
**2004 Microfinance Sector Development
in
Eastern Europe and Central Asia (ECA)**

Justyna Pytkowska
Ewa Bańkowska



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

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List of Acronyms

CGAP – Consultative Group to Assist the Poor
DAI – Development Alternatives International
EBRD – European Bank for Reconstruction and Development
IFAD – International Fund for Agricultural Development
IMI - Internationale Micro Investitionen
IPC – International Projekt Consult
IFI – International Financial Institution
NGO – Non-governmental Organization
NBFI – Non-bank Financial Institution
SME – Small and Medium Enterprise
USAID – United States Agency for International Development

Executive Summary

Goals of the Study

This report summarizes findings of the mapping study of the microfinance sector in the ECA region. The goal of the study was to observe the development of the sector in 2004 across different sub-regions and institutional types. It is the only such comprehensive study that looks at the whole variety of institutions engaged in microfinance and quantifies their activities in terms of outreach, penetration and types of services provided. It also reviews financial performance of microfinance banks and non-governmental organizations (NGOs)/non-bank financial institutions (NBFIs), and identifies factors influencing profitability and sustainability.

Target Audience

The report provides information for microfinance practitioners, investors and funders who are looking for more contextual information to better understand how microfinance operates in the sub-regions.

Report Structure

The report is divided into four sections as follows:

Chapter 1 reveals the size of the sector and its growth by looking at the volume of lending and depository operations, and the scope and depth of outreach to different client types in five sub-regions of ECA.

Chapter 2 analyzes the financial performance of NGOs/NBFIs and microfinance banks from a perspective of profitability, revenue, expense and productivity; it attempts to identify the factors influencing the financial bottom line, and analyzes the influence of factors such as the economic context, size of the microfinance institution (MFI) and target market.

Chapter 3 looks more closely at MFIs' products and their delivery mechanisms as well as the resources they utilize – funding, infrastructure and human resources.

Chapters 4 and 5 present the outlook for the future – what constraints currently exist and most seriously inhibit sector development? How do MFIs see the future of the microfinance industry in the region? And what strategies do they employ to better position themselves?

Annexes I and II present the key findings by institutional type and sub-region, and Annex III lists the MFIs that participated in the study.

Main Findings

The microfinance sector in the ECA region continues to grow, and achieved a rate of 60 per cent growth at the end of 2004, reaching 3 million borrowers with a total loan portfolio of over US\$4 billion. The most prevalent types of institutions are credit unions, mostly active in Central and Eastern Europe (CEE), Russia and Ukraine, where they reach 2 million borrowers. The other types of institutions have smaller outreach of less than 1 million borrowers, as they serve a narrower segment of the population – microentrepreneurs and farmers – while credit unions mostly provide consumer loans to salaried workers, mainly in CEE. However, about 4 per cent of credit union activities are performed by institutions specifically serving microenterprises, many of them in rural areas.

NGOs/NBFIs and microfinance banks have the majority of borrowers in the Balkans and Central Asia, while downscaling commercial banks concentrate their activities in Central Asia and Russia. While credit unions and NGOs/NBFIs are predominantly engaged in providing small loans up to US\$5,000, downscaling and microfinance banks offer loans ranging from a few hundred dollars to over US\$50,000, with less than half of their portfolio in loans below \$10,000. This drives their depth of outreach to over 200 per cent of GNP per capita. Downscaling banks, in particular, do not yet reach downmarket as their depth in the segment of smallest loans exceeds 70 per cent. NGOs/NBFIs in the same segment reach clients with loans of 28 per cent of GNP per capita.

All institutional types except credit unions deepened their outreach in 2004 by decreasing the average loan balance, which enabled them to reach lower-end clients. This means reversing the upward trend from previous years when MFIs continued to provide larger loans each year.

Most ECA microfinance borrowers live in urban areas, especially those in CEE and those who are clients of credit unions. In other sub-regions, urban and rural distribution of borrowers was more balanced but in Central Asia, which has a bigger share of rural population than other regions, the number of rural borrowers exceeded the number of urban borrowers. Both microfinance banks and NGOs/NBFIs have about half of their borrowers in rural areas and over 60 per cent of these clients are using loans for agribusiness. The remainder of rural borrowers use general business loans either because they run non-agricultural enterprises or because they have to use general-purpose business loans in the absence of specialized loans for agricultural production.

Of the three methodologies used in microfinance (solidarity group loans, individual loans and village banking), individual lending is most popular in the ECA region. It is used by downscaling banks and the majority of microfinance banks and NGOs/NBFIs. Some microfinance banks which originated as NGOs are also using solidarity group lending. Group loans are used particularly by clients of NGOs/NBFIs, especially low-end clients who run smaller businesses and lack collateral to guarantee a loan. Most business loans are served through group methodology while agricultural clients more often take individual loans.

While microfinance banks offered a range of banking products (deposits, money transfers, debit cards) that helped in attracting more clients and cross-selling the services, few NGOs/NBFIs offered non-lending products. These were mostly insurance and business development services provided in partnership with non-microfinance institutions.

In 2004, NGOs/NBFIs were on average more profitable than microfinance banks that operated on a very thin profit margin. The most profitable NGOs/NBFIs operated in the Balkans and in Central Asia. MFIs with bigger outreach were more profitable. No correlation was found between depth of outreach and profitability, as those institutions that served low-income clients were just as profitable as their counterparts serving higher-end clients. This indicates that there is no trade-off between social and financial goals. Though providing small loans is more costly, the revenues from such activities were higher. Having limited access to sources of finance, low-income entrepreneurs are willing to pay higher interest on loans from MFIs. This in turn allows the MFIs to cover their costs. More productive MFIs were more profitable as they were able to serve more clients without additional investments in infrastructure.

Due to increasing competition and the need to offer more attractive products, as well as the increasing professionalism and efficiency of many MFIs, significant decreases in portfolio yields were observed in 2004 among the majority of NGOs/NBFIs and many microfinance banks. On average, portfolio yields of NGOs/NBFIs were higher than those of microfinance banks because of smaller scale of operations, more difficult market segment served and higher risk of providing loans without collateral.

For credit unions and microfinance banks, the chief sources of funding remain client savings, while NGOs/NBFIs mostly rely on donor grants for funding capital. Gradually, NGOs/NBFIs are moving towards borrowing, both from concessional and commercial sources. The highest use of borrowing was observed in CEE and the Balkans.

The majority of MFIs surveyed in this study perceive the following major constraints to development of their institutions: regulatory environment, competition and access to funding.

Regulatory environment - in many countries there are no regulations governing microfinance activities, which leaves NGOs in a legal vacuum. In such circumstances, it is very difficult for an institution to prepare a long-term development strategy.

Competition - with the growth of MFIs and increase in outreach, competition for the best clients intensifies. As many institutions offer similar loan products they often serve the same client group. The strongest competition was observed in the Caucasus – almost all NGOs felt strong competitive pressure from other NGOs. There, the majority of NGOs work with urban clients in major cities and compete through price rather than other loan conditions, different products or services.

Access to funding - problems with funding are most acute for NGOs/NBFIs that are still very much donor-dependent. However, as grants become scarcer in the region, MFIs are looking for other sources of funding. Although the use of commercial sources of funding as well as own resources (net profit) is gradually increasing, many MFIs have difficulty in attracting the required level of funds.

Most MFIs expect that in future, the microfinance industry will integrate with the mainstream financial sector. This opinion is especially held in the Balkans, where MFIs have evolved into strong financial institutions. Only 16 per cent of responding MFIs expect the industry to move towards increased social performance, integration of finance with other socially oriented services (including a wider range of non-financial services), and extending outreach to excluded groups.

MFIs perceive that the best strategy to market their products is to differentiate themselves from their competitors, in terms of customer service, product quality and range of products. Innovation is perceived as the most important success factor for most MFIs. Additionally, developed infrastructure that provides good access to services increases the chances for success.

Foreword

The annual stocktaking exercise by the Microfinance Centre (MFC) found that practitioners perceived three key barriers to creating more inclusive financial markets:

- concerns about growing competition
- the lack of adequate financing
- a policy environment that too often constrains rather than enables microfinance.

I would like to suggest that while each of these is a potential barrier, it is also an opportunity for effective dialogue and action. I will argue that competition is really only beginning in most markets and is, on balance, a good thing for MFIs and certainly for their clients. I will suggest that the industry appears on the cusp of financing its growth through more commercial sources. And I will encourage all of us to embrace a broader vision of an enabling environment and to redouble our efforts to create the conditions for healthy competition. Product innovation, process re-engineering, a focus on increasing efficiency, broad applications of new technology, and creation of new strategic alliances will all be essential if we are to achieve this vision of financial democracy.

Competition

I'd like to suggest that we use a different lens to examine the nature of the markets we are competing to serve, who our competitors actually are, and how to succeed. The lens I'll suggest we use is that of the 'base of the pyramid' (BOP), first proposed by Professor C.K. Prahalad of the University of Michigan in his revolutionary book, *The Fortune at the Bottom of the Pyramid: Eradicating Poverty through Profits*. I will also draw on a small set of case studies by DAI (a development consulting firm) called *Discovering Hidden Assets: Financing at the Base of the Pyramid*. Professor Prahalad's argument is based on the premise that whether you are talking about cell phones, financial services, shampoo or agricultural exports, the growing markets will be those at the bottom of the global economic pyramid, particularly those households earning less than US\$2,000 per capita. There are 4 billion people in the so-called BOP markets. Meeting their demands for appropriate goods and services will be the driver of future market development and profitability for global corporations and domestic companies alike.

There is increasing evidence that BOP buyers will pay for quality products and services, but those goods and services must be adapted to their needs. The first generation of microfinance models – with their collateral substitutes, use of groups and stepped loans to manage risks and bring down the costs of delivery, and so on – offers an example of radically retooling financial services to make them work, profitably, for poor people. We need to continue applying BOP thinking to microfinance, to figure out the next generation of breakthroughs that will help us serve more and more BOP households and businesses better and better. And as the level and stability of clients' incomes grow, what will they want from their financial services provider? And how will MFIs respond to the rapidly evolving opportunity this presents? Recently I heard the Chief Executive Officer of Visa, Chris Rodrigues, speak at a conference of big companies interested in tapping BOP markets. He talked about the catalytic role that finance plays both in an economy and for individual households. Here's what he said: "Cash is like walking to market. Debit cards and other electronic payment systems are like having a bicycle. Credit cards and related services are like having a bicycle with gears."

As the awareness of the size of the BOP market grows, bigger financial services companies like Visa are noticing your clients and wanting to sell them bikes with gears! They are also starting to notice the 'good' microfinance – microfinance that is relatively high volume and efficient and yields strong and consistent profitability. At the moment you have an edge – you know how to serve these customers better than your potential big competitors. But you will

almost certainly need to innovate and constantly improve your products and processes to keep those customers and attract new ones to sustain your growth. So in this bigger competition for BOP markets, how can your institution come out as a survivor with loyal clients and growing market share? Here are a few general principles that have emerged from the very recent experience of tapping BOP markets and seem relevant to microfinance:

1) Keep an eye on your products and how to increase the value proposition

But it's not just the products that need re-engineering – it's the processes too. I see two key re-engineering challenges for the microfinance industry in the ECA region and worldwide:

- tailoring financial services to specific market segments
- achieving major breakthroughs in efficiency to reduce costs without eroding the value proposition to the client.

2) Develop a product line and aim for total customer profitability

Not all products are profitable from inception – some are loss leaders that attract customers, open the door to offer them other products and, over time (assuming those customers are retained), contribute nicely to the financial bottom line.

3) Not every microfinance provider needs to have a full line of service

In the US, there are thousands of banks, many of them specialized or quite local institutions and some of them offering just a small number of products targeted to a niche market. However, if your business model is as a niche player, you need to be very good at it and make sure you can retain that specialty as a profitable line.

4) Explore alternative revenue models

Fee-based services are the profitability drivers for many US banks. What role might you be able to play in fee-based services such as remittance or payment services?

5) Explore alternative delivery channels and service points

Multiple service points will be one of the keys to achieving more inclusive financial markets. This may well involve forging strategic alliances and partnerships to take advantage of another organization's delivery channels or distribution networks.

6) Seek improved technology applications to offer better products, increase efficiency, and enhance profitability

I think we're finally poised for some innovations that will stand the test of the market, including remittances, smart cards, credit scoring and others.

7) Use new business alliances aggressively to succeed in your business and extend your outreach

In considering which strategic alliances might be a good fit for your institution, don't just think of financial services and information technology (IT) companies. What about retailers? Distributors of consumer products? Hardware and construction material companies serving the low-end home improvement market? Suppliers of agricultural equipment and inputs? It's a two-way street – don't just think of who can help you deliver finance – who needs the finance you might be able to offer, to get their products and services into BOP markets?

Expanding and Diversifying Financing Sources

A recent CGAP survey identified the issue of financing as the first concern worldwide – over 90 per cent of the 120 MFIs they polled cited it as their biggest worry.

What is the current situation?

- There has been a substantial increase in commercial funding to MFIs from diverse sources.
- This growth in the proportion of funding obtained commercially is especially impressive given the very strong year-on-year growth among the region's MFI portfolios.
- There has also been a growth in deposits, but legal/regulatory restrictions are especially problematic in the region.
- There has been growth in MFI financing through debt, but this source is still substantially non-commercial in nature.
- There has been some equity, but it has been rare, and comprised almost entirely of MFI retained earnings and equity investments made in the family of ProCredit Banks.

Here's what I think the picture will look like in the near future:

- The demand for debt to finance growth – whether local or international, commercial or not – is far from peaking among the larger regulated institutions. Unregulated MFIs often face significant obstacles to competing with them for debt.
- But compete they must – there won't be nearly enough grants and equity available to cover the appetite for expansion capital.
- In terms of international capital, the ECA region will benefit from the pressure that many microfinance debt and equity funds are feeling to place their capital and to move beyond 'the usual suspects', especially in Latin America, to younger microfinance markets.
- There will also be opportunities on the domestic debt front. In the more dynamic
- economies, new market entrants will be attracted to the space traditionally occupied by domestic banks, motivating some of them in turn to try downscaling into the micro market.

But it's hard to imagine that some of them won't find it more attractive to lend to MFIs instead, which share some similarities with the small and medium enterprise (SME) market they're also trying to tap.

Marc de Sousa-Shields points out (in the USAID-funded study 'Financing MFIs: The Context for the Transition to Private Capital') that even small, relatively new institutions such as XAC Bank in Mongolia have moved to access private capital rapidly and profitably. He continues with advice for all of us: "A primary and obsessive focus should be to lever domestic capital as quickly as possible, as MFIs prove they can grow the value of their business in their core, low-income market."

He sees two important roles for the non-commercial capital providers such as USAID, Blue Orchard, EBRD, Oikocredit and Opportunity Investments. First, we should focus our investments not on the safe bets, but on the next generation of MFIs, and we should do it with the explicit goal of leveraging private domestic capital. And second, we should invest in improving the enabling environment and infrastructure for more inclusive financial markets, quasi-public goods such as better laws and regulations, credit information bureaus, ratings agencies, support services for pro-poor financial institutions, and microfinance associations.

The Enabling Environment for Microfinance

The ECA region, more than any other in the world, has a pretty urgent policy agenda. My priorities as a donor, interested in encouragement of the whole market rather than any specific retail institution, are likely to be different from those of MFC members. I think the priorities for legal and regulatory work in this region should be:

- to ensure that the legality of microfinance by institutions other than banks is settled
- to remove legal and regulatory barriers to non-depository MFIs borrowing domestically and internationally to finance their growth
- to create clear and fair transformation options.

I think an investment newsletter is a good step in this direction as a clearing house of information. We will also need to be proactive on consumer protection, to protect our reputations and distinguish ourselves from unscrupulous or predatory players that may enter the market. (This is one important way to head off policies that we won't like, such as imposition of interest rate caps.) And we need to keep our eye on how anti-money laundering and anti-terrorist financing provisions are being designed and implemented. They could pose huge unintended threats to microfinance operations and institutions.

Finally, on the policy front, as an industry, we need to be more proactive on improving the business environment for our clients, not just for our own institutions. In prioritizing what advocacy to undertake together, we need to look beyond very narrow concepts of institutional self-interest to ensure that the consumers in the BOP market have a chance to develop and benefit from more choices and better economic opportunities. But work on laws, regulations, policies and administrative practices does not go far enough. An enabling environment also includes the infrastructure needed for more inclusive financial sectors to develop – infrastructure such as credit information bureaus, credible ratings agencies, specialized consulting and other support services, and regional and national network associations.

