NBFIs by gender



Gender balance was seen not only among borrowers but also at a staff level. Almost half of the employees of NGOs/NBFIs were women, although they accounted for only 40% of managerial and loan officer positions. The share of female board members was even lower at 38%.

Providing access to financial services



Kostadinka Atanasova works in the apricot garden of Bulgarian cooperative Niva 93, an Oikocredit project partner.

Oikocredit provides credit and equity investments to 863 microfinance institutions (MFIs), cooperatives, fair trade organizations and small-to-medium enterprises in over 70 countries. At the end of 2010, 17.5% our portfolio was in the Eastern Europe and Central Asia region.

We finance about 600 MFIs with an average loan size of € 460,000 and half of those partners operate in rural areas.

Oikocredit strives to support and challenge partners to improve social performance to ensure end-clients can access fair, transparent financial services.

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Over-indebtedness

As part of the MCI survey[17] MFIs were asked about the level of indebtedness of their clients. Almost two-thirds of the respondents stated that indebtedness deepened in 2009. Almost 40% of MFIs believed that over a quarter of their clients were overindebted. In particular, MFIs from the European part of the region had greater over-indebtedness amongst clients.

MFIs observed a deterioration in clients' financial situation, caused by lower incomes. Almost all MFIs noted a decrease in revenues generated by enterprises of their clients. In countries with large remittances inflows, MFIs saw a drop in the value of transfers received by microfinance clients. The value of remittances received in ECA countries decreased by almost 10% during 2009 with the most severe drop observed in Central Asia[18].

The reactions of clients to deepening problems were mixed, starting from trying to ease their debt burden by changing the repayment schedule, through borrowing from other sources (formal and informal) to seeking additional employment or selling assets. As observed by the MFIs, leaving outstanding debts to be repaid by guarantors was the rarest way of dealing with the inability to repay debt.

Figure 4.13. Impact of the financial crisis on client livelihood

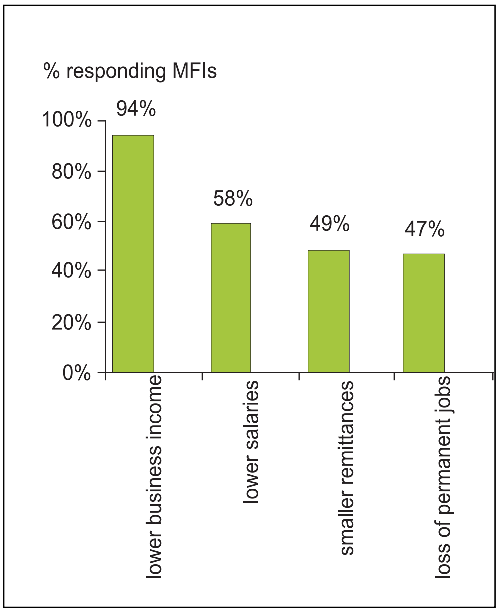
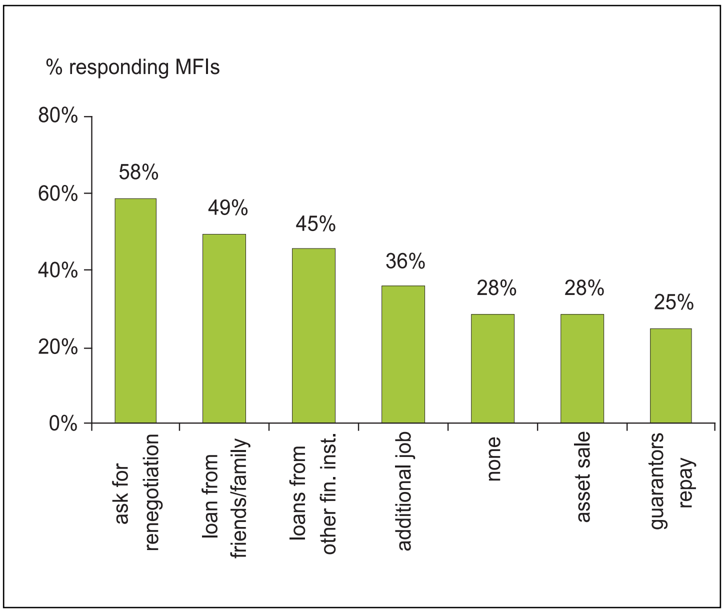


Figure 4.14. Mechanisms for coping with repayment problems by microfinance clients



Loan Pricing

A survey conducted by the MFC during the 13th Annual Conference of MFIs in May 2010[19] showed that the issue of microfinance interest rates was of concern among conference participants.

17 Please see Chapter 2 for more details about the survey
18 Please see Chapter 1 for more information about remittances flows
19 See Box 4.1. for more findings from the survey

More than half of the respondents, mainly donors, regulators, bankers, but also representatives of MFIs thought that interest rates charged to microcredit clients were too high.

However, the analysis of the yields on loan portfolio of NGOs/NBFIs in the context of their operations (country-specific conditions, target market and efficiency) show that while microfinance interest rates are indeed higher than in the mainstream banking sector they are not driven by the profit-maximizing policies of the institutions.

The average micro borrower paid 34% of interest and fees on loans[20] taken from NGOs/NBFIs. The highest price was paid in the BRU sub-region where the cost of a loan was almost half of the principal amount. Microfinance banks' interest rates were much lower (20%) with the highest interest rate being in the Caucasus.

Figure 4.15. Average interest and fee per borrower of NGOs/NBFIs and microfinance banks

	NGOs/NBFIs	Microfinance banks
Balkans	23%	16%
CEE	21%	17%
BRU	49%	20%
Caucasus	38%	26%
Central Asia	42%	20%
ECA total	**34%**	**20%**

In order to identify factors influencing microfinance interest rates a regression model[21] was constructed.

Two factors were found to be significant in explaining the differences in microfinance interest rates – the prime lending rate[22] in a given country and the depth of outreach of a MFI.
Profit, which is considered a driver of high interest rate, was not found to be significantly affecting portfolio yields. Also, the scale and outreach of microfinance operations did not significantly influence the yield. Although economies of scale are often seen in large MFIs which manage to operate more efficiently the effect was shadowed by the fact that large MFIs in the ECA region operate in economies with a deep banking sector and relatively low interest rates.

Figure 4.16. Regression model – coefficients for the predictors of portfolio yields of microfinance banks and NGOs/NBFIs

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	0.137	0.040		3.425	0.001
Prime lending rate	0.949	0.213	0.376	4.458	0.000
Depth of outreach	-0.047	0.021	0.202	2.199	0.030
ROA	0.165	0.136	0.102	1.212	0.228

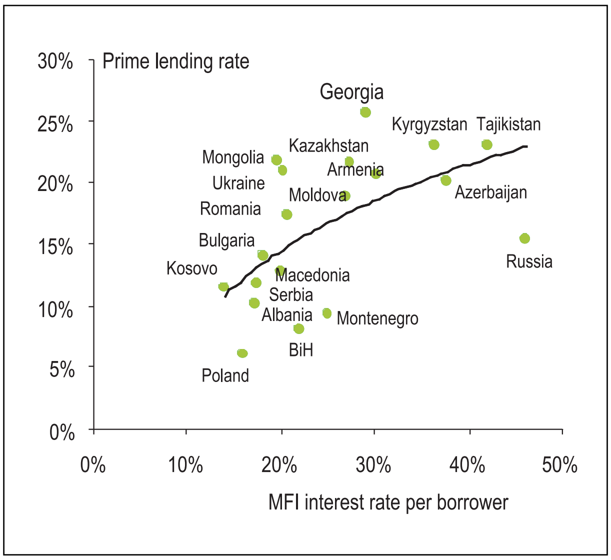
20 The interest and fee expense per borrower was calculated from the portfolio yields of MFIs
21 Linear regression (OLS) analysis was conducted where nominal portfolio yield was used as a dependent variable. Data of 195 NGOs/NBFIs and microfinance banks were included in the analysis. The R square coefficient was 0.405.
22 Prime lending rate: annualized interest rates commercial banks charge on new loans, denominated in the national currency, to their most credit-worthy customers. Source: World Development Indicators database, World Bank

Microfinance interest rates were positively correlated with bank lending rates. This shows that MFIs were influenced by similar factors affecting their interest rate policies as were mainstream commercial banks.

The prime lending rate tends to be higher in countries with more shallow financial markets, where the volume of loans to GDP per capita is lower. In Georgia where the volume of commercial bank lending constitutes only 30% of GDP the prime lending rate was 26%, while in Bulgaria with loans to GDP of 80% the prime rate was as low as 11%.

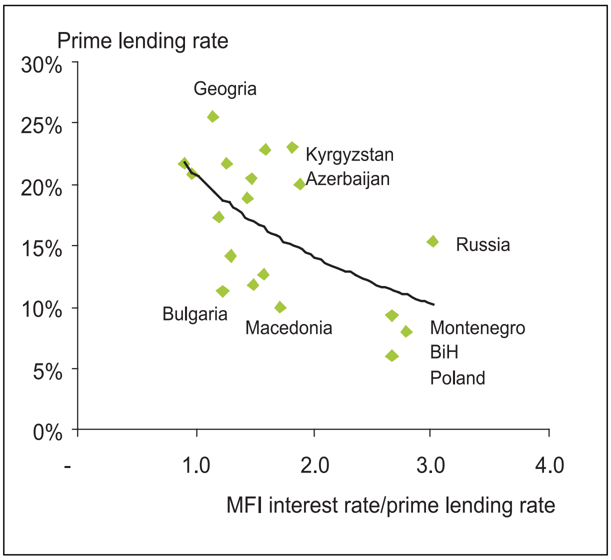
Additionally, the gap between the MFI interest rate and the prime lending rate was higher in countries with low prime rates. In countries such as Poland, Montenegro or Bosnia and Herzegovina the MFI interest rate more than double the prime lending rate. This finding supports the thesis that relatively high interest rates (compared to those of banks') of MFIs are seen in the countries where bank credit is more available and less expensive. MFIs in such countries serve specific groups of clients who are excluded from the main-stream banking sector for reasons other than the limited credit supply.

Figure 4.17. Correlation between primary interest rate in the country and nominal portfolio yield of microfinance banks and NGOs/NBFIs



R^2 = 0.3474

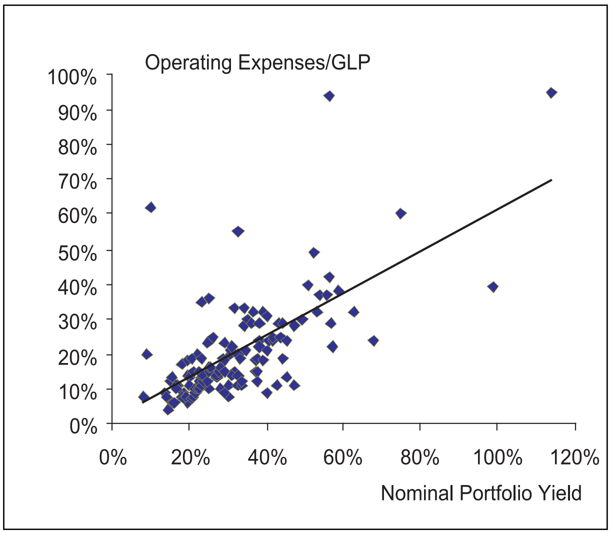
Figure 4.18. Correlation between country's prime lending rate and interest rates of microfinance banks and NGOs/NBFIs



R^2 = 0.3334

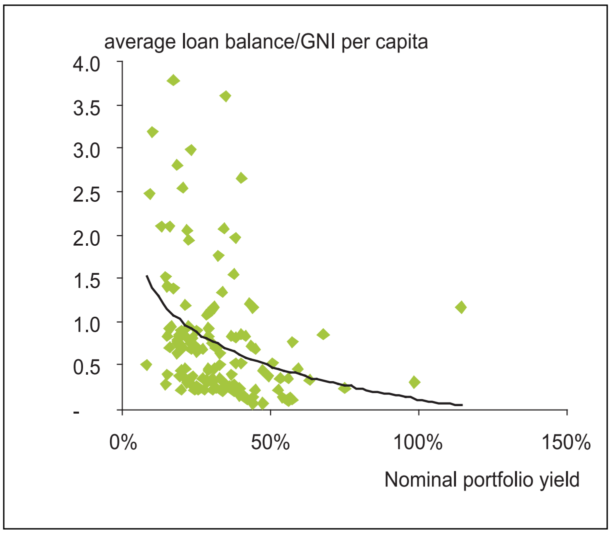
Furthermore, the decomposition of the MFI cost structure shows that an average NGO/NBFI in the ECA region spent 66% and a microfinance bank 52% of the total expenses on operational costs (administration and personnel). High operating costs were driven in a large part by the loan size, as small loans were more costly to deliver.

Figure 4.19. Correlation between nominal portfolio yield and operating efficiency of microfinance banks and NGOs/NBFIs



$R^2 = 0.4462$

Figure 4.20. Correlation between depth of outreach and nominal portfolio yield of microfinance banks and NGOs/NBFIs



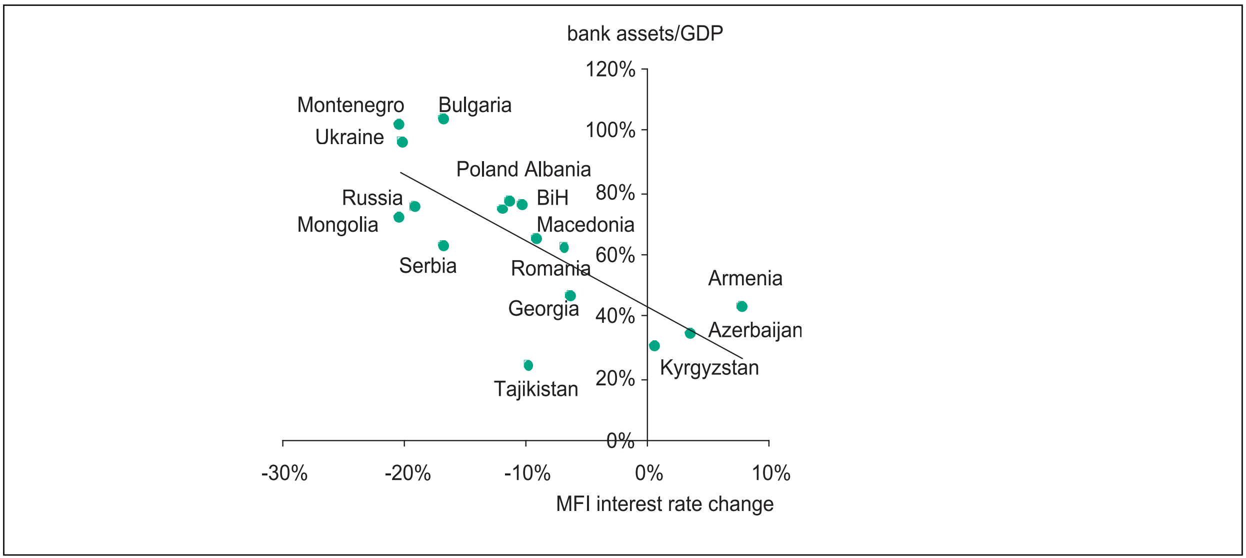
$R^2 = 0.1147$

From this perspective MFI's interest rates are the function of the cost of bringing financial services to clients in specific country setting.

During 2009 interest rates in the banking sector increased in most ECA countries while the microfinance interest rates went down. The nominal interest rate decreased in 84% of microfinance banks and 70% of NGOs/NBFIs and also the margin between the commercial banking and microfinance interest rates fell in 79% of MFIs.

Lowering of the MFI interest rates was seen in the countries with a more developed banking sector. In countries such as Ukraine or Montenegro the MFI interest rates went down by as much as 20% while in Armenia or Azerbaijan with smaller volume of bank assets to GDP the MFI rates increased by 5-10%.

Figure 4.21. Correlation between changes in MFI interest rates and bank sector development



$R^2 = 0.5744$

At the same time institutions which deepened their outreach increased their interest rates. This was coupled with an increase in operating costs.

No correlation between the change in interest rates and ROA was seen. Also, growth in the scale of operations (portfolio and borrowers growth) did not affect interest rates.

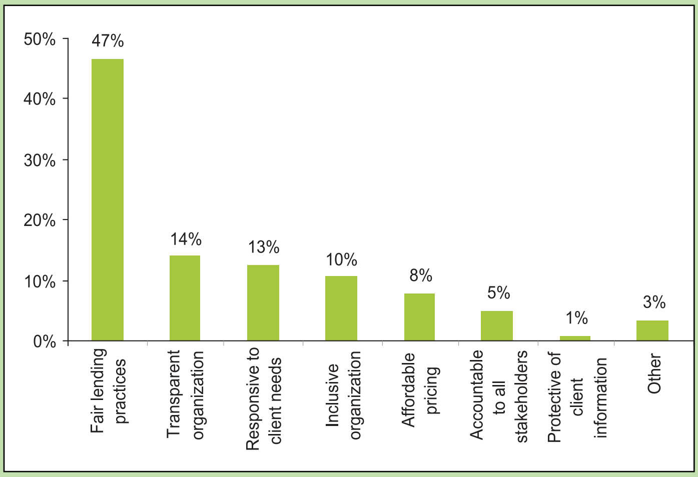
Box 4.1. Responsible Microfinance Survey

The recent financial crisis focused attention on the behavior of financial institutions and clients whose interests often diverge and lead to an unsustainable demand for credit. Once considered a socially conscious enterprise, microfinance has become a highly diversified business which now shows a broad variety of interests and approaches to microlending, which raises the question of how responsible and responsive microfinance really is.

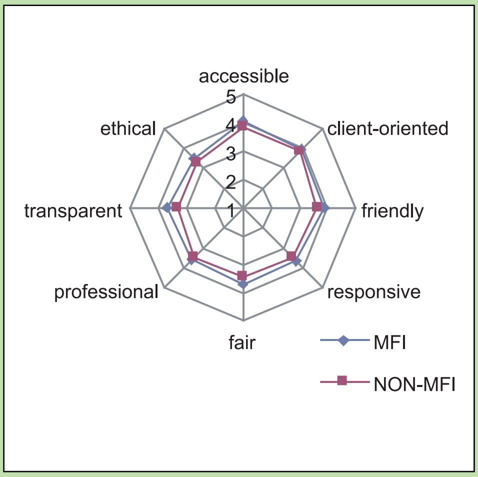
During the MFC Conference in Kazakhstan in May 2010 MFC conducted a survey among conference participants (148 respondents). Almost half of the respondents were staff of MFIs; other respondents included bankers, investors, development specialists, regulators, donors and business representatives.