I hope you agree with me that each of these three challenges – competition, financing constraints and inadequate legal and regulatory environments – also offers an opportunity for us to make big progress in extending access to financial services. To turn the challenges into opportunities, we will need to work better, to focus on what is truly important, and to work together in new ways.

Kate McKee

Director, Office of Microenterprise Development, US Agency for International Development (USAID)

Introduction

Microfinance in the ECA region emerged in early 90-ties, after the transition from centrally planned to market economies, allowing for the development of private entrepreneurship. At the same time, high unemployment forced many people to seek economic opportunities and start their own microbusinesses. MFIs focused on supporting the emerging microbusiness sector by providing loans to entrepreneurs who lacked access to other sources of finance to grow their businesses. This sector has not been served by banks because most entrepreneurs could not provide guarantees for loans.

In many ECA countries, the collapse of the Soviet bloc brought ethnic conflicts (in the Balkans and the Caucasus) resulting in large parts of the population affected by internal displacement and loss of livelihood. In those countries microfinance was part of a wider humanitarian package delivered by NGOs, which over time began to separate out microfinance activities. These in turn quickly realized that institutional sustainability is crucial to achieving their social goals and, as seen today, the majority of MFIs aim to achieve a double bottom line – fulfilling their social mission while ensuring financial sustainability.

Despite many similarities in the emergence and development of the private sector, differences can be seen between the sub-regions that stem mainly from the different course of economic and political changes. These affect the way the microfinance sector started and they way it operates today.

Institutional Types

MFIs adopt various legal forms and strategies ranging from grass-roots credit unions (financed from local resources, mostly client savings and retained profit), to not-for-profit NGOs and NBFIs that were established with the support of donors and later localized with local management while securing commercial sources of funds (loans or investment), to for-profit microfinance banks and downscaling commercial banks. They differ in their strategic goals, which affect their mode of operation, target clients and financing sources.

Credit unions

Credit unions are the most common type of MFI in Central and Eastern Europe, and provide very small, short-term consumer loans mainly to salaried workers. As they also mobilize savings, credit unions in many countries are self-financing and are growing at a fast pace. In countries such as Ukraine, Lithuania and Poland, credit unions provide a wide range of services that are competitive compared with services provided by banks. However, in other countries, many credit unions are struggling to set up sustainable operations, as they were state-subsidized in the past. There have also been some failed experiences with credit unions, especially in the Balkans, which explains some of the tight regulatory constraints placed on them.

Based on the success of such self-financing mechanisms both in ECA and elsewhere in the world, a number of credit union networks have been established, including in Central Asian and Caucasian countries. Many newly established networks of membership-based savings and credit associations or credit unions successfully operate in rural areas with high demand for financial services.

NGOs/NBFIs

These are non-deposit taking, not-for-profit organizations that operate in various legal forms and are predominantly engaged in providing microcredit services to financially excluded populations. In the majority of cases, these

institutions were established by donor-driven international networks. The majority of these MFIs is now locally registered and is funded by a mix of donors and microfinance investors.

Microfinance banks

Microfinance banks are fully regulated commercial banks that serve small and microenterprises with a broad range of financial services. The majority of ECA's microfinance banks are institutions affiliated with ProCredit Holding, which mostly operate in the European part of the region. These banks were formed with the foreign capital of IMI group (now ProCredit Holding). Their rapid advance was possible thanks to the strong financial support of their shareholders and the know-how of IPC consultants. Since the beginning, these banks were offering both lending and savings products for which there was high demand, particularly in the post-war Balkans where local banks were not perceived as safe.

A second group of microfinance banks comprises institutions that in recent years transformed themselves from NGOs/NBFIs in order to better serve their target clients. Transformation into a bank allowed them to offer a larger range of products and also attract more investment that would secure institutional growth. These institutions went through a different course of development where they were adapting old products and introducing new ones, including savings, over the course of time.

The third, smallest group comprises local banks that have a history of working with retail clients and thanks to a widespread outreach, were in a position (with support from international institutions) to become professional microfinance providers.

Downscaling commercial banks

A number of EBRD and KfW-led projects exist in the ECA region, aiming to develop microfinance units at local commercial banks in order to build on the existing infrastructure and most effectively reach downmarket. The largest such project works in several countries of Central Asia and in Russia. Microfinance units of these banks serve a very wide range of clients with loans ranging from a few hundred dollars to US\$50,000, which results in a very high average loan size and consequently has limited outreach.

Institutional Diversity in the Sub-Regions

South-east Europe (Balkans)

The countries of former Yugoslavia have suffered from the wars in Bosnia and Herzegovina, Croatia and Kosovo, which have also affected the neighboring countries of Albania and Macedonia. Donor support has been more significant here than elsewhere, especially in Bosnia and Herzegovina. Most of the large MFIs, as well as those growing most rapidly, operate there. An important share of the microfinance market is served by microfinance banks and increasingly by downscaling commercial banks. Competition is becoming an issue as many MFIs target the same client groups, which may lead to client over-indebtedness.

Central and Eastern Europe

This sub-region spans the countries that entered the course of quick economic reforms and integration with the European Union (EU). They also have a longer tradition of small private entrepreneurship than the rest of the ECA region, as even during Soviet times some level of private economic activities was allowed aside from the nationalized economy. In these countries credit unions have the longest tradition and well outnumber other types of MFI. The

banking sector in this sub-region is quite well developed with commercial banks as well as microfinance banks serving more and more entrepreneurs. However, their most common target group are urban enterprises from the upper segment, mostly SMEs.

The majority of CEE countries are classified as upper middle-income, and are therefore out of the donor spotlight, which is a drawback for non-bank MFIs with limited capacity for attracting commercial funding. This, together with the increasing competition from banks, causes non-bank MFIs to concentrate more on market niches of disadvantaged entrepreneurs (e.g. minority groups or rural areas), which limits their outreach and therefore makes it more difficult to develop an efficient institution. Lack of a diversified portfolio makes the whole institution more at risk.

Caucasus

After the years of ethnic conflicts and natural disasters, this sub-region is only just starting to rebuild its economy. Although there have been a large number of MFIs operating for many years, they remain small (with only a few notable exceptions) and offer limited services. In the early years these MFIs were operating as projects providing financial services complementary to humanitarian aid provided by international NGOs. In some cases, the geopolitical location of the Caucasus is also an important factor for donor presence in this sub-region. With the development of the commercial banking sector, which in such a small region has only a limited market of large businesses to serve, the microfinance market is becoming more crowded, with a growing number of microcredit providers.

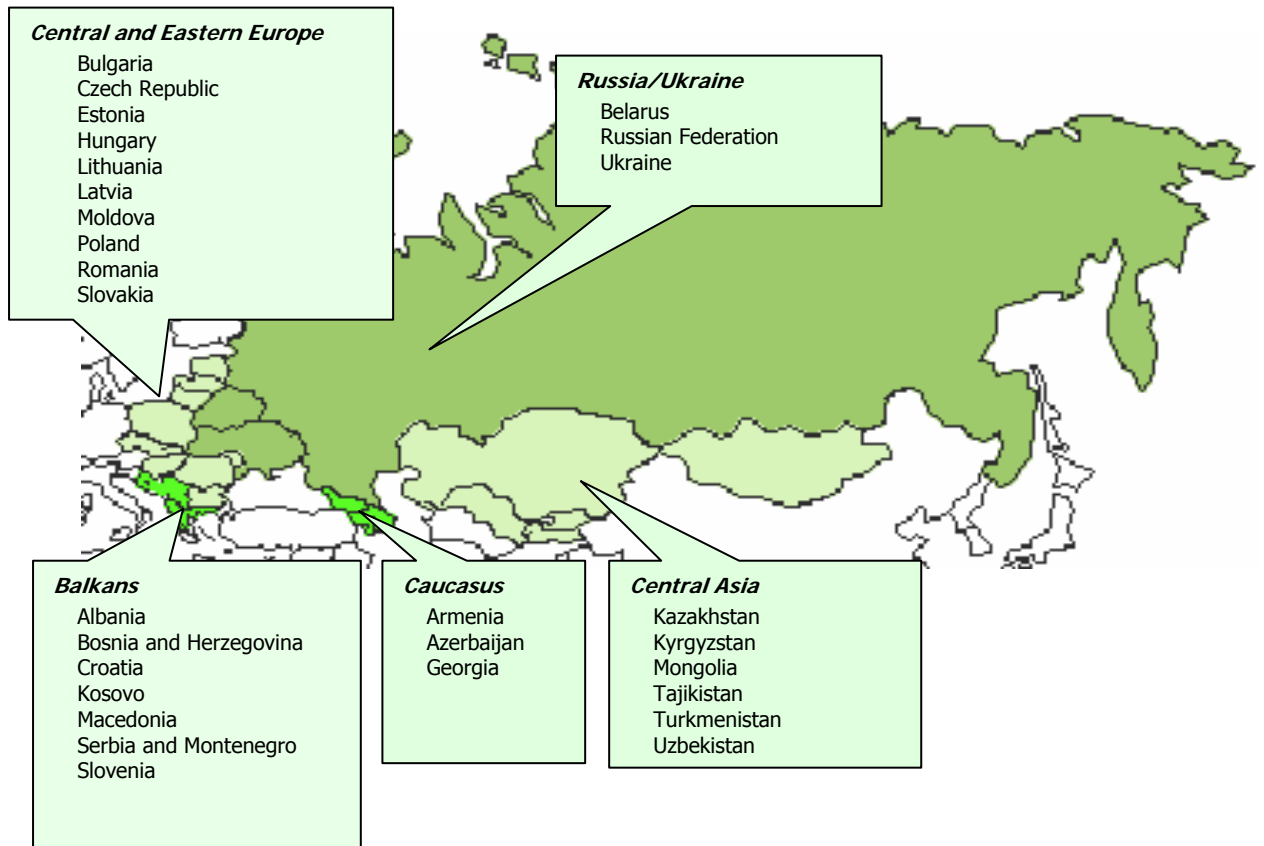
Central Asia

Today these countries are the poorest in the region with the lowest per capita income (in some countries as low as US\$180). Until recently the regulatory environment has been very unfavorable for lending activities of NBFIs, resulting in poor market coverage. However, newly adopted microfinance laws in Kazakhstan and Kyrgyzstan have led to a rapid increase in the number of MFIs being created. As the microfinance sector is youngest there, it still receives a lot of support from donors and international financial institutions (IFIs) aimed at increasing outreach of commercial bank downscaling projects, strengthening newly created credit unions, and building the capacity of emerging NGOs/NBFIs.

Russia/Belarus/Ukraine

Similarly to CEE countries, credit unions play a major role in serving microentrepreneurs in Russia and Ukraine. Thanks to good country coverage, they are able to serve much larger numbers of clients than any other type of institution. Their major competitors are commercial banks, which also have a very good network of offices (a legacy of the Soviet Union) and are able to reach clients in remote areas. Downscaling projects with IFIs allow these banks to address SME as well as microbusiness clients.

Figure 0.1: Eastern Europe and Central Asia and the Sub-regions



Methodology

The methodology used for this survey did not follow a strict theoretical model and was quite challenging for the following reasons. The entities covered in the study were very diversified, representing a variety of institutional forms, sizes, locations, and level of engagement in microfinance, as well as their degree of transparency and international exposure. For credit unions, due to their large scale, information was only available in aggregates on a country level, which made it impossible to analyze them in more detail. Also, downscaling commercial banks, for whom microcredit constitutes only a small part of their operations, did not report their performance on a segmented basis. Additionally, many of the smallest institutions, particularly in Central Asia, were not included in the study as it was not feasible to reach them.

The study was based on a survey conducted in the ECA region in early 2005 distributed via email. In total, the survey covered 7,000 institutions, including 6,800 credit unions represented by 14 networks and associations, 110 NGOs/NBFIs, 16 microfinance banks, and 63 downscaling banks. These constitute the majority of institutions operating in the ECA region in terms of their size and outreach to clients. Although we recognize that there are more institutions, they usually run very small operations. In particular, activities of downscaling banks may be underestimated in this study as well as those of credit unions in Russia and in the Balkans.

The survey contained 25 questions, which were divided into the following groups:

1. General information on size, outreach and financial performance
2. Loan portfolio
3. Credit and savings products
4. Research
5. Competition
6. Funding
7. Long-term strategy

Local networks and projects working with MFIs were asked for support in obtaining the completed survey. As for credit unions, the data were obtained chiefly from national associations. All the information received from respondents was self-reported, however it was often verified using secondary sources such as audited financial statements, annual reports or ratings reports.

As an additional source of information, resources open to the public were used. These included organizations' web pages and various sectoral reports. Data from the previous years of the study were included in the analysis, covering 2002 and 2003. This enabled the very first sector trend analysis, narrowed down to those organizations that took part in each of the three editions of the study. The analyses were conducted with the use of SPSS software. Financial data were reclassified and adjusted according to international standards.¹

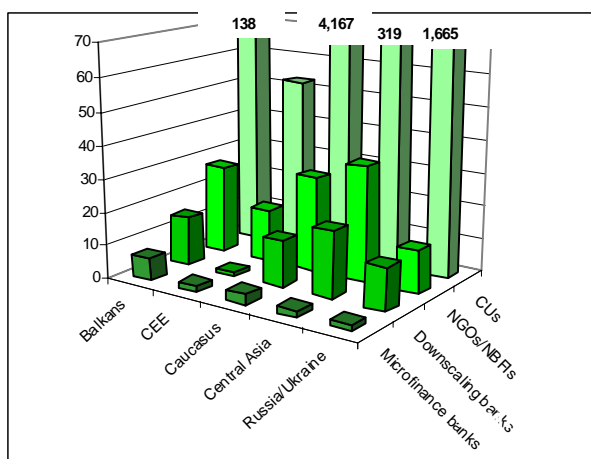
¹ *Measuring Performance of Microfinance Institutions; A Framework for Reporting, Analysis and Monitoring*, developed by SEEP Financial Services Working Group and Alternative Credit Technologies, LCC, available at http://www.microlinks.org/ev_en.php?ID=9701_201&ID2=DO_TOPIC

Chapter 1. Size of the Microfinance Sector

Number of MFIs

At the end of 2004 there were 6,800 MFIs active in the ECA region, the vast majority of which were credit unions.

Figure 1.1: Number of MFIs in ECA



These predominantly operated in CEE and in Russia and Ukraine. As in previous years, they outnumbered other types of institutions, with just over 100 NGOs and NBFIs, almost 60 downscaling commercial banks and 18 microfinance banks. Among these other institutional types, one-third of NGOs and NBFIs operated in Central Asia where the sector is youngest and therefore has the biggest number of new entrants. Also the downscaling commercial banks were most numerous there. Microfinance banks, on the other hand, were mostly located in the Balkans where they were present in every country of this sub-region.

Loan Portfolio Size

The total gross loan portfolio utilized by all MFIs in ECA amounted to US\$4 billion. The largest volume of lending activities was observed among credit unions. As in previous years, credit unions remained the dominant MFI type as they managed 40 per cent of the total volume of loan portfolio. On the sub-regional level they dominated the industry in CEE, had a fair share in Russia and Ukraine, but they were hardly present in the other sub-regions where the largest volume of operations was managed by microfinance banks. Only in Central Asia was the largest size of the portfolio in the hands of downscaling commercial banks.

The Caucasus so far hosts the smallest microfinance sector mainly because of the small size of this sub-region, which spans only three countries with a total population of 16 million.

As the sector is relatively young, growth is still quite dynamic – during 2004 the total microfinance loan portfolio grew by 65 per cent. Except for NGOs and NBFIs, the growth rates were similar for all institutional types; however, only credit unions grew faster in 2004 compared to previous years thanks to the rapid advance of Ukrainian credit unions, which tripled their portfolio during the year. After a few years of rapid advance, microfinance banks and downscaling banks decelerated the pace.