The term 'responsible microfinance' was most often associated by the respondents with fair lending practices. The other definitions such as 'transparent organization', 'responsiveness to client needs' or 'inclusive organization' are quoted far less by respondents when describing responsible microfinance.

What does responsible microfinance mean for you? (% respondents)



Rating of MFI values by MFIs and non-MFIs



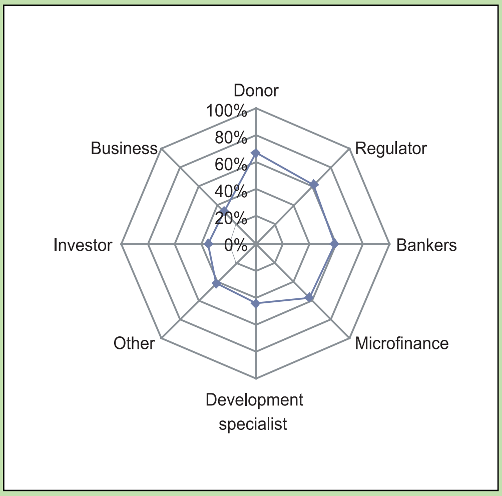
The positive opinion about responsible conduct was associated with fairness, ethical operations and transparency but in the overall assessment of MFI conduct these values were rated lower than such traits as accessibility, client-orientation, friendliness which were found to be the main characteristics of MFIs. Clearly MFIs scored the highest appreciation for providing access to finance but not necessarily in a client-responsible way.

Microfinance Interest Rates

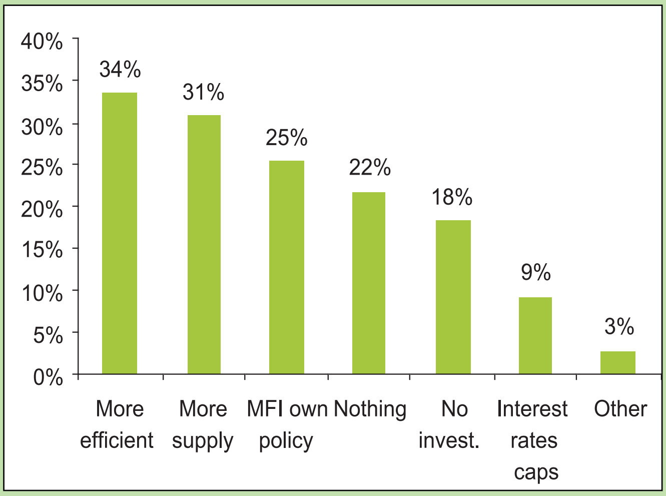
Over half of respondents (53%) thought that interest rates were excessive; most of these respondents were donors and regulators.

These respondents rated MFIs lower in most of the areas such as ethical conduct, fairness, client orientation, responsiveness, friendliness but also accessibility.

Excessive interest rates in the eyes of different stakeholders (% respondents)



Solutions to excessive interest r ate problem (% respondents)



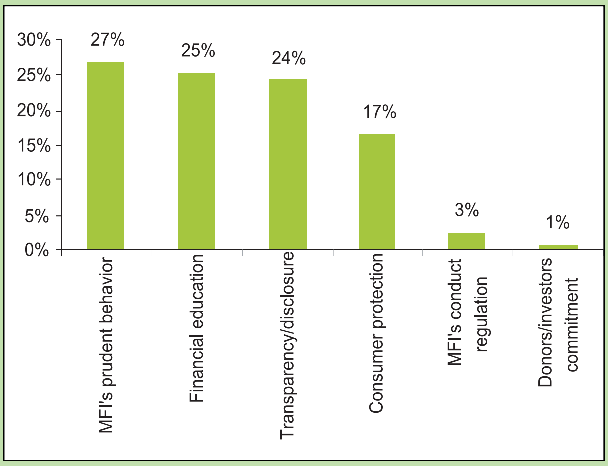
The most frequently proposed solutions for tackling high interest rates were improvements in MFI efficiency, an increase in credit supply to drive prices down through competition and self-regulation of MFIs. Only 9.1% of respondents would consider outright interest controls.

Client Protection

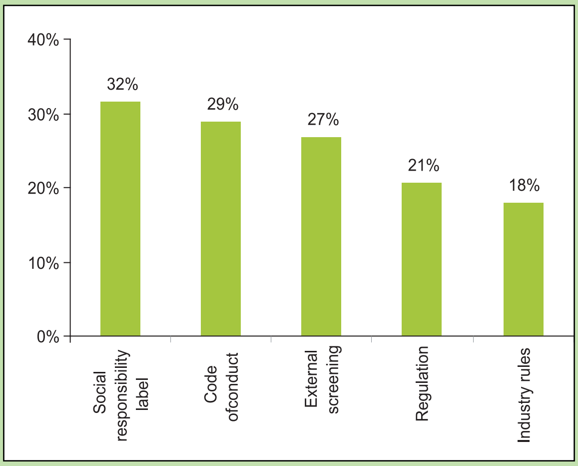
Almost all respondents (90%) thought that clients should be protected from potential abuses through MFI self-imposed prudent behavior, financial education and MFI transparency. The respondents were equally unanimous in their answers about clients' own responsibility to protect themselves (86% of respondents think that clients should take responsibility for the products and services that they buy). Borrowers were expected to put in more effort when choosing products and educate themselves in financial matters.

A smaller group of respondents (11%) who thought that clients should not be expected to protect themselves more often opted for solutions such as greater MFI transparency and the introduction of regulations for client protection.

Most effective ways of client protection (% respondents)



How to make microfinance more responsible? (% respondents)



Customer Protection initiatives

The results of the MFC survey at the Annual Conference in Kazakhstan highlighted the need for client protection against abuses from financial institutions. Several initiatives make an attempt at bringing a more customer-focused approach to the operations of microfinance providers.
Starting with the declaration of the willingness to adhere to the code of good practices MFIs can then run self-assessment tests to have a better understanding of the organization's client protection strengths and the areas which can be improved.

The SMART Campaign

Joining the SMART Campaign signifies the commitment to the Client Protection Principles and signals the readiness to take the next steps towards implementing the principles within MFI daily operations. The Client Protection Principles are the minimum standards that clients should expect to receive when doing business with an MFI, including the avoidance of over-indebtedness, transparent and responsible pricing, appropriate collection practices, ethical staff behavior, mechanisms for redress of grievances and the privacy of client data.

Already 58 microfinance providers and 4 local associations from the ECA region have endorsed the 6 Principles of Customer Protection.

The vast majority (83%) of them are NGOs/NBFIs, among them, larger institutions with a higher value of loan portfolio and reaching out to a larger number of borrowers. The institutions which endorsed the principles serve the lower end market – the average loan balance to GNI per capita for an NGO/NBFI which signed the Customer Protection Principles is 52% compared to 114% for those which did not sign.

A quarter of the endorsing institutions are located in Azerbaijan, 12% in Bosnia and Herzegovina and another 12% in Tajikistan. Overrepresentation of a few countries points out not only to the geographic concentration of socially-oriented institutions but also to the efficiency of the local networks in engaging their members.

Screening

The SMART Campaign also supports institutions with tools to assess the degree to which they fulfill the Customer Protection Principles. The questionnaire-based assessment provides a framework for evaluating an MFI's practices principle by principle.

The fulfillment of the Customer Protection Principles can be verified not only through the self-assessment, but also during social ratings or QAT assessments of Social Performance Management.

Social ratings are conducted by specialized rating agencies which assess both social risk (the risk of not achieving a given social purpose) and social performance whose ultimate goal is social impact.

QAT assessments measure the status and effectiveness of an institution's Social Performance Management systems and identify necessary action to improve performance.

Summary

The outreach of microcredit providers followed the trend of the banking industry in ECA countries – the breadth of credit outreach decreased during the year while the outreach to depositors widened. At the end of 2009 microcredit providers served 9% fewer borrowers and 2% more depositors compared to 2008. Credit unions managed to increase their depositors base more dynamically than microfinance banks, as after one year of a slow-down they returned to a double-digit growth rate. The highest increases in depositor numbers were seen in the CEE (Poland, Czech Republic) and Central Asia (Uzbekistan).

Microfinance banks, on the other hand, continued the slowing down trend. Growth was driven mainly by Access Bank in Azerbaijan and Khan Bank in Mongolia which contributed 18% to the total growth. In the sub-regions, Caucasus and BRU showed the highest growth in 2008.

The quality of outreach also changed – although the overall depth of outreach did not change, NGOs/NBFIs and microfinance banks decreased the loan size. However, the nature of this change remains unknown.

During the financial crisis and the visible worsening of the repayment performance microfinance industry players voice a concern about unfair lending practices and excessive interest rates. However, evidence was found that the microfinance interest rates mirror the lending rates of mainstream banks in their countries.