Figure 1.2: Total Value of Gross Loan Portfolio

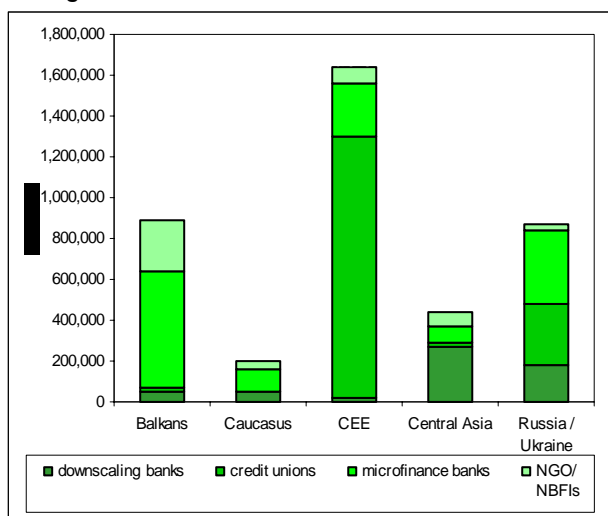
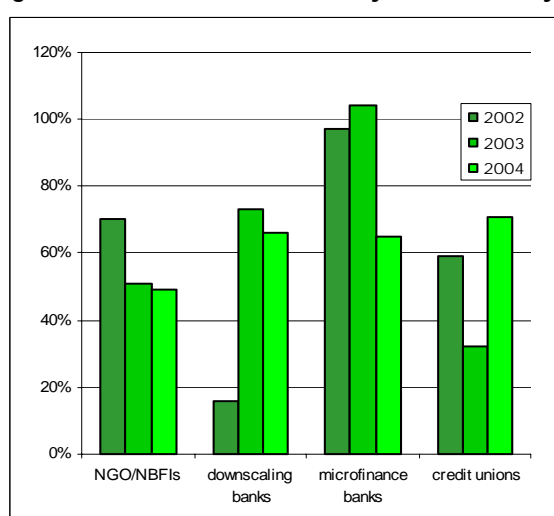


Figure 1.3: Loan Portfolio Growth by Institutional Types



NGOs/NBFIs were the slowest growers, with growth rates decreasing every year. This indicates that it is becoming more difficult for them to attract funding to increase their asset base. Taking into account the size of microfinance banks and credit unions, they were able to increase their portfolio by US\$670 million and US\$550 million respectively compared to the US\$160 million growth of NGOs/NBFIs. Attracting such amounts of funds was possible thanks to deposit-collection activities as well as (in the case of microfinance banks) strong commitment from shareholders to provide additional funding in the form of loans. Both institutional types financed more than half of their assets from client savings.

Largest MFIs by Loan Portfolio Size

Microfinance banks are by far the largest MFIs in ECA. There were only three NGOs/NBFIs among the top 15 institutions but this was still quite a development compared to 2003 when only one NGO/NBFI entered the list. Loan portfolio of the biggest microfinance bank was six times larger than that of the largest NGO/NBFI.

Figure 1.4: Top 15 MFIs by Loan Portfolio Size

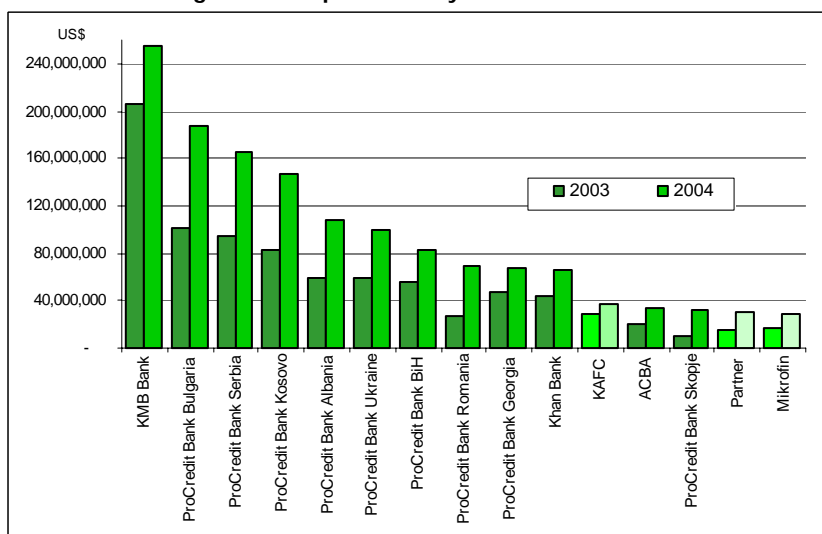


Table 1.1: Gross Loan Portfolio and Active Borrowers by Institutional Type

Institutional Type	Number of MFIs	Total Gross Loan Portfolio (US\$)	Share of Gross Loan Portfolio (%)	Number of Active Borrowers	Share of Active Borrowers (%)
Credit unions	6,342	1,615,976,373	40%	2,342,037	69%
Microfinance banks	16	1,382,587,573	34%	426,524	13%
Downscaling banks	63	573,581,690	14%	120,795	4%
NGOs/NBFIs	120	476,059,121	12%	482,924	14%
Total	6,541	4,048,204,757	100%	3,372,280	100%

Table 1.2: Gross Loan Portfolio and Active Borrowers by Sub-Region

Sub-region	Number of MFIs	Total Gross Loan Portfolio (US\$)	Share of Gross Loan Portfolio (%)	Number of Active Borrowers	Share of Active Borrowers (%)
Balkans	187	889,298,331	22%	308,794	9%
Caucasus	99	203,747,957	5%	186,356	6%
CEE	4,186	1,641,352,914	41%	1,686,600	50%
Central Asia	376	438,841,627	11%	371,924	11%
Russia/Belarus/Ukraine	1,693	874,963,928	22%	818,606	24%
Total	6,541	4,048,204,757	100%	3,372,280	100%

Number of Active Borrowers

With the growth of the loan portfolio, more and more people become clients of MFIs. During 2004, the number of borrowers increased to 3.4 million people, the majority of whom were served by credit unions (see Table 1.1). The two largest credit union networks alone (Poland and Romania) served half of all microfinance borrowers in ECA. The remaining clients were chiefly served by NGOs, NBFIs and microfinance banks, with downscaling banks having only limited outreach. Microfinance banks served a similar number of borrowers as NGOs/NBFIs largely due to the activities of Khan Bank in Mongolia, which served one-third of all microfinance bank clients.

Figure 1.5: Number of Active Borrowers

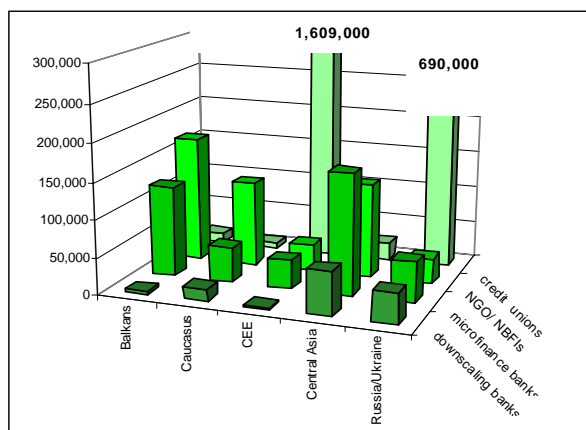
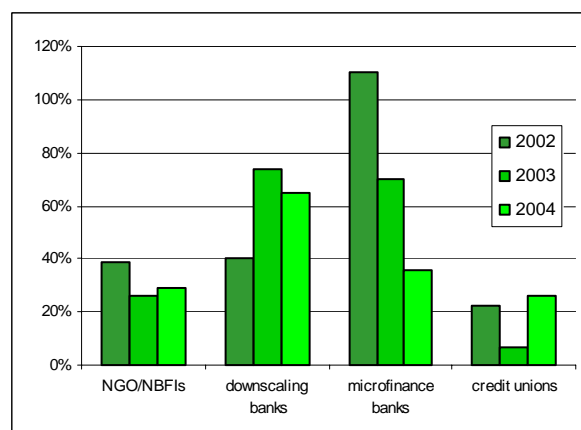


Figure 1.6: Active Borrowers Growth by Institutional Type



In the sub-regions, half of the borrowers were located in Central and Eastern Europe (see Table 1.2), where the highest coverage was achieved, with nearly 2 per cent of the economically active population² using microfinance lending services. Again, this penetration was achieved thanks to the activities of credit unions. The sub-region with the second-highest number of borrowers - Russia/Belarus/Ukraine - was most under-served as less than 0.5 per cent of the economically active population had access to microfinance.

Table 1.3: Market Penetration of MFIs

Sub-region	Borrowers/Population 15-65 years old
Balkans	1.9%
CEE	2.8%
Caucasus	1.7%
Central Asia	1.1%
Russia/Belarus/Ukraine	0.6%

NGOs and NBFIs, in accordance with their mission, mostly operated in three sub-regions with the poorest and most conflict-affected populations, i.e., the Balkans, the Caucasus and Central Asia. Among them the Balkan MFIs, in particular in Bosnia and Herzegovina, were the most advanced and largest institutions in the whole region, partly due to the high level of funding and technical assistance available to jump-start the institutions after the conflict.

Except for Khan Bank, microfinance banks were mostly active in the European part of the region, i.e., in the Balkans and CEE, while downscaling commercial banks had a majority of clients in Central Asia and Russia. This, most likely is a result of varying legal and economic conditions across the ECA region. While microfinance banks are opened up in countries with market economy where foreign capital can be safely invested. Downscaling projects, on the other hand, operate in countries with very large underserved market by the existing banks, in many cases state controlled and inefficient, but with very widespread infrastructure ensuring good outreach.

Unlike the loan portfolio, the scale of outreach grew at a slower pace, with the number of active borrowers increasing by only one-third in 2004. Downscaling commercial banks increased their client base more quickly than all other institutional types.

Urban and rural borrowers

Urban borrowers are still the dominant clientele of MFIs, accounting for 75 per cent. The largest networks of credit unions operating in CEE traditionally serve borrowers in cities and towns and have very little to offer rural clients. However, credit unions or savings associations that cater to rural populations exist, especially in Moldova, Russia and Kyrgyzstan, where they were established in recent years with support from international organizations in response to vast poverty and a demand for finance outside urban locations.

Because of the large total outreach of credit unions, almost every second rural borrower was using their lending services; the rest were distributed among NGOs/NBFIs and microfinance banks (see Table 1.4).

² Economically active population – all persons between 15 and 65 years old who can potentially be clients of microfinance services

Table 1.4: Serving Rural Borrowers by Different Institutional Types

	Distribution of Rural Clients among Institutional Types	Share of Institutions Serving Predominantly Rural Clients (with more than half of borrowers in rural areas)
Credit unions	48%	not available
Microfinance banks	25%	33%
NGOs/NBFIs	24%	45%
Downscaling banks	3%	not available
Total	100%	

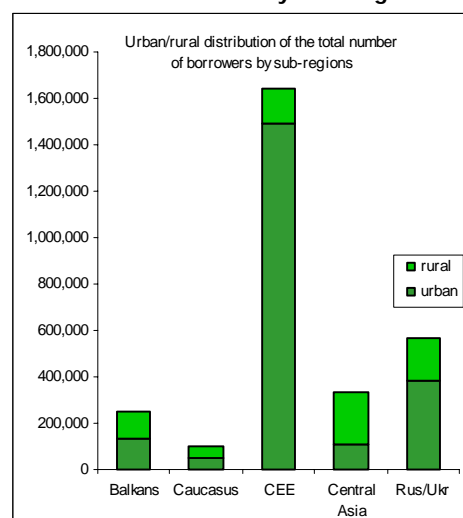
Downscaling commercial banks had the smallest outreach to rural clients because of a limited overall outreach and also because of their office location in towns. Except for a few IFAD-supported agricultural downscaling projects in the Balkans, only one bank in Central Asia was dedicated to serving predominantly rural entrepreneurs.

Table 1.5: Institutions with Largest Outreach to Rural Borrowers

Number of Active Rural Borrowers			
	Balkans	Caucasus	Central Asia
NGOs/NBFIs	AgroInvest (13,000) EKI (12,000) Partner (13,000)	UMCOR/AREGAK (12,000)	KAFC (21,000)
Microfinance banks	ProCredit Bank Serbia (14,000)	ACBA (20,000)	Khan Bank (118,000) XAC Bank (21,000)

There were only three microfinance banks with a strong focus on rural areas – Khan Bank, XAC Bank in Mongolia and ACBA Bank in Armenia. The remaining microfinance banks predominantly operated in urban areas. Among NGOs/NBFIs, more institutions were targeting rural borrowers. One-fifth of them had more than 75 per cent of rural clients.

In the sub-regions the biggest numbers of rural clients were located in Central Asia not only because of Khan Bank's operations but also due to the significant engagement of credit unions and downscaling banks. Additionally, the focus of NGOs/NBFIs on rural clients was higher than in other sub-regions as 60 per cent of NGOs and NBFIs served predominantly rural clients (more than half of their clients lived in rural areas). This reflects the composition of the population in countries in Central Asia where up to 60-75 per cent (except in Mongolia and Kazakhstan) live in rural areas. In other sub-regions this ratio is in most cases below 50 per cent. It was found that the urban/rural structure of MFI clientele correlates with the structure of the population in a given country.

Figure 1.7: Urban/Rural Distribution of Active Borrowers by Sub-Region

Female clients³

More than half of all active borrowers in the region were women. The majority of them (60 per cent) were served by NGOs/NBFIs. They also had the largest share of institutions dedicated to serving women, as there were 14 NGOs/NBFIs that had only female borrowers and three out of five institutions had more females than males among their clients. Microfinance banks had the second largest outreach to women but female borrowers constituted a minority of their clients.

Despite their smallest outreach, downscaling banks had quite balanced gender distribution. There were examples of downscaling projects in Central Asia that specifically served women.

Figure 1.8: Gender Distribution of Active Borrowers by Institutional Type

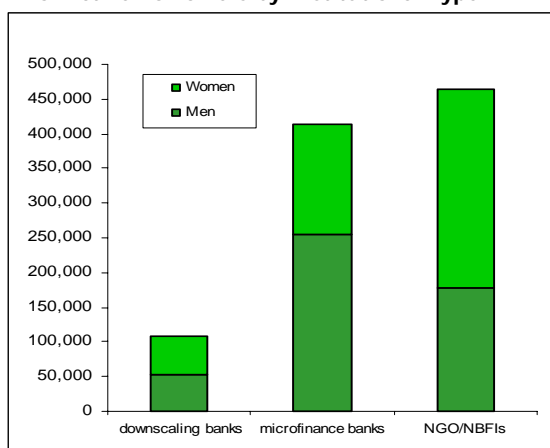
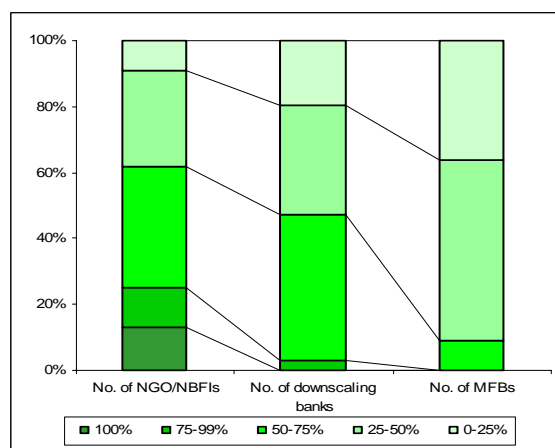


Figure 1.9: Targeting of Female Borrowers



In the case of NGOs/NBFIs, the share of female borrowers significantly decreases with the growth of loan portfolio size. Women are more often clients of NGOs/NBFIs that operate in urban areas. Almost half of all female borrowers in ECA were clients of Central Asian MFIs, where women well outnumbered male borrowers. This was quite exceptional as in only one other sub-region - Russia/Belarus/Ukraine – did women constitute the majority of borrowers.

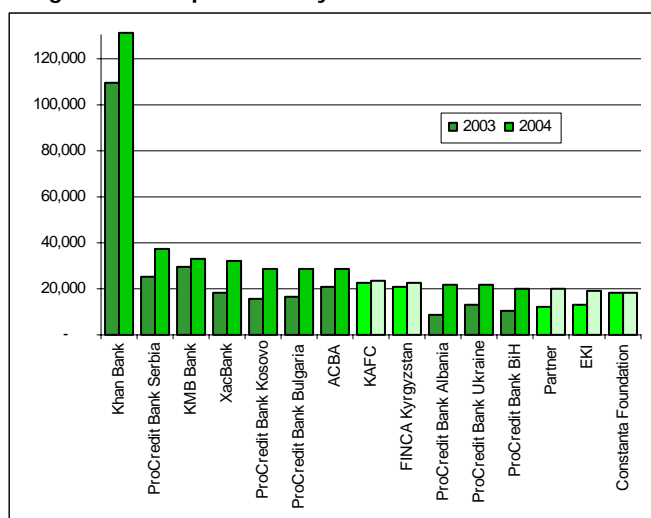
³ Information about female participation in credit union activities was not fully available to perform the analysis.

Largest MFIs by Number of Borrowers

A top-ten list is somewhat different in terms of the number of borrowers compared to the ranking by loan portfolio size. Here, except for one bank, the difference between microfinance banks and NGOs/NBFIs was smaller. Still, more microfinance banks had bigger and still increasing breadth of outreach. Among the largest NGOs/NBFIs, only two exceeded 20,000 borrowers and this situation had not changed compared to the previous year.

For comparison, the largest MFIs in the world reached over 3 million borrowers (BRI Indonesia and BRAC Bangladesh).

Figure 1.10: Top 15 MFIs by Number of Active Borrowers



Client Savings

The volume of deposits reached US\$2.9 billion, with the largest concentration in Central and Eastern Europe, where the majority of credit unions operate. As in previous years, credit unions remained the biggest savings collectors with almost 60 per cent of deposits. However, their share is decreasing every year as more microfinance banks start using client deposits as a source of funds for their lending activities.

Both microfinance banks and credit unions rely on deposit collection to fund their lending activities, as savings constitute over 70 per cent of the capital for their loan portfolio. As in previous years, NGOs/NBFIs are generally not allowed to collect deposits from their clients.

Table 1.6: Scale and Outreach of Depository Services by Institutional Type

	Total Value of Deposits US\$	Share of Total Value %	Number of Depositors	Share of Depositors %
Credit unions	1,702,939,804	59%	3,036,364	73%
Microfinance banks	1,189,100,861	41%	1,097,084	27%
Total	2,892,040,665	100%	4,133,448	100%

Depth of Outreach

Two proxy indicators are most commonly used to evaluate the extent to which MFIs reach low-income clientele. The underlying assumption is that low-end clients use smaller loans (because of smaller financing needs and lower repayment capacity), therefore the average loan size in absolute terms (in US\$ or other currency) and relative to GNP per capita (depth of outreach⁴) are used.

⁴ Depth of outreach is calculated as average loan balance per borrower divided by GNP per capita. This measure normalizes the loan size for different levels of country income making cross-country comparisons possible. Lower values of the ratio mean smaller loans, which are associated with deeper outreach to the poor. Higher values mean that the outreach is shallower, as the institution serves clients with larger businesses. Deepening the outreach happens through the decrease of the depth of outreach ratio, therefore the downscaling effect is observed among MFIs whose depth of outreach change was negative during the year.

The analysis of the loan size reveals that downscaling commercial banks serve a broader clientele of microentrepreneurs as well as SMEs with loans ranging from a few hundred dollars to US\$50,000. Although the majority of borrowers have loans below \$5,000, when compared to the level of income it turns out that the depth of outreach is more shallow than for other institutional types and exceeds the threshold for microfinance activities set up at 250 per cent of GNP per capita. This is because the majority of downscaling banks operate in low-income countries of Central Asia and the Caucasus with low GNP per capita ratios.

Microfinance banks also serve a broader spectrum of entrepreneurs and a large portion of their portfolio is involved in loans over US\$10,000.

Credit unions are most devoted to low-end clients; however, their average loan balance increased by a third from last year, indicating that many of them shifted to provide larger loans. For NGOs/NBFIs, the depth of outreach was rather shallow compared to credit unions. Only ten NGOs/NBFIs served truly low-end segments, having a depth of outreach below 20 per cent of GNP per capita. The average loan balance slightly decreased, which meant a deepening of their outreach. In fact, 60 per cent of MFIs actually deepened their outreach, most notably the Balkan MFIs, where three-quarters of NGOs/NBFIs reached further down to poorer clients.

Commercial banks most significantly deepened their outreach by lowering the average loan size during the year but still they served a much higher segment compared to other institutional types.

Table 1.7: Average Loan Balance and Depth of Outreach by Institutional Type

	Avg. Loan Balance	Avg. Depth of Outreach	Avg. 02/03 Depth of Outreach Change	Avg. 03/04 Depth of Outreach Change
Credit unions	446	26%	-6%	35%
NGOs/NBFIs	1,142	80%	13%	-3%
NGOs/NBFIs – loans < US\$1,000	396	28%	n/a	n/a
Microfinance banks	3,971	209%	2%	-3%
Microfinance banks - loans <US\$1,000	495	65%		
Downscaling banks	4,395	332%	-13%	-23%
Downscaling banks - loans < US\$1,000	451	72%	n/a	n/a

In order to better understand the extent to which low-end clients are served, an analysis of the portfolio by loan size was conducted. The loan portfolio was divided into five groups for loans below US\$1,000, up to US\$5,000, up to US\$10,000, up to US\$50,000 and over US\$50,000.

In the case of NGOs/NBFIs, 90 per cent of active borrowers use loans below US\$5,000, which account for three-quarters of the loan portfolio. Despite the high average loan balance of microfinance banks, borrowers with loans below US\$5,000 constitute over 60 per cent of their clientele; however, these banks also serve high-end SME clients, which although less numerous make up more than half of the loan portfolio. This indicates that banks serve a larger range of borrowers with a significant volume of loans to small and medium-size businesses.

For NGOs/NBFIs, the deepest outreach was observed in Russia/Belarus/Ukraine and the Caucasus, where the average loan balance was around 50 per cent of GNP per capita (see Table 6.3 in Annex I).

However, NGOs/NBFIs tend to scale up over a period of time through diversification of their clientele, to include not only low-end microentrepreneurs but also some segments of better-off clients.

It was found that institutions that target female borrowers usually have deeper outreach. Women belong to the

Figure 1.11: Distribution of Loan Portfolio by Loan Size

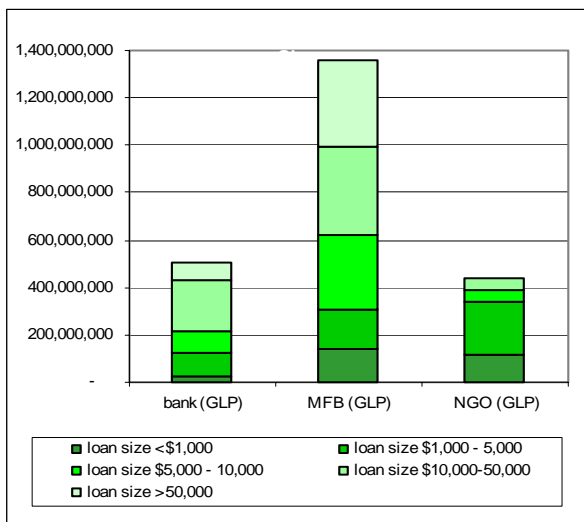
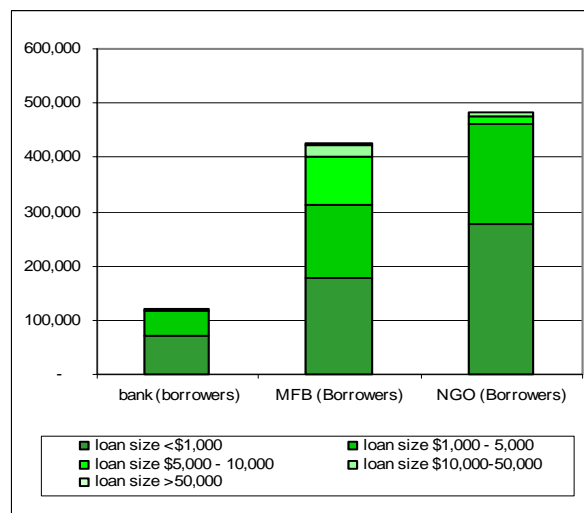


Figure 1.12: Distribution of Active Borrowers by Loan Size



poorest group of MFI clients – institutions for whom at least three-quarters of their clients are women, reported on average 50 per cent depth of outreach. As women usually run smaller enterprises than men, they are served by more poverty-focused MFIs. They are more often served by NGOs rather than banks.

Although there is a commonly held opinion that lending to female clients is less risky, and at the same time less profitable, there is no statistical relationship between percentage of female clients and portfolio at risk or return on assets.

Table 1.8: Performance of NGOs/NBFIs by Percentage of Women Served

Share of Female Borrowers	Avg. Loan Balance	Depth of Outreach
0-25%	1,916	134%
25-50%	1,163	94%
50-75%	1,111	74%
75-100%	526	39%

Chapter 2. Financial Performance⁵

Profitability

NGOs/NBFIs and microfinance banks continued to improve their financial position. The majority of MFIs surveyed were operationally self-sufficient, showing a strong focus on reaching financial independence.

Figure 2.1: Sustainability of NGOs/NBFIs

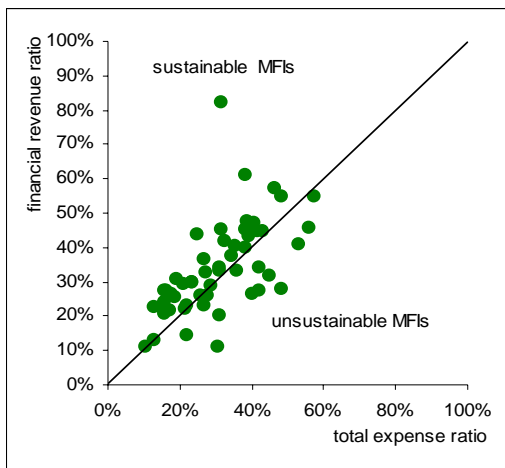
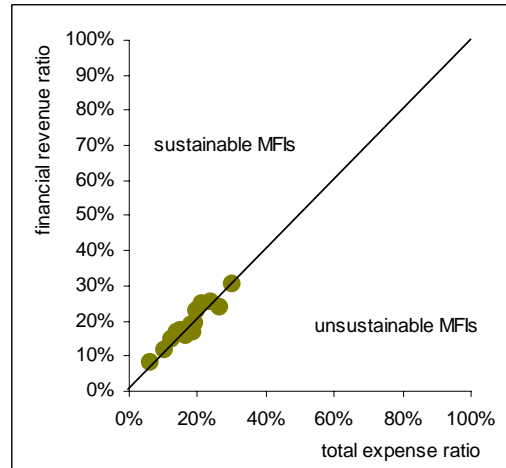


Figure 2.2: Sustainability of Microfinance Banks



Financial revenue ratio = financial revenue/avg. total assets
 Total expense ratio = total expense/avg. total assets

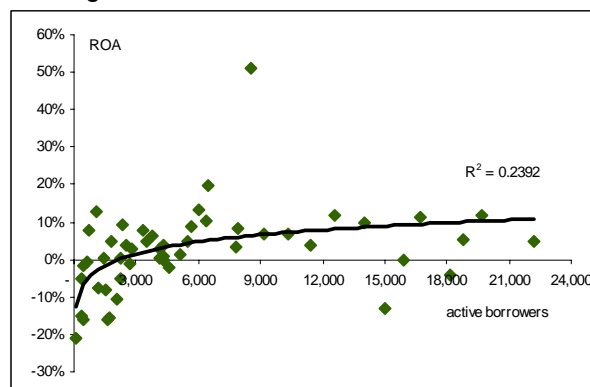
NGOs/NBFIs were on average more profitable than microfinance banks, both in terms of operating self-sufficiency and return on assets, which ranged from -20 per cent to as much as 50 per cent. There were already 69 operationally self-sufficient NGO MFIs compared to 57 such institutions last year.

With a few exceptions (younger institutions), microfinance banks had a positive return on assets; however, in all cases it did not exceed 3 per cent.

Table 2.1: Profitability of NGOs/NBFIs and Microfinance Banks

	Avg. AROA ⁶	Avg. OSS ⁷
Microfinance banks	0.3%	114%
NGOs/NBFIs	2.1%	133%

Figure 2.3: Return on Assets of NGOs/NBFIs



R² for this trend line was 0.24, which was quite a good result in statistical terms. R² shows the degree to which the trend line explains the relationship between two factors.

⁵ The analysis was performed on data from 15 microfinance banks and 52 NGOs/NBFIs. Financial data of credit unions and downscaling banks were not available.

⁶ AROA – Adjusted Return on Assets = Adjusted Net Operating Income, net of Taxes/Avg. Total Assets

⁷ OSS – Operational Self-Sufficiency = Financial Revenue/(Financial Expense + Net Loan Loss Provision Expense + Operating Expense)

For all NGOs/NBFIs, the scale of outreach (number of active borrowers) was influencing profitability. For MFIs that reached fewer than 3,000 clients it was much more difficult to establish sustainable operations and therefore they were predominantly unprofitable.

No correlation was found between profitability and the size of the loan portfolio or the asset base.

No trade-off was observed between profitability and depth of outreach. NGOs/NBFIs serving low-income clients were able to be just as profitable as their counterparts serving better-off clients, indicating that it is possible to achieve a double bottom line. It shows that when appropriate services are offered, clients are willing to cover the costs connected with their delivery and therefore allow the MFI to be sustainable.

Table 2.2: Profitability of NGOs/NBFIs by Sub-Region

	Avg. AROA	Avg. OSS
Balkans	5.7%	141%
Caucasus	-0.1%	126%
CEE	-6.6%	111%
Central Asia*	5.6%	142%
Russia/Belarus/Ukraine	-2.5%	126%

*One significant outlier with very high profitability was removed from the sample

The most profitable NGOs/NBFIs were those that achieved high profit margins by generating high financial revenues and retaining low expenses. Among them were MFIs that operated predominantly in Central Asia and the Balkans. These two groups of NGOs/NBFIs were quite distinctive in their characteristics. Central Asian MFIs were usually financed from donor funding and in view of diminishing donor presence in the region adopted a strategy of funding their growth from reinvested profits. Such profits were possible thanks to high portfolio yields in areas of high demand for financial services where banks had very little to offer microentrepreneurs. Balkan NGOs/NBFIs, on the other hand, were more mature and were already using commercially priced borrowing to fund their portfolio; achieving high profitability allowed them to attract more commercial investors. Unlike Central Asian MFIs, such profits were achievable through a low cost structure rather than high portfolio yields (see Figure 2.8).

In fact, the yields of Balkan MFIs decrease every year as the market becomes more competitive, so only the low cost structure can ensure higher returns. Most of the MFIs that did not reach financial sustainability were located in CEE and were usually small and donor-dependent. Often they focused on disadvantaged groups of entrepreneurs. For microfinance banks, there was no clear relation between the level of profitability and institutional characteristics, as most of the institutions achieved similar results.

Portfolio Yields

Nominal portfolio yield on loan portfolio varies greatly among institutional types and sub-regions.

Microfinance banks have much lower yields, reflecting their larger loan size and bigger scale of operations, which allow for cost reductions and therefore the possibility of offering cheaper products. NGOs/NBFIs on the other hand provide smaller loans, they often serve more difficult client groups, and their loans are mostly uncollateralized and therefore carry higher risk. They also often work in regions of high demand where clients have no access to formal

financial services and are willing to pay a higher price, which is still a cheaper alternative compared to credits offered by local informal lenders.

Compared to 2003, the majority of institutions experienced a decrease in portfolio yields. More than half of microfinance banks and two-thirds of NGOs/NBFIs decreased their yield. This was caused by two factors – increasing competition and improving efficiency. Competitive pressure mobilized MFIs to review their pricing strategies in order to be able to offer products at a lower price. As they grow over time, MFIs are able to benefit from economies of scale and run their operations more cost-effectively. They can then pass these savings on to their clients by lowering interest rates.

In the sub-regions, Caucasian NGOs/NBFIs in particular decreased their yields. Incidentally, they indicated the strongest competitive pressure from other NGOs/NBFIs, so decreasing the interest rates was a means to surpass other MFIs and attract more clients. The degree of fear of competition from NGOs/NBFIs was for this sub-region correlated with the degree of decrease in the yield.

Table 2.3: Nominal Portfolio Yields by Sub-Region

	NGOs/NBFIs			Microfinance banks		
	2004 Portfolio Yield	Avg. 03/04 Change	Share of MFIs with Decreased Yield	2004 Portfolio Yield	Avg. 03/04 Change	Share of MFIs with Decreased Yield
Balkans	28%	-19%	74%	20%	-8%	71%
Caucasus	48%	-22%	79%	32%	24%	50%
CEE	29%	-7%	67%	18%	0%	50%
Central Asia	48%	-18%	50%	37%	-14%	100%
Russia/Belarus/Ukraine	45%	-3%	60%	23%	12%	0%
All sub-regions	39.5%	-16%	68%	24%	-1%	60%

Revenues and Expenses

As MFIs price their products based on the cost of provision of services, financial revenues are highly correlated with expenses. Microfinance banks had both lower revenues and expenses compared to NGOs/NBFIs.

Table 2.4: Financial Revenue and Total Expense Ratio of NGOs/NBFIs and Microfinance Banks

	Financial Revenue Ratio	Total Expense Ratio
NGOs/NBFIs	33.8%	30.8%
Microfinance banks	18.6%	18.1%

For both NGOs/NBFIs and microfinance banks, revenues and expenses were higher among institutions with a smaller asset base. Larger MFIs, on the other hand, were able to work out a low operating cost structure, which allowed them to offer more competitive products and reach more clients. Even though they had higher leverage and used more costly external sources of funds (borrowings, savings) this did not affect their cost structure but allowed them to grow and create more efficient institutions.