Chapter 5

Funding Structure

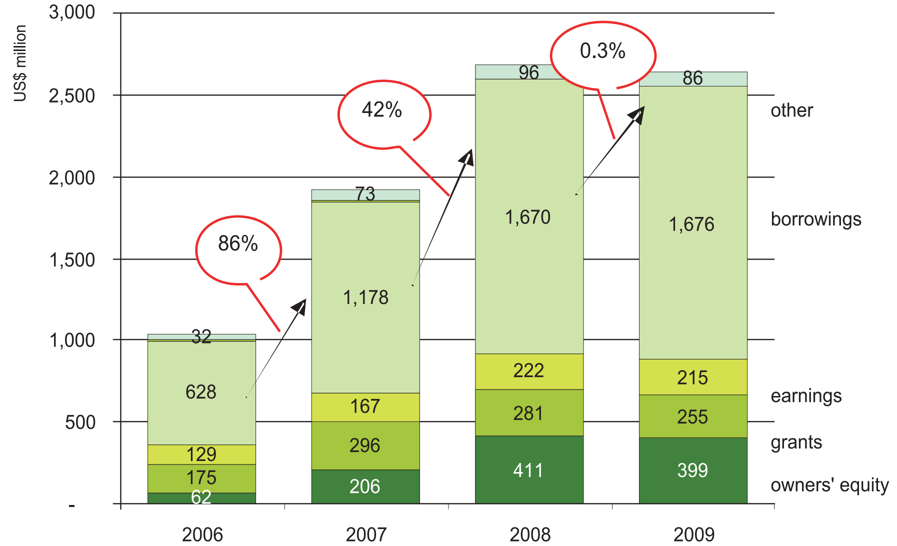
After several years of impressive growth the flow of funds into the ECA region came to a halt. The lack of growth opportunities for MFIs, problems with portfolio quality and the uncertainty among international investors about the resilience of the microfinance sector to the financial crisis led to very little growth in external funds among NGOs/NBFIs. Microfinance banks even lowered the amount of borrowings in their funding structure but compensated this by higher deposit inflows.

NGOs/NBFIs

The funding structure[23] of NGOs/NBFIs changed little as compared to the previous year. At the end of 2009 63% of the assets of NGOs/NBFIs (compared to 64% in 2008) were financed with borrowed funds, mainly from international microfinance investors but also from local commercial banks and private individuals.

The total volume of borrowings remained above USD 1.6 billion but just over half of the institutions (52%) decreased the amount of credit in use. The largest reduction in the amount of liabilities to investors was observed in the BRU sub-region.

Figure 5.1. Funding structure of NGOs/NBFIs 2006 - 2009



The smallest institutions were affected more often by the decrease in the volume of borrowings used. These reductions were coupled with the decrease of lending operations shown in the drop of the value of the loan portfolio, assets and also the number of employees.

23 The funding structure analysis covers 190 NGOs/NBFIs. The analysis of credit conditions is based on the details of 790 credit contracts the total value of which constitutes 89% of the value of borrowed funds of ECA NGOs/NBFIs.

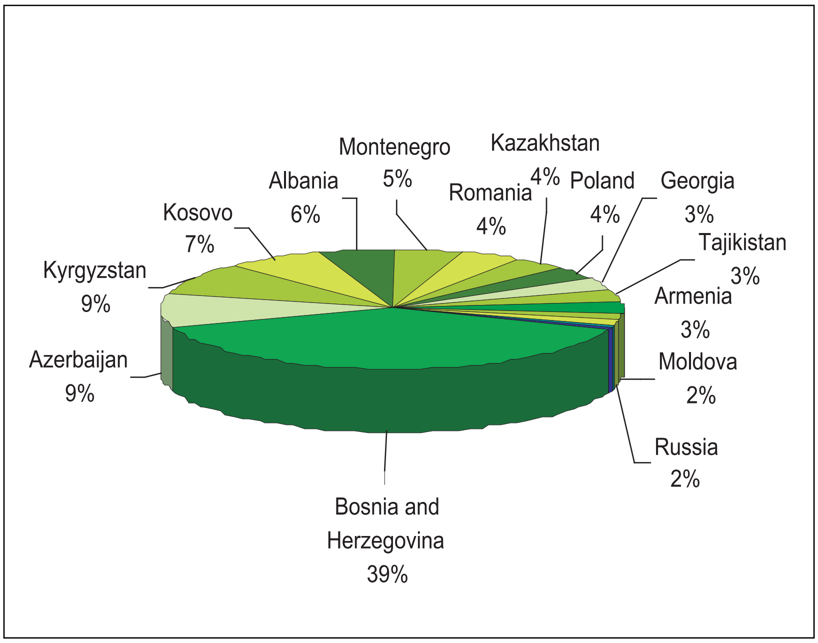
The leverage of NGOs/NBFIs increased to 2.9, indicating that the value of liabilities of an average institution exceeded by almost 3 times the value of equity. The largest institutions had the highest leverage and increased it to a larger extent during the year. However, the higher leverage is observed mostly in larger institutions with gross loan portfolios in excess of USD 15 million; smaller institutions either maintained the same debt to equity ratio or even decreased it as is the case for MFIs in the 1-5 million bracket (see Fig. 5.1.).

Figure 5.2. Average debt to equity ratio

Gross loan portfolio	2007	2008	2009
>USD 50M	5.1	4.4	5.8
USD 15-50M	3.5	4.1	5.3
USD 5-15M	3.2	2.7	3.1
USD 1-5M	2.4	2.0	1.7
<USD 1M	1.5	1.5	1.6
Total	**2.5**	**2.4**	**2.9**

Only small changes were seen in the geographic distribution of borrowings. Bosnia and Herzegovina remains the largest recipient of borrowings, having received 39% of the total value of funds borrowed by ECA NGOs/NBFIs. Other countries account on average for about 5% of the external funds allocated to the region, with Kyrgyzstan and Azerbaijan accounting for 9%, Kosovo 7% and Albania 6%.

Figure 5.3. Distribution of borrowed funds by country



Bosnia and Herzegovina remains the 'white elephant' of microfinance the ECA region

Funding Sources

Almost 90% of external borrowings came from international investors while local commercial bank borrowings made up less than 10%. The use of local bank funding fell during the year and the share of international borrowings in the funding structure increased.

Figure 5.4. Distribution of NGOs/NBFIs' borrowed funds by type of provider and sub-region

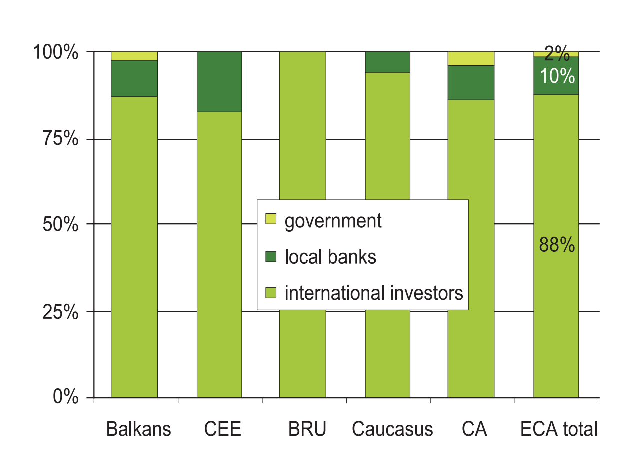
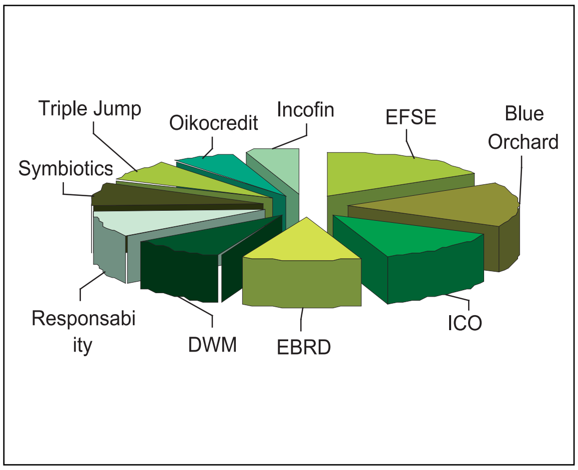


Figure 5.5. Distribution of 50% of NGOs/NBFIs' debt by lending institution



Four microfinance investors: EFSE, BlueOrchard, ICO and EBRD remained the main providers of credit supplying over a quarter (28%) of all funds to MFIs in the region. There was no change in the concentration of providers compared to 2008 – half of the volume of funds was sourced from 10 investors.

The major change was seen in the increase of the role of ICO Spain which became the fourth largest investor (see Box 5.1.), and the withdrawal of Oikocredit which decreased the value of its investment in NGOs/NBFIs almost by a half from USD 70 million to USD 40 million, reducing its engagement mainly in the Balkans.

Box 5.1. Instituto de Credito Official (ICO), Spain

Instituto de Crédito Oficial (ICO) is a state-owned corporate entity attached to the Ministry of Economy and Finance and has the status of the State's Financial Agency of Spain. Its aim is to enhance economic growth while achieving greater social and territorial cohesion.

The Microcredit Fund (FCM) was set up in 1998 as a form of bilateral cooperation for development. Its purpose is to improve the standard of living of vulnerable groups and foster the execution of basic social development projects. The fund is implemented through loans granted to foreign on-lending institutions which, in turn, make the resources available to the end-beneficiaries (micro-entrepreneurs) either directly or through local financial institutions.

By the end of 2009, the aggregate amount of approved loans to institutions operating in ECA countries (Albania, Bosnia and Herzegovina, Montenegro, Serbia) reached EUR 107 million and made up 15% of the total balance disbursed worldwide.