Among NGOs/NBFIs, several other factors influenced the revenue and expense levels.

Institutions that generated higher revenues also had higher expenses and operated in lower-income countries with low financial depth.⁸ These are countries where financial intermediation is limited and economic problems have still not been fully addressed. Demand for financial services is not sufficiently addressed by the formal financial sector. Having limited access to sources of finance, entrepreneurs are willing to pay higher interest rates on loans from MFIs, which allows them to cover their costs.

Figure 2.4: Financial Revenue and Total Expense Ratio

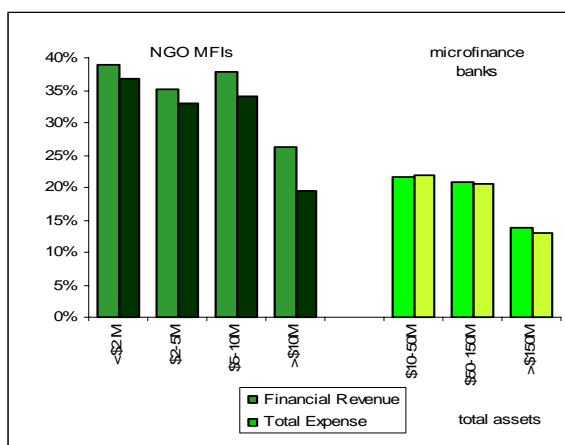
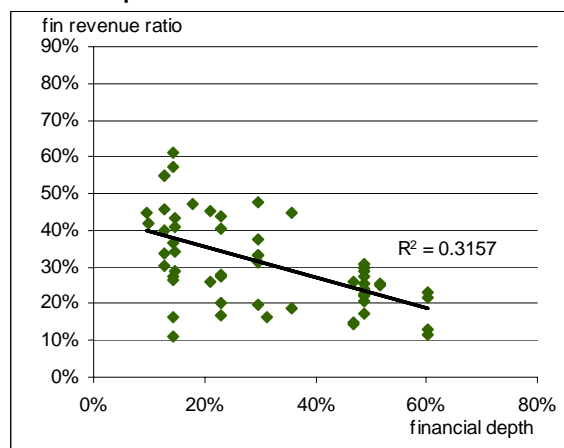


Figure 2.5: Correlation between Country Financial Depth and MFI Financial Revenue Ratio



R² for this trend line was 0,32 which was a very good result in statistical terms. R² shows the degree to which the trend line explains the relationship between two factors.

Even though serving a smaller loan is less time-consuming as client assessment and disbursement procedures are simplified, the volume of transactions during the year is usually higher because of the shorter term of small loans. Therefore, delivering small loans requires more effort from the MFI staff, leading to higher personnel costs among those NGOs/NBFIs that serve poorer clients and concentrate on female borrowers. Understandably the poverty level of clients did not influence the administrative or financial expense. Only the number of rural borrowers had an impact on administrative expenses, as the cost of rent was significantly lower in non-urban areas. This held particularly for countries with an inflation rate above 6 per cent⁹ – there, MFIs engaged in rural lending were able to have lower expenses compared to those working with urban clients.

At the same time, NGOs/NBFIs that served lower-end clients were able to earn higher revenues. These clients are willing to pay a higher price as they do not have access to services of formal banking institutions. This indicates that there is no trade-off between an MFI achieving its financial and social goals.

⁸ Financial depth (IMF) - ratio (in per cent) of broad money, which includes currency in circulation and bank deposits, to GDP

⁹ Countries with inflation rate above 6 per cent included: Armenia, Azerbaijan, Bulgaria, Kazakhstan, Kyrgyzstan, Moldova, Romania, Russia, Serbia, Tajikistan and Ukraine.

Figure 2.6: Financial Revenue and Personnel Expense Ratio of NGOs/NBFIs by Depth of Outreach

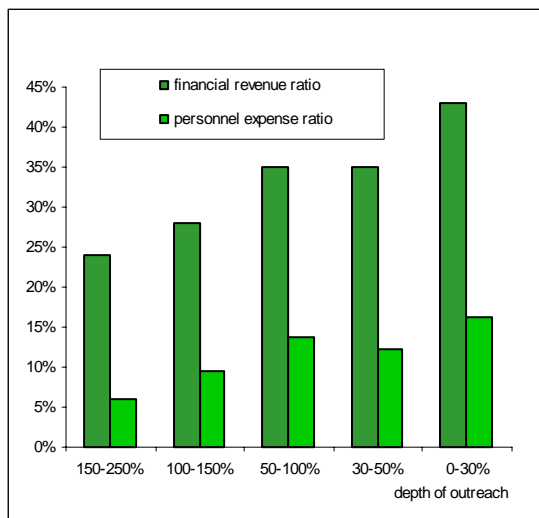
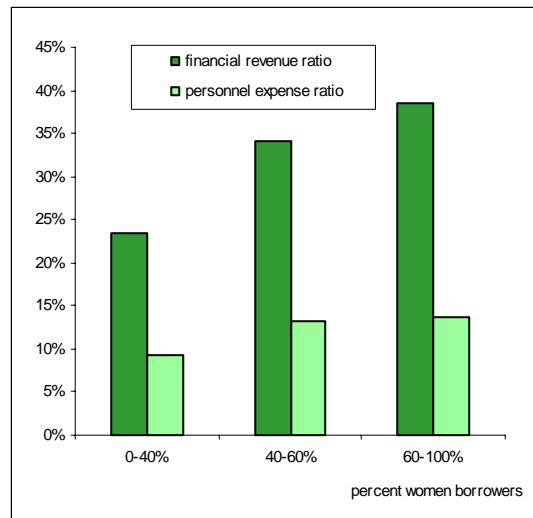


Figure 2.7: Financial Revenue and Personnel Expense Ratio of NGOs/NBFIs by Share of Women



Microfinance banks, because of their scale and their targeting of higher-income entrepreneurs, had lower expenses than NGOs/NBFIs. However, when looking at different types of expenses, the average financial expense was on the same level for both institutional types. Even though banks use more commercial funds (borrowing from financial institutions, savings) their average financial cost is comparable to that of NGOs/NBFIs who incur the inflation-adjusted cost of capital.

However, the differences were observed in the share of each expense type. In the case of NGOs/NBFIs, the largest expense category was personnel, while administrative costs were relatively lower. This indicates that NGOs/NBFIs to a greater extent allocated their resources to personnel rather than infrastructure. This is linked to a different approach to client service, as NGOs/NBFIs spend more time in the field visiting their clients. Additionally, the majority of them do not handle cash disbursements and repayment but rather outsource these services to local banks. Therefore, they do not require so much in terms of office space and security.

Figure 2.8: Revenue and Expense Structure of NGOs/NBFIs

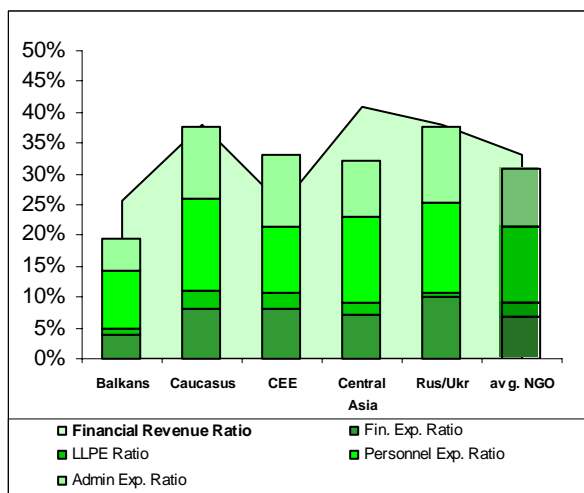
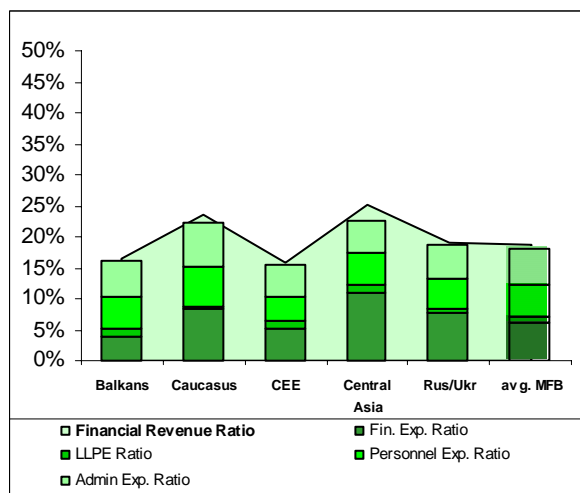


Figure 2.9: Revenue and Expense Structure of Microfinance Banks



Productivity

MFIs differ in the productivity of their staff depending on the type of clients they serve as well as the size of the MFI. MFIs with deeper outreach had more productive staff. As serving smaller loans is less time-consuming and client assessment and disbursement procedures are simplified, staff caseload among MFIs serving low-income clients was higher. The same was observed among MFIs serving predominantly rural clientele, where solidarity groups were often larger and group leaders carried out a client pre-screening process, thus easing that burden on the MFI. Larger MFIs, both in terms of scale and outreach, had more productive staff, resulting from the fact that such institutions were better managed and had more experienced loan officers who could handle larger workloads.

Even though group lending methodology was predominantly employed to serve smaller loans, no difference was observed in the average year-end caseload per staff member in comparison to the individual lending methodology. This was because many MFIs employed a modified group methodology where the solidarity group was formed only to provide the mutual guarantee, but each loan was disbursed individually to each group member.

However, a difference was observed in the number of loans disbursed during the year per staff member, which was twice as high in the case of group lending. Again, this relates to the terms of group loans, which are most often smaller and over a shorter period of time, therefore more clients are served during a year.

Table 2.5: Staff Productivity by Methodology

Methodology	Avg. Number of Loans Disbursed During the Year Per Staff Member	Avg. Number of Active Loans at Year-end Per Staff Member
Individual	90	87
Group	182	85

Better staff productivity resulted in higher profitability. A higher number of borrowers per staff member decreased the administrative expense ratio, as the MFI was able to achieve scale without increasing its infrastructure. This did not cause an increase in personnel expense, which indicates that well-balanced incentive schemes can effectively increase workload without negatively impacting on personnel expenses. At the same time, staff productivity was positively influenced by salary levels relative to GNP per capita. The MFIs that offered better financial conditions to their employees benefited from a higher number of borrowers per staff member. Importantly, high salary levels did not influence personnel expenses. This indicates that effective staff incentive schemes can increase an institution's productivity without any significant burden on the cost of labor.

NGOs/NBFIs were more productive than banks, and the most productive ones operated in the Balkans where the largest institutions were present.

Table 2.6: Staff Productivity by Sub-Region

	NGOs/NBFIs	Microfinance banks
Balkans	132	60
Caucasus	102	77
CEE	40	46
Central Asia	71	65
Russia/Belarus/Ukraine	44	29
ECA Average	92	57

Portfolio Quality

Although NGOs/NBFIs have a slightly weaker quality of loan portfolio than microfinance banks, they have very good delinquency management. Of all institutions, only seven had over 5 per cent of portfolio in loans more than 30 days overdue. This shows that MFIs are able to assess the repayment capacity of their clients and structure the loan terms accordingly. At the same time, proper guarantee schemes allow MFIs to recover two-thirds of overdue loans, making a loan loss rate of 0.8 per cent.

NGOs/NBFIs in ECA have a very conservative provisioning strategy, as in many countries regulations require them to establish reserves not only for portfolio at risk but also for the healthy portion of the portfolio. Therefore, on average, the reserves for loan losses are four times higher than the actual portfolio at risk (PAR).

Table 2.1: Staff Productivity by Institutional Type

	PAR > 30 days
Microfinance banks	0.8%
NGOs/NBFIs	2.1%

Institutions with a higher PAR ratio had higher expenses connected with creating loan loss reserves, and were less profitable. These two factors correlated significantly, indicating that poor portfolio management does not allow the institution to be financially successful. On average, unprofitable institutions with negative return on assets (ROA) had three times higher PAR>30 than their profitable counterparts.

Chapter 3. MFI Resources

Sources of Funding

The following funding sources were available for MFIs:

Equity

- paid-in equity or shareholders' equity for MFIs with clear ownership structure
- grants – donated equity provided by development agencies or charity foundations; these funds predominantly originated from public sources
- retained earnings – surplus income generated from MFI operations

Liabilities

- subsidized debt – no-interest or low-interest loans from donor agencies or international finance institutions (IFIs) that come from public (government) sources or socially-oriented investors
- commercial debt:
 - loans from international investment funds that are privately run but more than half of their capital comes from government sources;¹⁰ they are more commercially oriented than IFIs but still accept lower returns and take higher risk than purely commercial profit-maximizing investors
 - Loans from local private sources such as domestic banks
- savings – retain deposits from population or from financial institutions used by licensed deposit-taking institutions

The extent to which MFIs use different sources very much depends on each MFI's legal status, age, size and the country of operations and donor landscape. Unregulated NGOs and NBFIs, which in ECA are not allowed any deposit-taking activities, have a quite different funding structure compared to that of licensed microfinance banks or credit unions.

Microfinance banks, as regulated financial institutions with a clear ownership structure, have much higher potential to access external funding, thus they can more easily leverage their own resources. For an average microfinance bank, the level of debt (including deposits) to equity exceeded seven, indicating that they attracted seven times as much external funds as their equity base.

This leverage has remained the same compared to the previous year, which may indicate that the banks have found the optimal balance between borrowed and own funds. However, the structure of external funding has changed, as more than half of them constituted client deposits, a share of which increased slightly compared with 2003. The share of concessional loans dropped as banks moved towards more commercial sources.

Although complete information was not available for credit unions, the vast majority of them engaged in deposit taking where as much as 80 per cent of total assets was funded from members' savings. On the other hand, however, there were credit unions (particularly some of those established by international agencies) that had more limited deposit-taking activities and were funded from international commercial or subsidized sources.

¹⁰ 'The Market for Foreign Investment in Microfinance: Opportunities and Challenges', CGAP Focus Note No. 30, August 2005

NGOs/NBFIs, on the other hand, relied chiefly on equity. Their debt to equity ratio averaged 2.6 but this value was skewed towards larger MFIs. In fact, for half of the institutions the value of liabilities did not exceed 30 per cent of equity. Grants remained the main funding source but for an average NGO/NBFI, their share decreased over the past year by 10 per cent in favor of borrowed funds, both commercial and concessional.

Figure 3.1: Funding Sources of NGOs/NBFIs

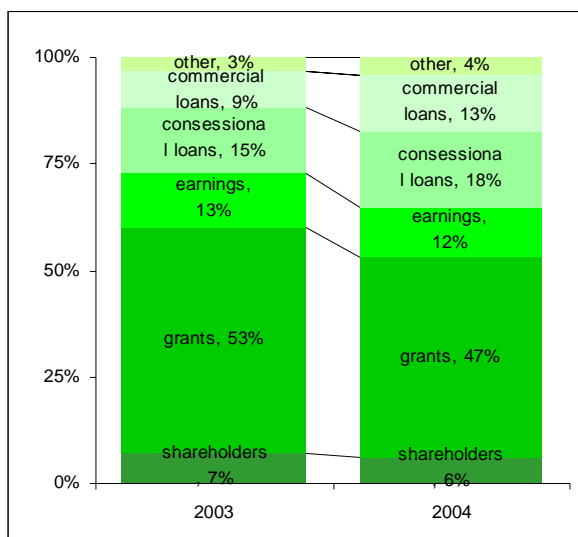
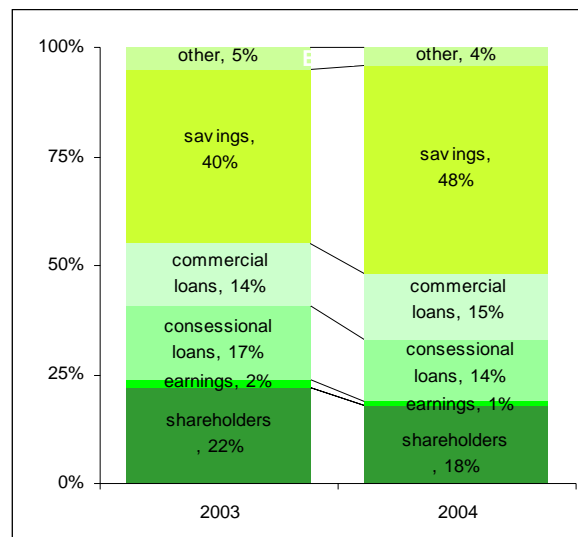


Figure 3.2: Funding Sources of Microfinance Banks



On average, funding in an NGO/NBFI was structured as follows: 66 per cent funded from equity and 34 per cent from liabilities. The capital/asset ratio was correlated with age and size and decreased with the growth of an institution. Larger and older MFIs predominantly used borrowed funds while the small ones relied on donor equity. For half of the institutions the capital/asset ratio was greater than 76 per cent and these were mostly small MFIs with less than US\$5 million in the loan portfolio.