Source: www.ico.es

Figure 5.6. Largest investors by the sub-regions

Balkans	CEE	BRU	Caucasus	Central Asia
EFSE	FM Holding	ResponsAbility	Symbiotics	BlueOrchard
ICO	EBRD	Deutsche Bank Ltd. (Moscow)	ResponsAbility	Symbiotics
BlueOrchard	Bank Zachodni WBK	Minlam	Triple Jump	ResponsAbility
EBRD	EFSE	OXFAM/NOVIB	DWM	DWM
DWM	Oikocredit	Oikocredit	Incofin	Oikocredit

Currency

Foreign currencies continued to dominate borrowings as only 21% of the total volume of credit was denominated in local currencies, with a third of it in currencies pegged to EUR (BAM and BGN).

Local currencies were most often seen in contracts with local banks and sometimes with the government. In the sub-regions, local currency loans prevailed only in Russia. Almost half of the total value of borrowed funds of NGOs/NBFIs was denominated in EUR and a further 29% in USD. Albanian Lek was the third most used currency.

Figure 5.7. Distribution of funds borrowed of NGOs/ NBFIs by source and currency type

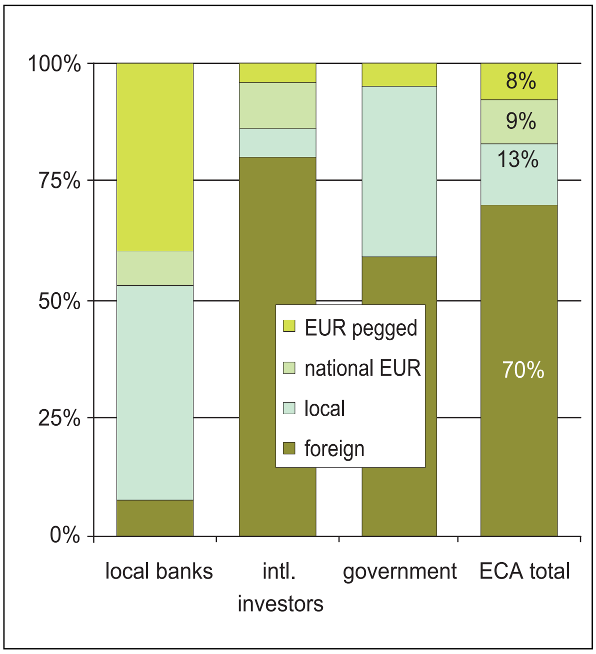


Figure 5.8. Distribution of funds borrowed of NGOs/ NBFIs by sub-region and currency type

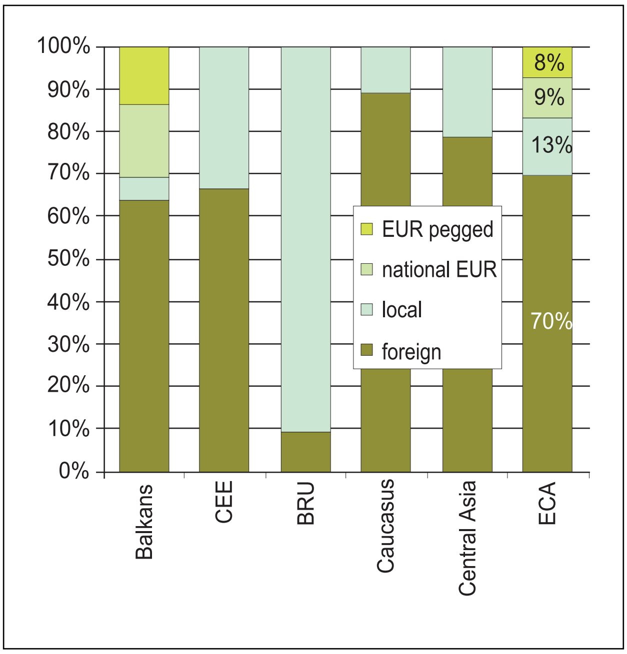


Figure 5.9. Distribution of funds borrowed of NGOs/NBFIs by currency

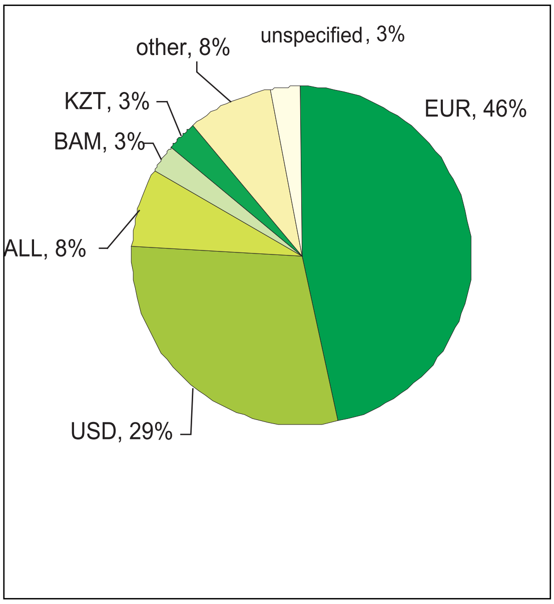
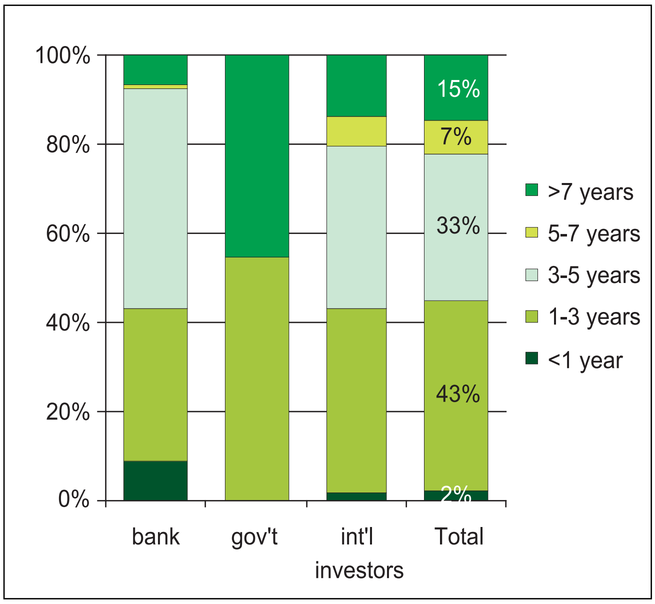


Figure 5.10. Distribution of funds borrowed of NGOs/NBFIs by source and maturity



Term

Over 40% of the funds borrowed by NGOs/NBFIs had a maturity of 1-3 years, and a third was contracted for 3-5 years. Long-term funds continue to be sourced mainly from governments and they are the rarely offered by the local banks.

Box 5.2. ProCredit Bank Armenia

In February 2008 ProCredit Bank Armenia launched its operations and opened its first branch in the city centre of Yerevan. The institution aims to substantially increase access to credit for small businesses and to provide straightforward, transparent banking services for the local population. By entering the Armenian retail banking market and mobilizing a large share of deposits and remittances, the bank is able to channel these funds to small and medium-sized enterprises and thus contribute measurably to the country's development. ProCredit Bank Armenia is being supported by the EBRD (in part using funds provided by the Canadian government), FMO and KfW.

ProCredit Bank strives to be a true "house bank" for very small and small businesses. In the meantime, it has established itself as a "neighbourhood bank" for people living and working in the vicinity of its branches, with excellent customer service provided by friendly, professional and efficient staff. ProCredit Bank also aims to foster a savings culture among ordinary people by not setting a minimum amount for deposits and by investing in financial education activities for its customers which highlight the benefits of regular saving.

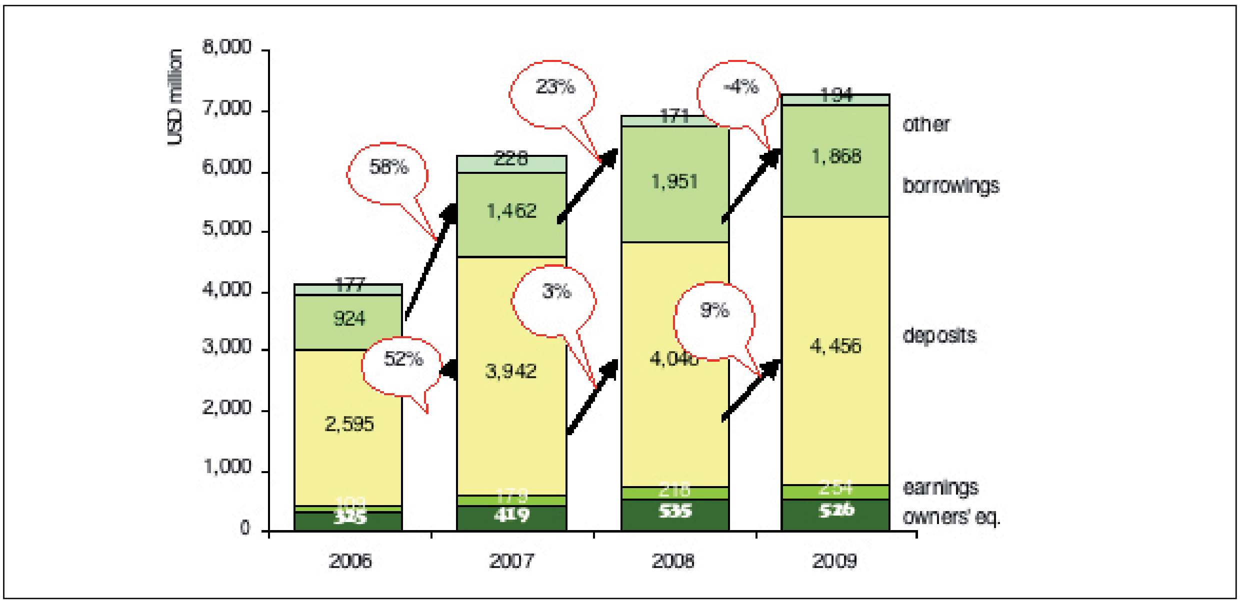
In the autumn of 2009 ProCredit Bank Armenia started offering financial services to agricultural businesses and planned to expand this service to all regional branches by the end of 2010. In 2011 the bank will continue to pursue its targeted approach to branch network expansion, with a focus on becoming the leading bank for small and medium-sized businesses in Armenia.