With age, MFIs gain experience and learn liability management, and therefore can start using borrowings. In ECA a visible increase in leverage happened, on average, after five years in operation. At that stage MFIs most often utilized subsidized loans, which were long term and carried a lower price, allowing these MFIs to grow without significantly affecting their profitability. MFIs that had been operating for more than eight years had on average the highest leverage and already funded one-third of their portfolio from commercial sources.

Table 3.1: Capital Asset/Ratio and Commercial Funding Liabilities Ratio of NGOs/NBFIs by Age

Age	Avg. Capital/Asset Ratio ¹¹	Avg. Commercial Funding Liabilities Ratio ¹²
0-4 years	76%	4%
5-8 years	62%	15%
Over 8 years	39%	31%

Larger MFIs are also better positioned towards investors, as they tend to be more professionally managed, have better internal controls and can absorb larger amounts of funding. Many investors limit their interest to those with portfolios larger than US\$3 million or US\$5 million, which allows them to achieve larger impact or profits through

¹¹ Capital/Asset ratio = Total Equity/Total Assets

¹² Commercial Funding Liabilities Ratio = Commercial Liabilities/Average Gross Loan Portfolio

fewer deals. Additionally, the scale and experience of these MFIs allowed them to run the operations cost-effectively and therefore absorb higher financial costs. However, the largest NGOs/NBFIs in the ECA region (over US\$10 million in loan portfolio) remained predominantly funded from donor equity and concessional loans and their use of commercial funds was very limited. They were able to achieve such size thanks to strong support from development organizations, which continued to finance them despite their capacity for more commercial exposure. In total, these institutions were using 64 per cent of the total volume of concessional loans engaged in the region.

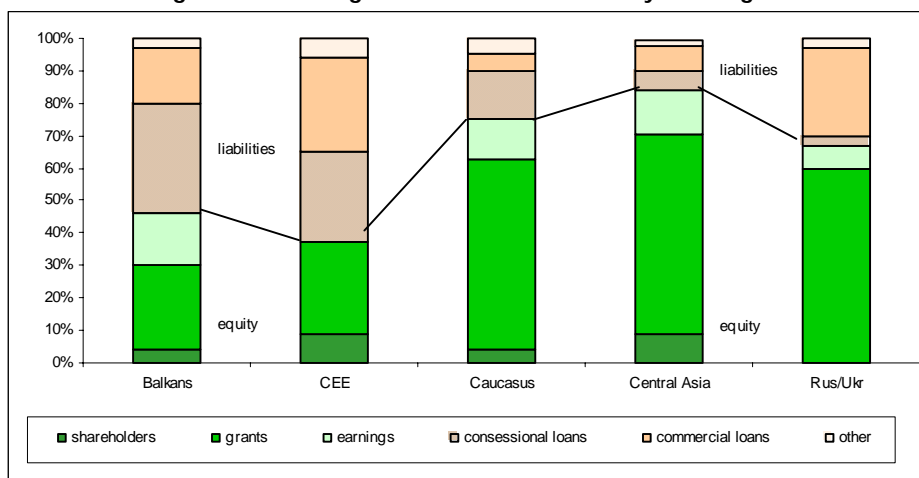
Table 3.2: Capital Asset/Ratio and Commercial Funding Liabilities Ratio of NGOs/NBFIs by Loan Portfolio Size

Gross Loan Portfolio	Avg. Capital/Asset Ratio	Avg. Commercial Funding Liabilities Ratio
Up to \$ 1 million	86%	5%
1 – 4 million	69%	15%
4-10 million	43%	26%
over 10 million	51%	12%

It is important to note that there were a number of MFIs that did not follow the general path of moving from grant funding to private borrowing by going through an intermediate phase of using concessional funds of non-commercial investors. In view of the scarcity of public funds, some younger and smaller but profitable MFIs were using commercial debt.

Large differences were observed among MFIs in the sub-regions. In more economically advanced countries with higher financial depth,¹³ institutions were better leveraged. These MFIs operated in the Balkans and Central and Eastern Europe and were often registered as non-bank financial institutions which, as opposed to the status of a foundation, means they can operate on a commercial basis and attract funds from formal financial institutions. Interestingly, in Russia/Belarus/Ukraine as well as in Central Asia, the majority of borrowed funds were commercial, indicating that MFIs had very limited exposure to socially responsible lenders and either utilized grants from donors or commercial borrowing.

Figure 3.3: Funding Sources of NGOs/NBFIs by Sub-Region



13 Financial depth (IMF) - ratio (in per cent) of broad money, which includes currency in circulation and bank deposits, to GDP

Infrastructure and Employees

As microfinance banks run much larger operations, have more clients and also offer a wider range of products, their staff is more numerous compared to NGOs/NBFIs. However, due to the different nature of operations, product types and security reasons, bank branches are larger, serving more borrowers per branch. NGOs/NBFIs, on the other hand, tend to go more into the field and open smaller branches that reach fewer clients.

Table 3.3: Employees and Infrastructure of NGO/NBFIs and Microfinance Banks

	Avg. Number of Employees	Avg. Number of Offices	Avg. Number of Borrowers per Office
NGOs/NBFIs	57	11	510
Microfinance banks	522	19*	915

*except for Khan Bank that operates through 400 offices

In terms of employee structure, women constitute half of the workforce, on average 51 per cent of total staff. Women most often take back-office positions rather than occupy managerial positions; only two in five managers are women. There are even fewer women on boards of directors. Microfinance banks tend to employ women both as front-office and back-office staff more than NGOs/NBFIs do. However, when it comes to management positions, NGOs/NBFIs tend to have more women executives than banks have. The exceptions are microfinance banks in the CEE sub-region, where women dominate at all levels of employment.

Table 3.4: Women Employees at NGOs/NBFIs and Microfinance Banks

	Avg. Share of Women Among Staff	Avg. Share of Women Among Front-Office Staff	Avg. Share of Women Among Back-Office Staff	Avg. Share of Women Among Managers	Avg. Share of Women Among Board Members
NGOs/NBFIs	50%	48%	51%	44%	38%
Microfinance banks	62%	61%	64%	34%	37%
Both institutional types	51%	49%	53%	42%	38%

NGOs/NBFIs that focus on female clients also have more women among their staff, especially as front-office staff.

Products

Types of loan products

Credit unions have the most diversified products as they often serve both business and non-business clients, providing them with a wide range of products adjusted to various needs. The largest number of different loan types was observed at one of the largest Polish credit unions where a borrower had a choice of 12 different loans.

Microfinance banks offer a variety of products (on average six types of loans products) both for micro- and small enterprises as well as salaried workers.

NGOs/NBFIs serve a more limited clientele concentrating on microentrepreneurs and providing them with predominantly business loans and to some extent agricultural and consumer loans. On average, an NGO/NBFI offers four types of loans. The Balkan NGOs/NBFIs have on average the most diversified range of loans, while Central Asian MFIs have the least differentiated products.

Downscaling banks offer the smallest number of loans for microbusinesses and usually they have two or three business loans that differ in size and repayment period, as such loans constitute only a small share of all bank activities.

Business loans (for trade, production and services) prevail among loan types. For both NGOs/NBFIs and microfinance banks, business loans account for 70-80 per cent of their loan portfolio and active clients. Agricultural loans account for about 14 per cent of all loans. Both microfinance banks and NGOs/NBFIs have about half of their borrowers in rural areas and over 60 per cent of these clients are using loans for agribusiness. The rest of rural borrowers use general business loans either because they run non-agricultural enterprises or have to use general-purpose business loans in the absence of specialized loans for agricultural production. However hard it is to judge how many rural clients are engaged in agricultural activities, it seems that MFIs have not yet developed a satisfactory range of agricultural products and many rural clients use business loans for general purposes to finance agricultural activities. The lowest ratio was observed in the Caucasus, where only one in three rural clients had access to agricultural loans.

Except for credit unions, consumer loans are regarded as a complementary product as they were provided to less than 3 per cent of NGO/NBFI clients and 10 per cent of microfinance bank borrowers. They were mostly short-term loans of the smallest amount, which were used to smooth household consumption flows.

Housing loans are the newest product, as only 10 per cent of NGOs/NBFIs and one-third of microfinance banks across the region provided them to their clients. These were loans for a mortgage for construction of a new domicile or for renovation/repair of the existing one, provided chiefly in the Balkans and Central Asia.

Lending methodology

From three methodologies used in microfinance (solidarity group loans, individual loans and village banking), individual lending was the most popular methodology in ECA. It was used by downscaling banks and the majority of microfinance banks as well as NGOs/NBFIs. Some microfinance banks – those that had transformed themselves from NGOs – were also using solidarity group lending. Group loans were used particularly by clients of NGOs/NBFIs,

Figure 3.4: Average Number of Loan Products

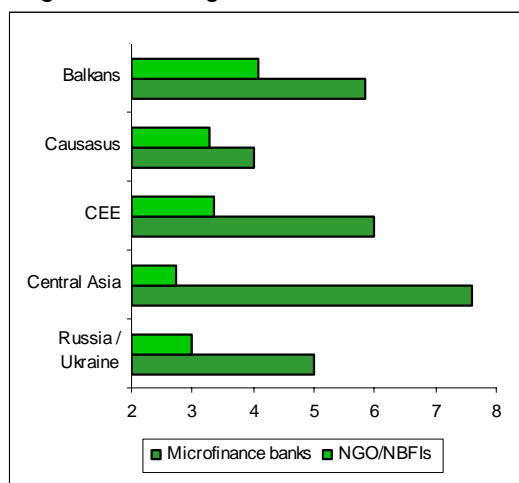
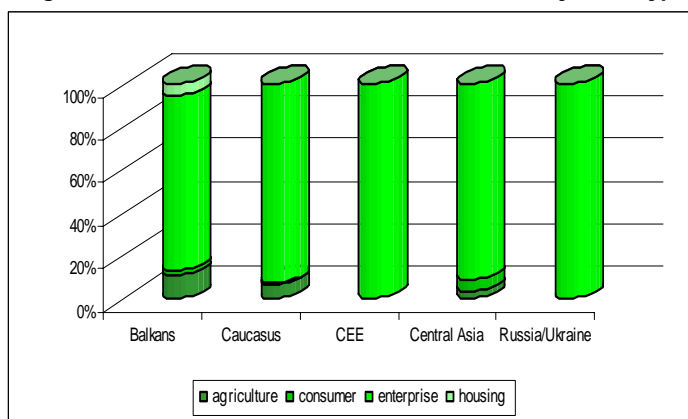


Figure 3.5: Distribution of NGO/NBFI Borrowers by Loan Type



especially low-end clients who ran smaller businesses and lacked collateral to guarantee a loan. An average size of a disbursed group loan reached US\$672, while individual loans averaged US\$3,845.

This methodology was in most cases adapted to better suit the local context following the Latin American model, where all group members received a loan at the same time and the group only served as a guarantee mechanism. In many cases, such group clients were served more like individual clients in the respect that the loan conditions were adjusted to their individual needs and each client had a management information system (MIS) record where his or her loan was tracked separately.

Individual loans were just as popular among NGO/NBFI clients, with almost half of all borrowers using them. MFIs that provided predominantly individual loans had a larger product range, as individual loans were used not only for enterprise but also for consumer and housing loans.

Not many NGOs/NBFIs utilized village banking. Such loans constituted less than 1 per cent of the whole gross portfolio and borrowers.

Among business loan clients, more were engaged in group loans rather than individual loans, while the opposite was observed for agricultural loans, where the majority were disbursed through individual lending.

Figure 3.6: Distribution of Borrowers by Methodology and Loan Product Type in NGOs/NBFIs

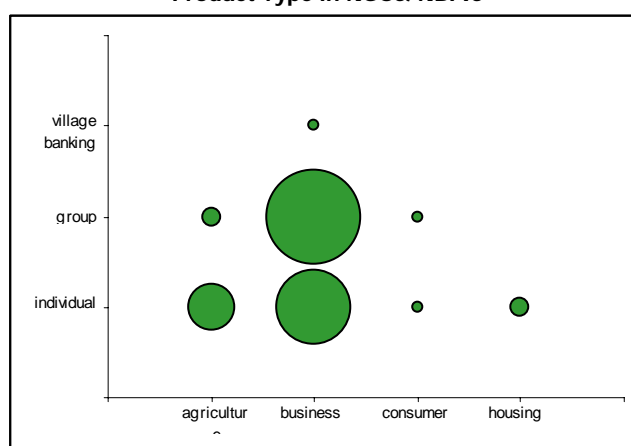


Table 3.5: Average Size of Disbursed Loans of NGOs/NBFIs by Loan Type and Methodology

		Group loans	Individual loans
Avg. Size of Disbursed Loan (US\$)	Business loans	689	4,524
	Agricultural loans	482	2,959
	Consumer loans	923	1,462
	Housing loans		4,390
Avg. Size of Disbursed Loan relative to GNP per capita	Business loans	64%	702%
	Agricultural loans	77%	269%
	Consumer loans	96%	201%
	Housing loans		495%

Other products

Microfinance banks also offered other banking services which allowed them to attract more clients and cross-sell their products as well as to increase their funding base by collecting client deposits. On average, microfinance banks offered more than four savings products, mainly current accounts or term deposits. Clients also had a choice of other savings accounts where they could save for certain purposes, like savings 'pro kids' or housing savings. The other banking products included money transfers and debit cards.

Few NGOs/NBFIs offered non-lending products like insurance or business development services and these were provided in partnership with non-microfinance institutions, such as commercial insurance companies.

Partnerships

Partnerships between NGOs/NBFIs and other institutions are still very rare in the ECA region but there are a number of good examples of how an MFI can increase its range of products without diverting from its core business of loan provision. For instance, through linking with another service provider, such as an insurance company, loan officers of an MFI act as insurance agents facilitating the acquisition of life or house insurance. Some institutions also link with a local training provider and direct their clients to training in business management. One MFI facilitated access to local markets for its clients by acting as a wholesaler of client products and negotiating better deals with local retailers.

Other examples include partnering with a local bank to provide larger loans for graduate clients where an MFI provides the amount up to its usual limit and the bank tops it up with the remaining amount that is required by the client. In such cases, the MFI took responsibility for client assessment and performance of the loan until the final repayment.

In Serbia, where the law does not allow non-bank institutions to lend, MFIs partner with local banks which disburse loans on behalf of the MFI while MFIs carry out all pre-screening and follow-up activities to ensure the repayment. The opposite example was also found, where an MFI partnered with a local NGO that identified, pre-screened and then referred potential clients to the MFI.

Among microfinance banks, the more common partnerships involve working with commercial companies for the purchase of clients' goods (most often machinery) via leasing or installment loans in the case of smaller equipment.

Market Research

MFIs appreciate the importance of market research in their performance. Ninety per cent of respondents mentioned using market research tools to improve their operations. Awareness of increasing competition led over 60 per cent of MFIs to conduct studies on their competitors. The same number of institutions were intensively looking for different ways to measure potential demand for services in present and new locations for current and new loans.

Among other topics for market research studies, MFIs mentioned client satisfaction and image awareness. Among those MFIs that had conducted market research studies, three-quarters of them introduced changes in their

Figure 3.7: Types of Market Research Performed by MFIs

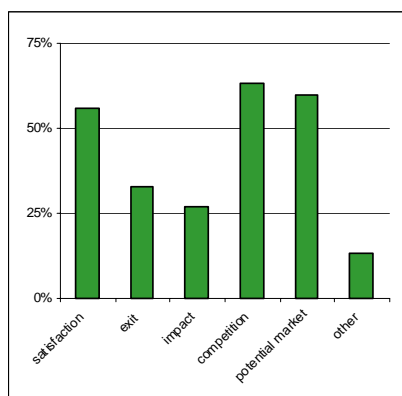
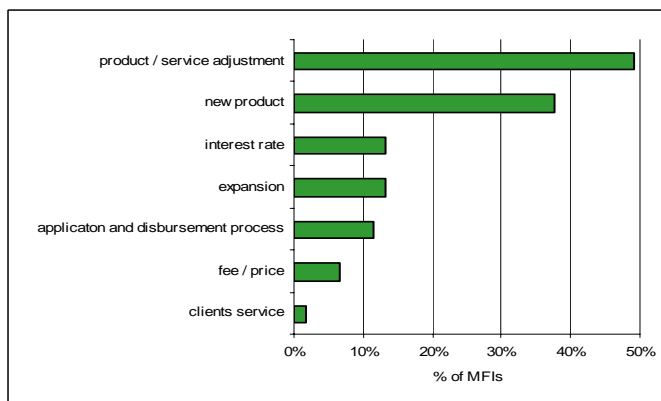


Figure 3.8: Changes Introduced after Market Research



operations based on the study findings. Major changes focused on refining existing products and services as a response to clients' needs and expectations. More than 30 per cent of MFIs introduced new products. The important areas of change were adjustments of interest rates (most often lowering them) and improving the process of loan application and disbursement. Only a few MFIs mentioned a direct change in their procedures or systems, introducing institutional innovations related to clients' service, staff incentives or staff training.

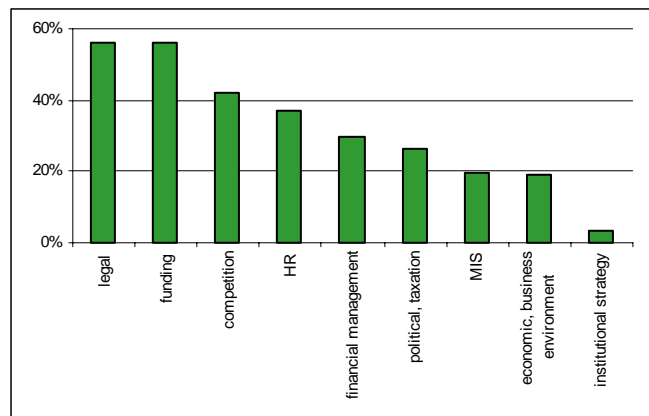
Chapter 4. Constraints to Growth

The majority of MFIs surveyed in this study perceived the following major constraints to development of their institutions: regulatory environment, competition and access to funding.

Regulatory Environment

In many countries there are no regulations governing microfinance activities, which leaves NGOs in a legal vacuum. In such circumstances, it is very difficult for an institution to prepare a long-term development strategy. In many cases the existing microfinance law is overly prohibitive, limiting the scope of operations as well as imposing caps on revenue generated from lending activities. Legal difficulties are often topped by changing fiscal regulations as well as political instability, which adds to the perception of the unknown future.

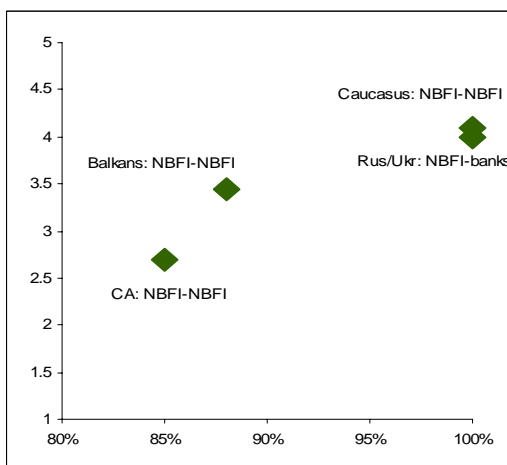
Figure 4.1: Main Constraints to Growth



Competition

With the growth of MFIs and increase of outreach, competition for the best clients intensifies. As many institutions offer similar loan products they often serve the same client group. The strongest competition was observed in the Caucasus – almost all NGOs felt quite strong competitive pressure from other NGOs. There, the majority of NGOs work with urban clients in major cities and compete through price rather than other loan conditions, different products or services.

Figure 4.2: Perception of the Competitive Pressure



In the Balkans a similar situation occurs but the MFIs there were more aware of the need to differentiate themselves from their competitors by serving new market segments and offering new products.

Only in one sub-region was the competition from other institutional types felt to be significant – in Russia/Belarus/Ukraine a wide network of bank outlets ensures quite good outreach to clients.

In most cases MFIs undertook various measures to beat the competition, usually by improving services and product terms (shorter processing time, longer loan period), introducing new products (consumer loans, agricultural loans), following a

client-oriented approach and bringing services closer to clients.

Funding

Problems with funding are most acute for NGOs/NBFIs that are still very much donor-dependent. However, as grants become scarcer in the region, MFIs are looking for other sources. Although the use of commercial sources of funding as well as own resources (net profit) gradually increases, MFIs have difficulty in attracting the required level of funds for the following reasons:

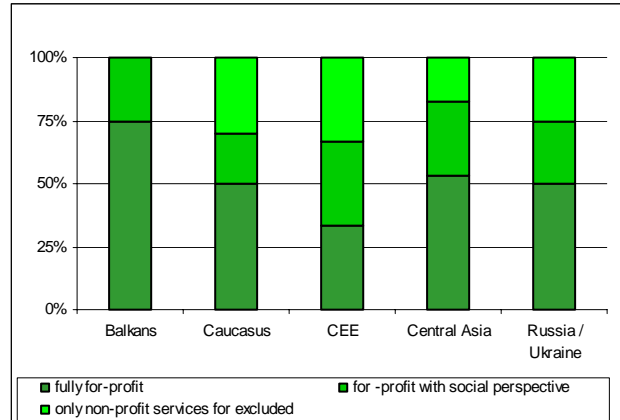
- deposit mobilization is not allowed in most ECA countries for unregulated institutions
- in a number of countries regulations prevent MFIs from using borrowed funds for on-lending
- not-for-profit status does not attract equity investors
- many MFIs do not have the capacity for proper liability management
- most borrowing is available only in foreign currency and MFIs don't have the capacity to manage currency risk
- investors have little knowledge about the institutions operating in the region and tend to approach the same few institutions that are most transparent
- MFIs lack skills in talking with investors and negotiating deals
- MFIs often lack collateral for and knowledge about guarantee funds

Chapter 5. Goals and Strategies

Long-term Business Strategy of NGOs/NBFIs

MFIs are quite vague as regards assessing the directions the microfinance industry in their country might take over the next ten years. Nevertheless, most of them expect microfinance to become integrated into the mainstream financial sector. This opinion is especially shared in the Balkans, where MFIs have evolved into strong financial institutions. Only 16 per cent of MFIs who responded expect the industry to move towards increased social performance, integration of finance with other socially oriented services (including a wider range of non-financial services) and extending outreach to excluded groups.

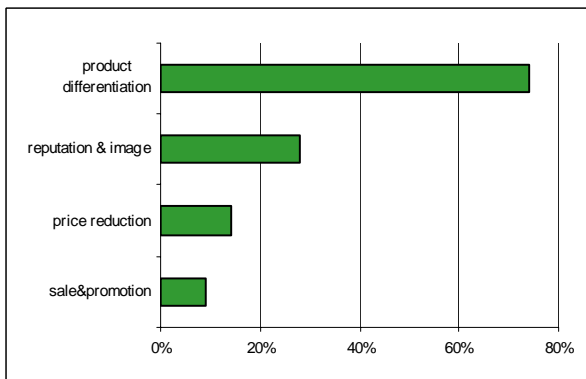
Figure 5.1: Perception of Directions of Microfinance in 10 Years



The clearest social focus is present in MFIs in the CEE sub-region, probably due to the more developed mainstream financial sector where banks have an active role already (therefore MFIs select an untapped niche).

For most NGOs/NBFIs in the ECA region, the best strategy to market their products is to differentiate themselves from their competitors, in terms of customer service, product quality and product range. Most MFIs recognize that price reduction alone does not attract clients unless the other loan conditions meet their needs.

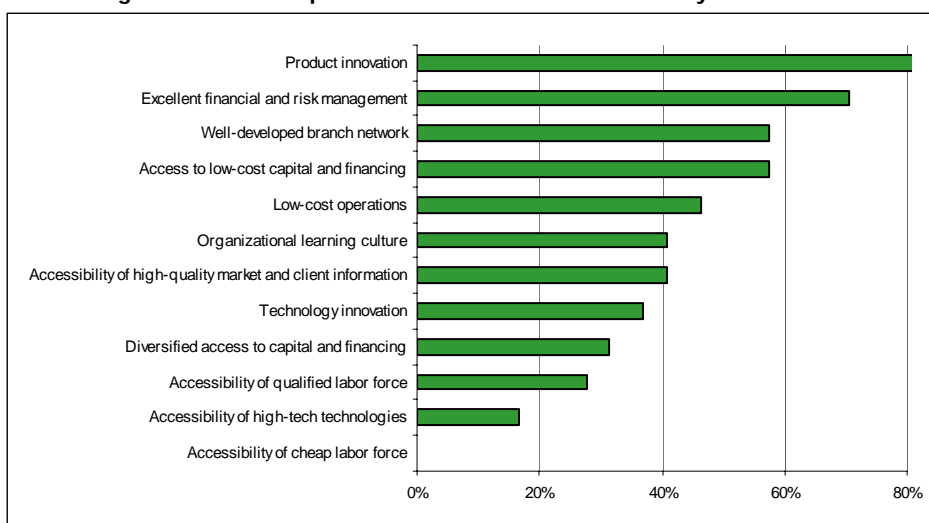
Figure 5.2: Marketing Strategies of NGOs/NBFIs



Innovation is perceived as the most important success factor for most MFIs. Offering innovative products, together with excellent financial and risk management, is key to ensuring a good position in the market. Additionally, developed infrastructure that provides good access to services increases the chances for success.

However, MFIs pay more attention to effective access to low-cost capital than to lowering their operational costs. Diversifying sources of financing is given less attention by most NGOs/NBFIs.

Figure 5.3: Most Important Success Factors Perceived by NGOs/NBFIs



Strategic Goals

MFI are quite unanimous in stating their strategic goals. Most of them aim to increase loan portfolio size and the number of active borrowers. Maintaining or improving financial sustainability and gaining larger market share often accompany these goals. Some MFIs are focusing on becoming or remaining a leader in their country or region, or in their specified domain or range of services.

The goal of institutional growth is most often realized by geographical expansion, aimed at covering an entire region or even country with a network of branches. Such an undertaking usually involves increasing the number of employees and providing training to new and current staff, increasing staff efficiency, as well as improving marketing strategies. As MFIs often mention difficulty in accessing funding as their major constraint to growth, they often decide to transform into a for-profit organization and attract equity investors as well as local or international commercial lenders.

The third, very common way of achieving the strategic goals mentioned above is developing a wider range of products. This includes introducing new, often innovative products, refining existing products and adjusting them to meet clients' needs.

Some MFIs connect reaching strategic goals with focusing on the specified target group. Most often they mention micro and small entrepreneurs as the group with the biggest potential to contribute to a general rise in employment and improvement in living conditions. Another key target group are rural borrowers. Only a few MFIs focus on excluded people, trying to reach them with efficient financial services and products.

Among socially oriented MFIs, one of the strategies for achieving greater outreach is working on improving the legal framework, mainly through cooperation with government, participating in international programs or creating partnerships with other MFIs. The quality of MFIs' strategic goals and ways of achieving them are improving. They are more precise, and clearly distinguish goals from the strategy to achieve them. It seems most MFIs treat the microfinance industry as a business opportunity, planning to reach well-defined targets in terms of both their social and financial impact.

Annex I. Institutional Types of MFIs

Credit Unions

Credit unions constitute the most widespread group of MFIs in the ECA region. Their number reached nearly 6,500 and they were most active in CEE (especially in Poland and Romania), where they had the largest share of the loan portfolio and served the majority of all credit union borrowers. Russian and Ukrainian credit unions cover the bulk of the remaining borrowers, but the clients take smaller loans.

Table 6.1: Scale and Outreach of Credit Unions by Sub-Region

	N	Gross Loan Portfolio	Share of GLP	Number of Active Borrowers	Share of Active Borrowers	Value of Savings	Share of Value of Savings	Number of Savers	Share of Savers
Balkans	139	21,418,023	1%	12,410	1%	3,445,978	0%	10,282	0%
Caucasus	53	620,673	0%	7,045	0%	384,135	0%	11,742	0%
CEE	4,167	1,284,428,088	79%	1,609,116	69%	1,633,356,322	96%	2,646,394	87%
Central Asia	319	13,329,362	1%	23,774	1%	2,085,051	0%	2,013	0%
Rus/Bel/Ukr	1,665	296,180,227	18%	689,692	29%	63,668,319	4%	365,933	12%
Total	6,343	1,615,976,373	100%	2,342,037	100%	1,702,939,804	100%	3,036,364	100%

Of all MFIs, credit unions were the leaders in collecting deposits as they managed 60 per cent of the whole savings value. However, only in CEE were savings the main funding source for the loan portfolio – in any other sub-region savings reached much lower levels and except for the Caucasus where they funded half of the loan portfolio they were 5-7 times lower than the value of loans.

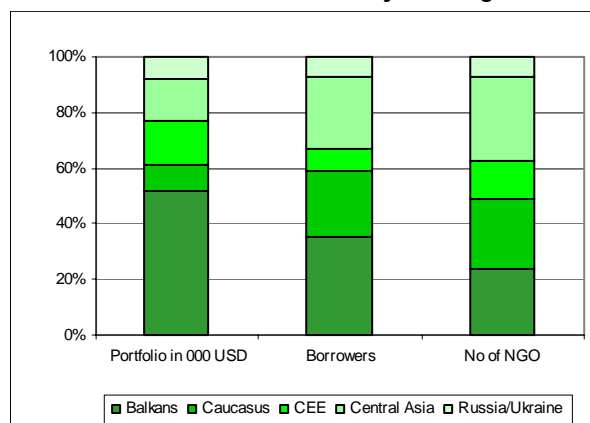
Of all MFIs, credit unions were also providing the smallest loans. Their depth of outreach averaged 29 per cent due to the fact that the majority of them offered very short-term consumer loans to largely salaried workers, although in many cases they were used for entrepreneurial activities of family members.

Non-Governmental Organisations and Non-Bank Financial Institutions

At the end of 2004 there were 110 NGOs/NBFIs active in the region. The total portfolio managed by them was the smallest among all MFI types, but they had the second largest number of borrowers after credit unions. Altogether, NGOs/NBFIs managed 11 per cent of the gross loan portfolio, serving 14 per cent of borrowers.

The region with the largest NGO/NBFI presence was the Balkans, where half of the whole NGO/NBFI portfolio and one-third of all active borrowers were located. Balkan NGOs/NBFIs were also comparatively larger than their peers in other sub-regions, twice exceeding the ECA

Figure 6.1: Gross Loan Portfolio and Number of Borrowers of NGOs/NBFIs by Sub-Region



average. The smallest institutions operated in CEE with average outreach of only 2,500 borrowers.

Table 6.2: Average Scale and Outreach of an NGO/NBFI by Sub-Region

	Avg. Size of Loan Portfolio	Avg. Number of Active Borrowers
Balkans	9,525,552	6,096
CEE	4,853,148	2,423
Caucasus	1,462,253	3,973
Central Asia	2,025,378	3,619
Russia/Belarus/Ukraine	4,681,354	4,251
Total	4,175,957	4,199

NGOs/NBFIs achieved the slowest growth of all institutional types. Since 2003 the loan portfolio has grown by 49 per cent and the number of active borrowers by less than 30 per cent. The slowest growth was observed in the Caucasus. NGOs/NBFIs chiefly rely on donor grants (which are becoming less available) or on borrowed funds from international investors (which are also limited). So far, local financial markets are not yet sourced for funding on a large scale, except for Bosnia and Herzegovina, where most of the NGOs/NBFIs already have loans with at least one commercial bank. Therefore, the average debt to equity ratio of 2.6 and the median of 0.3 indicate that only a few institutions managed to leverage their own resources while the majority use predominantly equity grants from donors.

Even though NGOs/NBFIs target low-income microentrepreneurs, their loans are much larger than in other regions of the world. Only ten institutions (which account for 10 per cent) reported depth of outreach less than or equal to 20 per cent, and these were MFIs from Central Asia and the Caucasus. The upscaling trend of previous years reversed in 2004 as many MFIs moved towards serving lower-end clients, most notably in the Balkans and Russia/Belarus/Ukraine, where in view of the competition from banks and others, NGOs/NBFIs started to look for new market niches among under-served low-income populations.