Source: www.procredit-holding.com

Microfinance Banks[24]

Unlike NGOs/NBFIs, microfinance banks managed to grow their loan portfolio slightly, if only by 1%, during the year and financed this growth more from collected deposits than borrowings. The total value of credit liabilities decreased by 4% and the value of savings grew by 9%. The largest growth was seen in Central Asia and the largest reduction in the value of borrowed funds in the Belarus/Russia/Ukraine sub-region.

Figure 5.11. Funding structure of microfinance banks in 2006 - 2009



Belarus, Russia and Ukraine was also the sub-region where the value of deposits decreased. The largest growth in deposit taking was seen in the Caucasus.

Borrowed funds were less geographically concentrated than in the case of NGOs/NBFIs. The largest amount was obtained by the banks in Serbia, followed by Azerbaijan. Armenia, with the youngest microfinance bank in the ProCredit family (see Box 5.2.), was the third largest receiving country. Deposits were concentrated in Kosovo and Mongolia.

Figure 5.12. Distribution of borrowed funds of microfinance banks by country

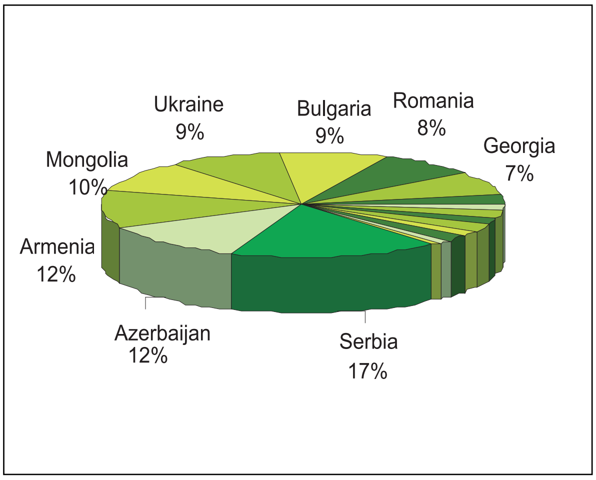
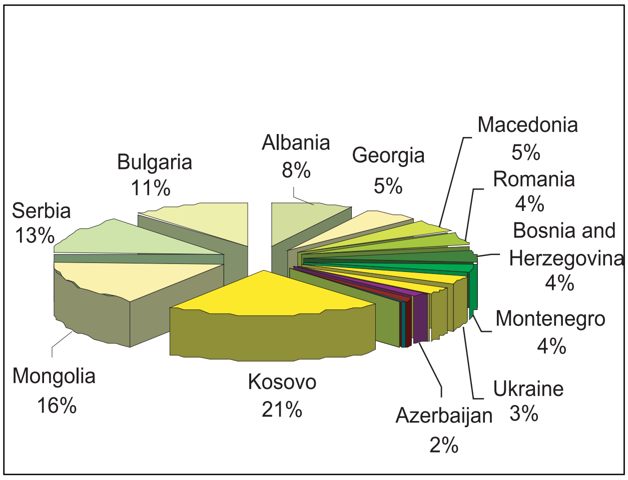


Figure 5.13. Distribution of deposits of the microfinance banks by country



24 All 20 microfinance banks were included in the analysis

The leverage of microfinance banks returned to the level previously seen in 2007 as more than half of the institutions increased the value of deposits and several institutions even doubled the amount of liabilities over equity. However, unlike NGOs/NBFIs, the largest banks decreased the ratio of debt to equity.

The most visible changes were seen in the segment of small banks where leverage increased to 7.5. The reason for such a change was the migration of one bank, previously classified as medium-sized, into the segment of small banks because of the significant decrease in operations and reduction of the loan portfolio to below USD 50 million.

Figure 5.14. Average debt to equity ratio of microfinance banks

Gross loan portfolio	2007	2008	2009
>USD 200M	10.8	8.8	8.5
USD 50-200M	7.1	7.7	7.9
<USD 50M	2.5	3.7	7.5
Total	**8.2**	**7.1**	**8.1**

Funding Sources

Microfinance banks borrowed almost exclusively from international investors. EFSE, KfW and ProCredit Holding were the three largest lenders.
Only in the CEE did funds lent by local commercial banks make up over 10% of the borrowed funds.

Figure 5.15. Distribution of microfinance banks' borrowed funds by type of provider and sub-region

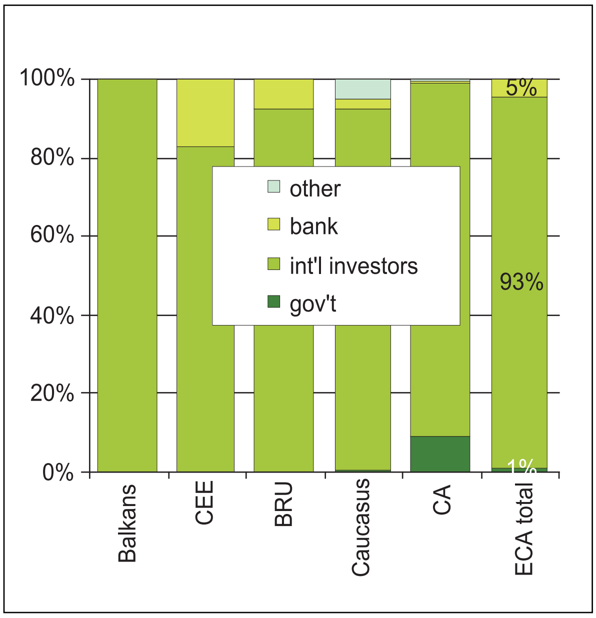


Figure 5.16. Distribution of 50% of microfinance banks' debt by lending institution

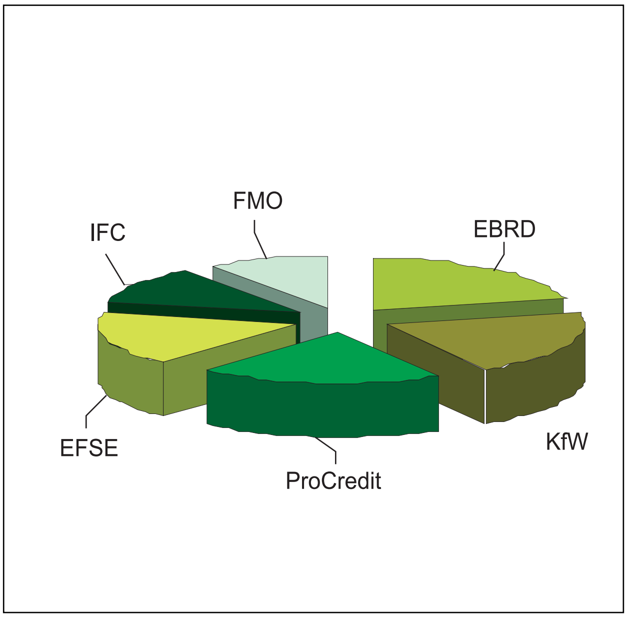
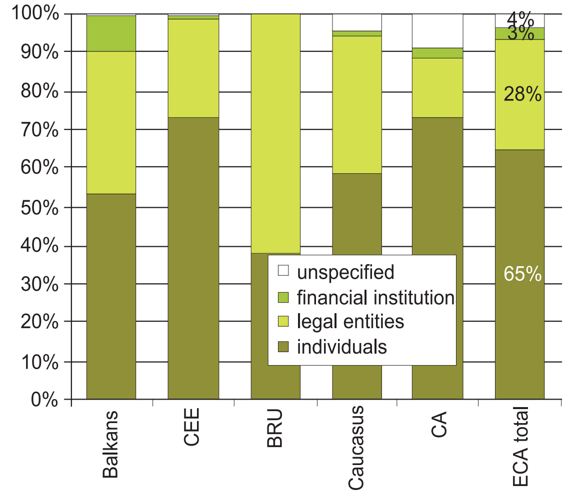


Figure 5.17. Distribution of microfinance banks' deposits by source and sub-region



The majority (65%) of deposits were collected from individuals and legal entities. Financial institutions provided less than a third of the total value of microfinance banks' deposits.

Currency

Microfinance banks continued borrowing mainly in foreign currencies, as funding in such currencies was provided by international investors. Although local commercial banks and governments predominantly lent in local currencies the use of these sources was very limited. Consequently, EUR and USD funds constituted 79% of the total volume of savings.

Figure 5.18. Distribution of funds borrowed by microfinance banks by source and currency type

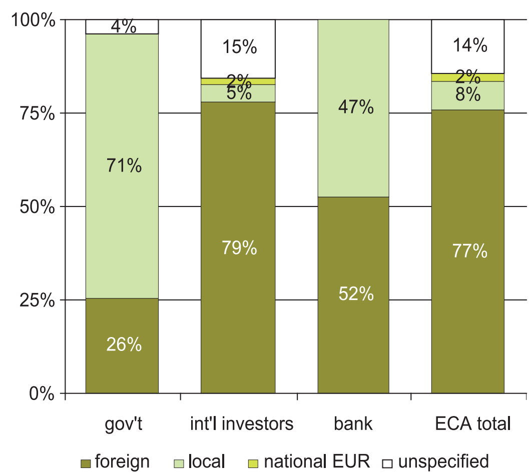


Figure 5.19. Distribution of funds borrowed by microfinance banks by currency

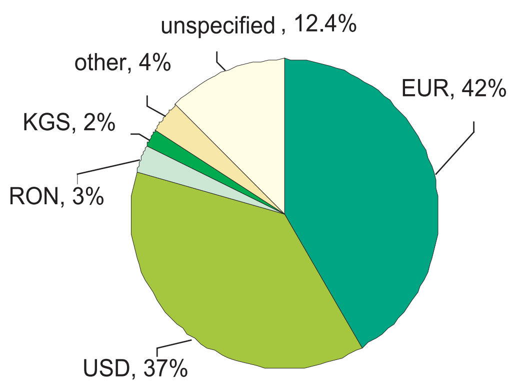


Figure 5.20. Distribution of deposits collected by microfinance banks by currency type

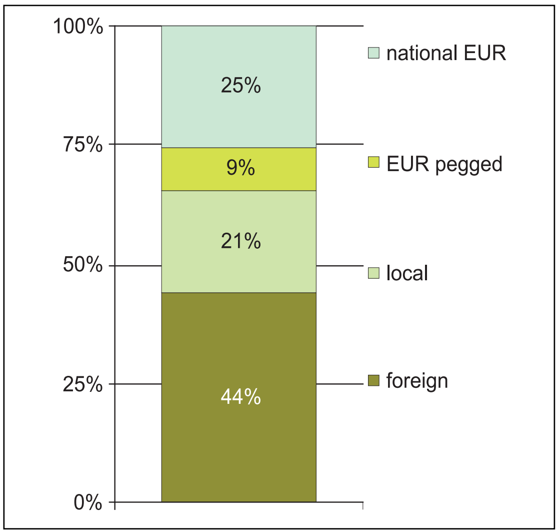
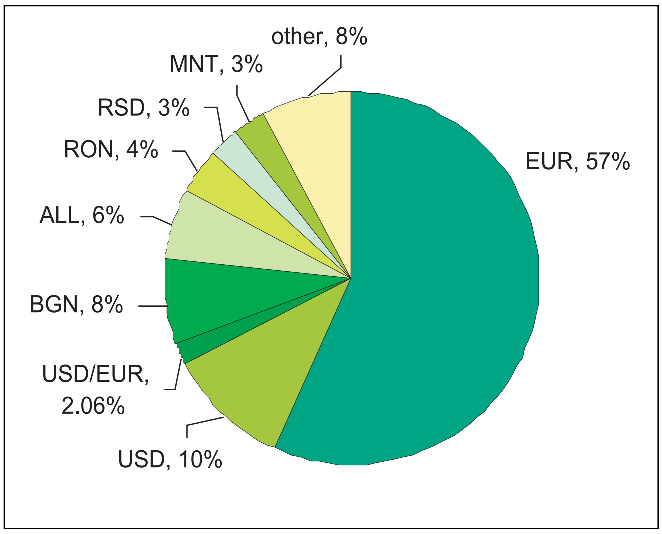


Figure 5.21. Distribution of deposits collected by microfinance banks by currency



Less than half of savings was denominated in foreign currencies but as much as 25% was in EUR in countries where it is a national currency. In total, only 30% of all deposits was kept in local currency accounts other than EUR accounts.

Term

Over a quarter of borrowings were taken for over 7 years and they came from international investors. The shortest term funds originated from governments.

Figure 5.22. Distribution of funds borrowed by microfinance banks by source and maturity

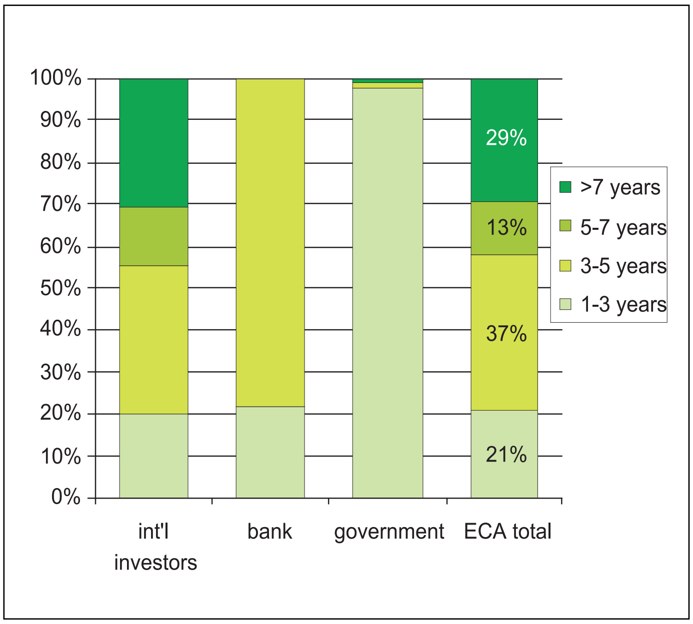
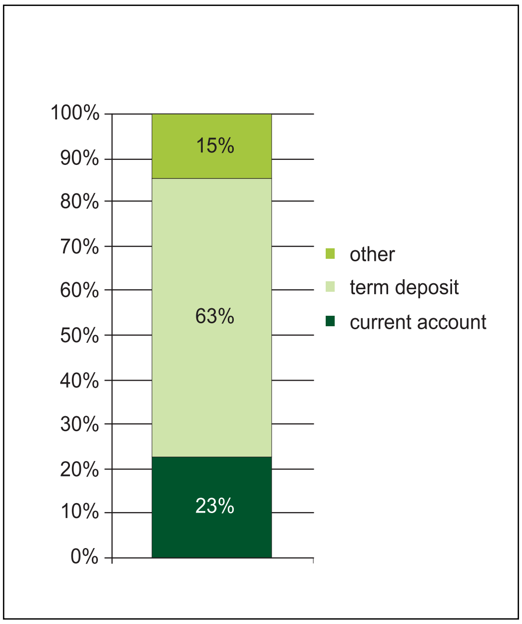


Figure 5.23. Distribution of deposits collected by microfinance banks by source and maturity

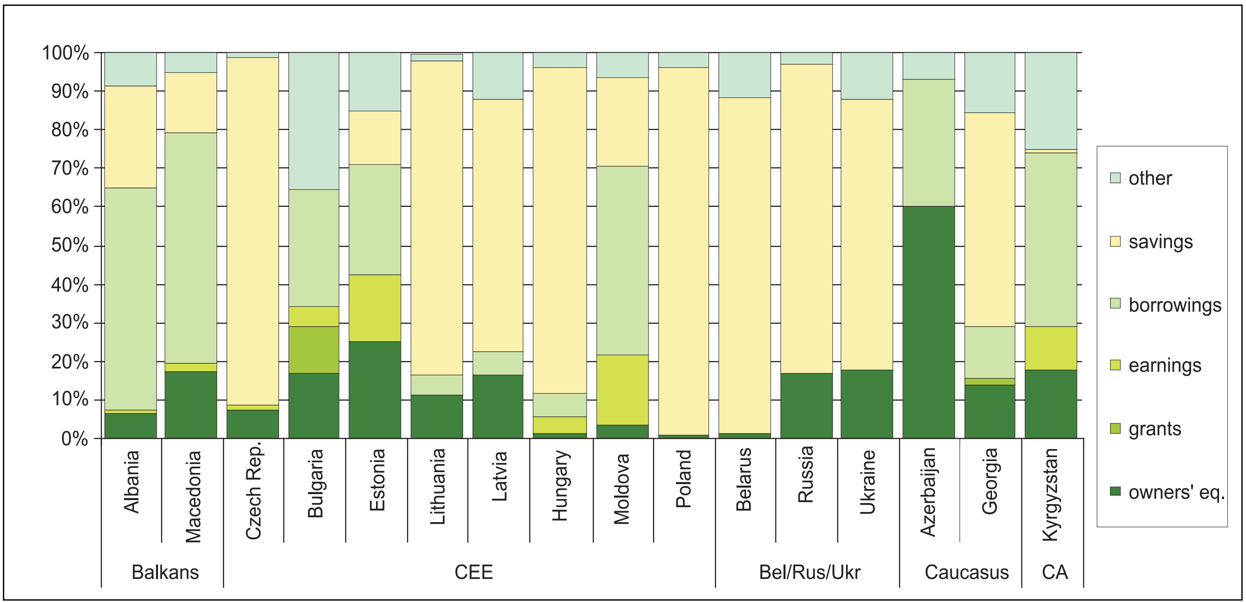


Savers kept less than a quarter of their funds in current accounts and almost two-thirds in term deposit accounts.

Credit Unions

As in the case of NGOs/NBFIs and microfinance banks 2009 brought few changes in the funding structure of credit unions. In the majority of countries the leverage of credit unions increased but this was mainly due to the decreased value of equity.

Figure 5.24. Funding structure of credit unions



Three types of credit unions continue to exist:

– non-deposit taking institutions which are legally not permitted to collect client savings (Azerbaijan, Bulgaria)
– deposit-taking institutions which use predominantly borrowed funds for lending operations (Albania, Macedonia, Estonia, Moldova, Kyrgyzstan)
– deposit-taking institutions which use predominantly client savings for lending operations (Czech Rep., Lithuania, Latvia, Poland, Belarus, Russia, Ukraine, Georgia)

Summary

The funding structure of microcredit providers did not change significantly during 2009. Borrowed funds obtained from international investors denominated in foreign currencies continued to be the primary funding source for NGOs/NBFIs. The use of local bank funding fell considerably. Investor funds continued to be concentrated in Bosnia and Herzegovina where 39% of the value of total borrowings of NGOs/NBFIs was allocated.

Microfinance banks funded their lending operations mainly from client deposits. Over half of the value of deposits was attracted from individual savers through term deposit accounts. Deposits were most often denominated in EUR or USD. Funds borrowed from international investors were also mostly denominated in foreign currencies.

The majority of credit unions were using client savings for lending operations in most countries, although there were still countries where borrowings were the most important funding source.

Appendix 1

List of Microfinance Institutions

Balkans

NGOs/NBFIs	Microfinance banks	Downscaling banks	Credit unions and cooperatives
Albania			
BESA Fund	ProCredit Bank Albania	Credins Bank	ASC Union
FAF-DC			Jehona National Union of SCAs
Opportunity Albania			
VF Albania			
Bosnia and Herzegovina			
EKI	ProCredit Bank BiH	Fima Bank	
Lider		Intesa Sanpaolo	
LOKmicro		NLB Tuzlanska Bank	
MI-BOSPO		Nova Banka Banja Luka	
Mikra		Raiffeisen Bank	
MIKRO ALDI		UniCredit Bank	
Mikrofin		Volksbank	
SINERGIJAplus			
Partner			
Prizma			
Sunrise			
Women for Women			
Zdravo			
Kosovo			
AFK	ProCredit Bank Kosovo	NLB Prishtina	
Beselidhja/Zavet MicroFi-nance		Raiffeisen Bank	
FINCA Kosovo			
KEP			
KGMAMF			
KosInvest			
KRK			
Lesna			
Qelim			
START			
Macedonia			
Horizonti	ProCredit Bank Skopje	IK Bank	FULM Savings House
		NLB Tutunska Bank	Moznosti Savings House
		TTK Bank	
Montenegro			
AgroInvest		Crnogorska Komercijalna Banka	
Alter Modus		Erste Bank	
MI Credit		NLB Montenegrobanka	

Serbia			
AgroInvest	ProCredit Bank Serbia	Cacanska Banka	
Micro Development Fund	Stedionica Opportunity Bank	Komercijalna Banka	
		NLB Belgrade	
		Privredna Banka	

Central and Eastern Europe

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			
			National Federation of Savings Cooperatives
Latvia			
			Latvian Cooperative Credit Union Association
Lithuania			
			Association of Lithuanian Credit Unions
Moldova			
MicroInvest	ProCredit Bank Moldova	Agroindbank	Savings and Credit Associations of Citizens
ProCredit Moldova		Banca Sociala	
		FinCom Bank	
		Mobiasbanka	
Poland			
FDPA			SKOK
Fundusz Mikro			
Inicjatywa Mikro			
Polish Association of Loan Funds (PSFP)			
Rural Development Foundation			
Romania			
Express-Finance	ProCredit Bank Romania	Banca Comerciala Carpatica	
LAM		Banca Transilvania	
OMRO			
Patria Credit			
Romcom			

BRU

NGOs/NBFIs	Microfinance banks	Downscaling banks	Credit unions and cooperatives
Belarus			
		Belarusian Bank for Small Business	Belarusian Credit Unions
		BelGazProm Bank	
		Belrosbank	
		BTA	
		Minsk Transit Bank	
		Prior Bank	
		RRB	
Russia			
BFSB	FORUS Bank	Absolut Bank	
ChFSBS		Chelindbank	Russian Credit Union League
Counterpart Enterprise Fund		KMB Bank	
FINCA Russia		Locko Bank	
Microfinancial Center		MDM Bank	
RWMN		NDB Bank	
Sodruzhestvo Fund		Probusiness Bank	
		SovComBank	
		Spurt Bank	
		Uraltrans Bank	
		URSA	
		Vostochny Express	
Ukraine			
HOPE Ukraine	ProCredit Bank Ukraine	Forum Bank	National Association of Ukrainian Credit Unions (NASCU)
		Kreditprom Bank	
		KredoBank	
		MegaBank	

Caucasus

NGOs/NBFIs	Microfinance banks	Downscaling banks	Credit unions and cooperatives
Armenia			
ANIV	ACBA	Anelik Bank	
AREGAK	ProCredit Bank Armenia	AraratBank	
ECLOF		Armeconom Bank	
Farm Credit		Ineco Bank	
Finca Armenia			
General Financial and Credit Company			
Kamurj			
Nor Horizon			
SEF			

Azerbaijan			
AgrarCredit	Access Bank Azerbaijan	Azerbaijan Credit Bank	AKIA Azerbaijan
Avrasiya Credit		AzerdemiryolBank	
Azer Credit		AzerigazBank	
Azeri Star		Bank of Azerbaijan	
Caspian Invest		Bank of Baku	
Cred-Agro		Bank Respublika	
Finance for Development		Mugan Bank	
Finance Technology		NBC Bank	
FINCA Azerbaijan		Nikoil Bank	
Invest Credit		Para Bank	
Komak Credit		Rabita Bank	
Normicro		Royal Bank	
Omni Finance		Tekhnicabank	
TBC Credit		Turanbank	
Viator Microcredit Fund		Unibank	
Georgia			
AgroCredit	Bank Constanta	Bank Republic	
Alliance Group	ProCredit Bank Georgia	Basis Bank	
Crystal		VTB Bank Georgia	
FinAgro			
FINCA Georgia			
Georgian Credit			
ImerCredit			
Lazika Capital			
VF Credo			

Central Asia

NGOs/NBFIs	Microfinance banks	Downscaling banks	Credit unions and cooperatives
Kazakhstan			
Abzal-Credit		CenterCredit Bank	
A-Invest			
Arbat			
Arnur Credit			
Asian Credit Fund			
Atyrau Valyut			
Bereke			
Fund for Financial Support of Agriculture			
KazMicroFinance			
Kyzylorda-Kredit			
Karazhat-Nesie			
ORTA Nesie			
Oral			
PF KFOND			
Sator			

Kyrgyzstan			
AgroKredit Plus	Aiyl Bank	ECO Bank	Credit Unions of Kyrgyzstan
AgroKredit Plus MCA		KICB	
Bai Tushum and Partners		KKB Bank	
Bereke-Credit			
Credit Systems			
Elet-Capital			
Finca Microcredit Comany			
First Microcredit Company			
FNT Credit			
Joldosh Group			
Kompanion Financial Group			
Mehr-Shavkat			
Mol Bulak Finance			
OXUS Kyrgyzstan			
Credit Mongol	XAC Bank		Mongolian Credit Unions
	Khan Bank		
Tajikistan			
Amlok	First Microfinance Bank	Agroinvest Bank	
Armon		Amonatbank	
Arvand		Eskhata Bank	
ASTI		Tajprombank	
Baror		Tojiksodirotbonk	
Bekhnamo		TSOB	
Borshud			
Business Credit			
Chiluchor Chasma			
Credit-Express			
Ehijon Kuhiston			
Fermier			
Finansovyi Dom			
FINCA Tajikistan			
Furuz			
Gender va Taraqieet			
Grand Kredit			
Haft-Gang			
Haqiq			
HUMO			
Imdodi Hutal			
Imdodi Rushd			
Imkoniyat			
IMON			
Ishkoshim			
Jovid			
Kamishkurgon			
Kiropol			
Madina			

Maqsadi Dasigiri			
Mekhnatabad			
Muzafariat			
Nasrin			
Nahustlizing			
Nisor Fom			
Nov Credit			
Omad			
Orifi shahri Vahdat			
OXUS Microfinances			
Phoenix			
Rushdi Obshoron			
Rushdi Pomir			
Rushdi Zanon			
Rushdi vodii Zarafshon			
Saidahmad			
Saodat Invest			
SAS			
Shurobod			
Servis Kredit			
Somit			
Spitamen Kapital			
Sugd Mikrofin			
Tavildara			
Vaslat			
Vahsh Microfin			
Vorisi Zamon			
Voruh			
ZAR			
Uzbekistan			
Barakat		Microcredit Bank	AKC Uzbekistan
Ekhtirom Plus			
Garant Invest			
IMKON Express Invest			
Kafolatli Sarmoya			
Kapital Plus Mikrokredit Tashkiloti			
Konstanta Kapital			
SABR			
Tadbirkor Invest			