Figure 6.2: 2003-2004 NGO/NBFI Portfolio Growth by Sub-Region

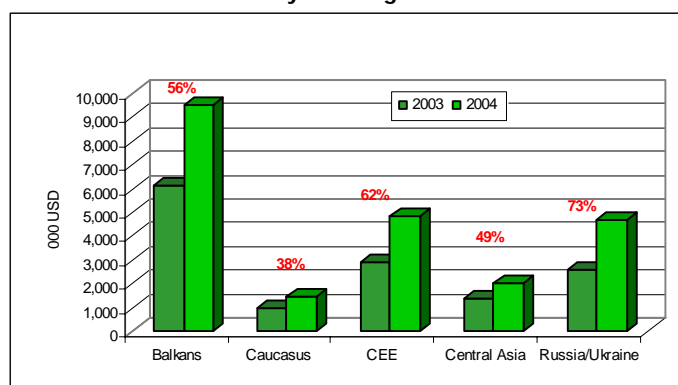


Table 6.3: Average Loan Size and Depth of Outreach of NGOs/NBFIs by Sub-Region

	Avg. Loan Balance	Depth of Outreach	03/04 Depth Change
Balkans	1,510	80%	-9%
Caucasus	544	54%	1%
CEE	2,729	117%	-1%
Central Asia	600	96%	-1%
Russia/Belarus/Ukraine	1,460	46%	-7%
All NGOs/NBFIs	1,142	80%	-3%

Like all the other institutions in ECA, NGOs/NBFIs have a strong sustainability focus and therefore in most cases are operationally self-sustainable. However, not all of them generated enough profits to account for the erosion of capital and full cost of funding. These institutions were mostly located in CEE and Russia/Belarus/Ukraine where most of them had negative returns. In the Caucasus, the negative average was severely affected by a few institutions with very negative profitability; however, most of the remaining NGOs/NBFIs there generated positive returns.

Table 6.4: Financial Performance of NGOs/NBFIs by Sub-Region

	Avg. OSS	Avg. AROA	Avg. Financial Revenue Ratio	Avg. Total Expense Ratio	Avg. PAR >30 days
Balkans	141%	6%	26%	20%	1.2%
CEE	111%	-6%	25%	33%	3.3%
Caucasus	126%	-1%	38%	38%	3.3%
Central Asia	154%	13%	49%	33%	1.0%
Russia/Belarus/Ukraine	126%	-2%	38%	38%	0.7%

Microfinance Banks

There were 16 microfinance banks in the region at the end of 2004, managing 34 per cent of the total gross loan portfolio and serving 13 per cent of all active borrowers.

Microfinance banks were most active in the Balkans, where the largest share of their loan portfolio and savings was located, and in Central Asia where Khan Bank served a remarkable number of over 100,000 active borrowers. The other microfinance banks had much smaller outreach but still well exceeded NGOs/NBFIs. The average microfinance bank had more active borrowers than the largest NGO/NBFI, and even in the section of loans below US\$5,000 an average microfinance bank had more borrowers than an average NGO/NBFI.

Table 6.5: Average Scale and Outreach of Microfinance Banks by Sub-Region

	Average Gross Loan Portfolio	Average Number of Active Borrowers (without Khan Bank)
Balkans	81,675,563	17,459
CEE	130,154,027	19,508
Caucasus	36,101,062	9,747
Central Asia	na	na
Russia/Belarus/Ukraine	179,826,636	27,427
All microfinance banks	87,786,360	19,772
Microfinance loans <10,000	36,997,369	17,956
Microfinance loans <5,000	16,019,928	12,265

Microfinance banks target both microentrepreneurs and small and medium-sized enterprises. The majority of the loan portfolio was involved in SME loans, which drove the average loan balance above 200 per cent of GNP per capita. However, 60 per cent of borrowers had loans below US\$10,000 and in that segment the depth of outreach was much closer to the one observed among NGOs/NBFIs.

Table 6.6: Average Loan Size and Depth of Outreach of Microfinance Banks by Sub-Region

	Avg. Loan Balance	Depth of Outreach	03/04 Depth of Outreach Change
Balkans	4,226	197%	-10%
Caucasus	2,535	248%	33%
CEE	6,425	228%	-20%
Central Asia	515	87%	-2%
Russia/Belarus/Ukraine	6,234	298%	-18%
All microfinance banks	3,971	209%	-3%
Microfinance loans <\$10,000	2,065	118%	-4%
Microfinance loans <\$5,000	1,412	82%	n/a

Most microfinance banks deepened their outreach, in particular in CEE and in the Russia/Belarus/Ukraine sub-regions.

The gross loan portfolio managed by microfinance banks grew on average by 65 per cent, but at a lower pace than in the last two years when it doubled every year. The growth was highly correlated with the increase in the number of depositors as well as the increase in the volume of deposits. This shows the importance of savings collection in the growth of an institution's lending operations.

Figure 6.3: Gross Loan Portfolio and Number of Active Borrowers of Microfinance Banks by Sub-Region

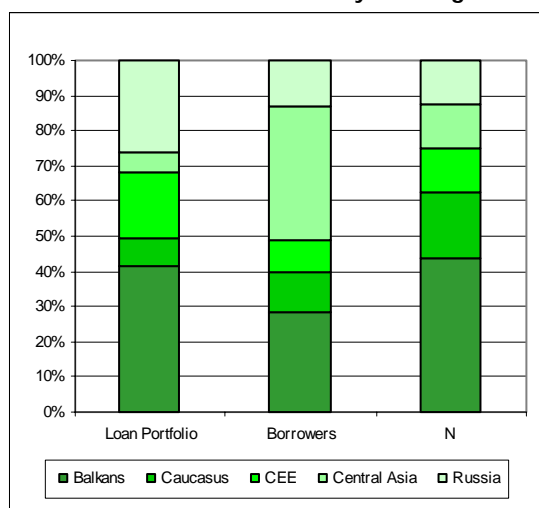
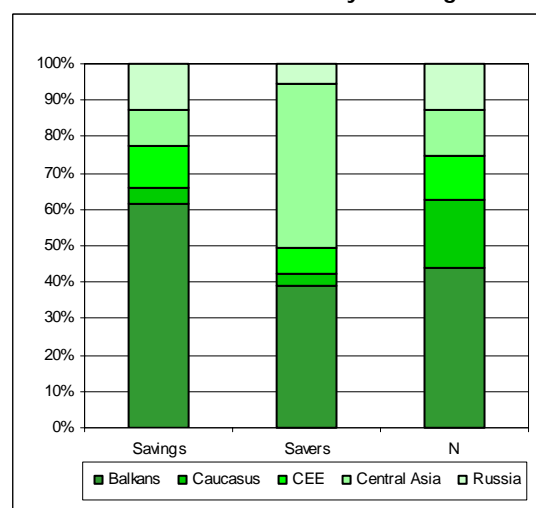


Figure 6.4: Volume of Savings and Number of Savers of Microfinance Banks by Sub-Region



Almost half of the assets of an average microfinance bank were funded from deposits collected from clients or from financial institutions. The rest were covered from shareholder capital and from borrowing, which in many cases was provided by the shareholders themselves or by other IFIs. Microfinance banks were able to secure quite good leverage with borrowed funds exceeding own capital by 7 times.

Microfinance banks were in most cases profitable but their profits were low as they operated on a very thin profit margin. Because of the large scale of operations and the large average loan size, their expenses were quite low but revenues were also much lower.

Table 6.7: Financial Performance of Microfinance Banks by Sub-Region

	Avg. OSS	Avg. AROA	Avg. Financial Revenue Ratio	Avg. Total Expense Ratio	Avg. PAR >30 days
Balkans	113%	0.2%	16%	16%	0.7%
CEE	119%	0.3%	23%	22%	0.9%
Caucasus	107%	0.1%	16%	15%	0.3%
Central Asia	120%	1.2%	25%	23%	2.5%
Russia/Belrus/Ukraine	111%	-0.2%	19%	19%	0.3%
All microfinance banks	114%	0.3%	19%	18%	0.8%

Downscaling Commercial Banks

There were 63 commercial downscaling banks included in the research. At the end of 2004 their gross loan portfolio accounted for 14 per cent of the gross loan portfolio in ECA, while they served 4 per cent of all active borrowers.

The banks from Central Asia dominated, managing half of the total loan portfolio and half of the number of borrowers, mainly due to the downscaling projects of EBRD in Kazakhstan, Tajikistan and Uzbekistan. These were also the quickest growers in 2004 as well as in the previous year. Russia/Belarus/Ukraine followed, with one-third of the sector share.

Given the fact that the majority of downscaling banks operate in low-income countries, their depth of outreach is very shallow. Even in the segment of loans below US\$5,000 the average depth of outreach neared 200 per cent, which was much higher than in the case of microfinance banks. However, this situation is slowly changing as the banks are systematically going downmarket to reach more microentrepreneurs.

Figure 6.5: Gross Loan Portfolio and Number of Active Borrowers Downscaling Banks by Sub-Region

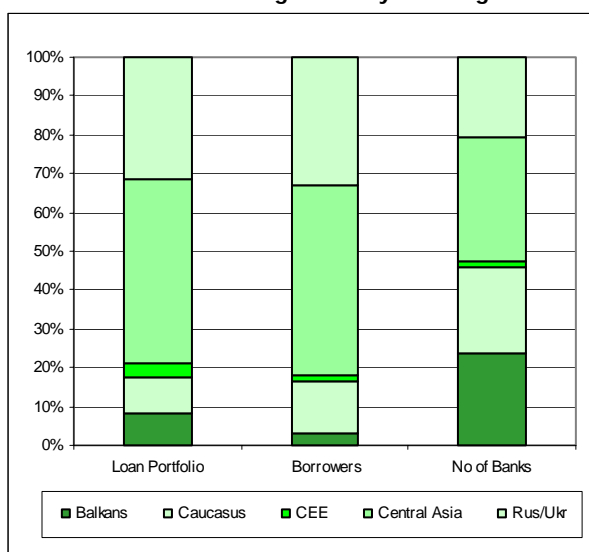


Figure 6.6: 2003-2004 Gross Loan Portfolio Growth of Downscaling Banks by Sub-Region

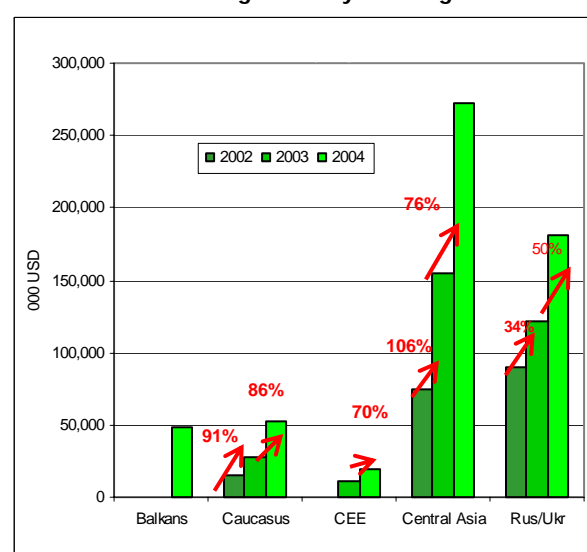


Table 6.8: Average Loan Size and Depth of Outreach of Downscaling Banks by Sub-Region

	Average Loan Balance	Depth of Outreach	03/04 Depth of Outreach Change
Balkans	7,269	309%	n/a
Caucasus	3,660	359%	-40%
CEE	8,925	306%	-16%
Central Asia	2,999	364%	-15%
Russia/Belarus/Ukraine	5,883	262%	-18%
All downscaling banks	4,395	332%	-23%
microfinance loans <\$10,000	1,959	253%	n/a
microfinance loans <\$5,000	1,294	173%	n/a

Annex II. Sub-Regional Outlook

The Balkans

Microfinance in the Balkans is the most developed among all sub-regions as it hosts the most advanced NBFIs, the largest portfolio of microfinance banks and also some activities of downscaling commercial banks and credit unions. The Balkans have received a lot of support from international organizations and since the beginning MFIs have followed international best practice.

Balkan MFIs manage one-fifth of the ECA loan portfolio and serve a tenth of all microfinance borrowers in ECA, but considering the size of this sub-region the penetration of the market is the second highest. For every 1,000 people of productive age, 13 are microfinance clients. Higher penetration is observed only in CEE, where credit unions have pretty good coverage of 18 borrowers per 1,000 citizens.

Figure 7.1: Gross Loan Portfolio in the Balkans by Institutional Type

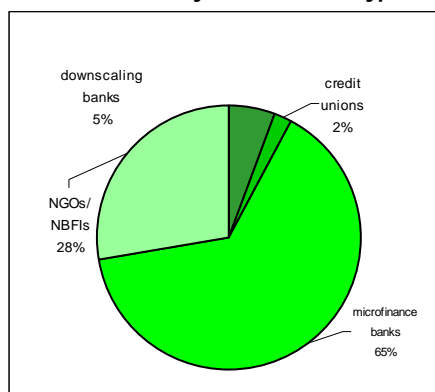
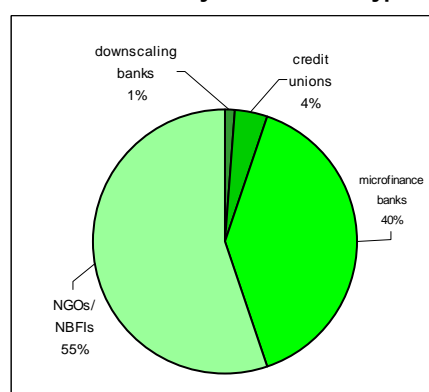


Figure 7.2: Number of Active Borrowers in the Balkans by Institutional Type



The vast majority of Balkan clients are served by NGOs/NBFIs and microfinance banks. The outstanding growth rate of Balkan MFIs slowed down significantly to 66 per cent, equalizing with the rest of the region. In terms of numbers of borrowers the growth rate also decreased, reaching 46 per cent. Balkan microfinance banks are quite outstanding among others in terms of the volume of savings, as they collect the biggest share, of almost 40 per cent.

The average microfinance bank served almost three times as many borrowers, but in the segment of loans below US\$5,000 (covering the majority of NGO/NBFI clients), the average microfinance bank had 12,000 borrowers, which was twice as many as for an average NGO/NBFI.

The size of the average loan in this sub-region is quite high but many of the institutions continue moving downmarket, which is evidenced through the deepening of their outreach.

Table 7.1: Average Loan Balance and Depth of Outreach of Different Institutional Types in the Balkans

	Avg. Loan Balance	Depth of Outreach	03/04 Depth of Outreach Change
Credit unions	1,618	76%	na
Microfinance banks	4,226	197%	-10%
Microfinance banks - loans <\$10,000	2,530	118%	-13%
Microfinance banks - loans <\$5,000	2,139	96%	na
NGOs/NBFIs	1,510	80%	-9%
NGOs/NBFIs -loans <\$10,000	1,430	74%	na
NGOs/NBFIs - loans <\$5,000	1,163	60%	na
Downscaling banks	7,269	309%	na

Most NGOs/NBFIs declare in their strategy a focus on turning into commercial institutions. The reason behind this is the need to attract more commercial funds in order to grow and meet the existing demand. These institutions are already doing well in terms of leverage, with a debt-to-equity ratio exceeding 1.3. Almost all Balkan microfinance banks and NGOs/NBFIs were profitable, with higher returns achieved by NGOs/NBFIs.

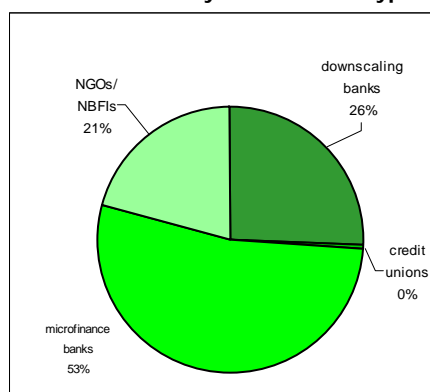
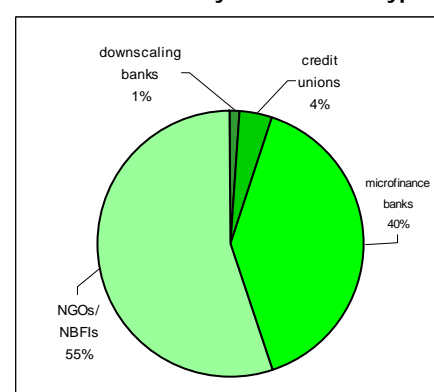
Table 7.2: Financial Performance of Different Institutional Types in the Balkans

	Avg. OSS	Avg. AROA	Avg. Financial Revenue Ratio	Avg. Total Expense Ratio	Avg. PAR >30 days
Microfinance banks	113%	0.2%	16%	16%	1%
NGOs/NBFIs	141%	6%	26%	20%	2%

NGOs/NBFIs in the Balkans excelled among all sub-regions in terms of a very low cost structure and very productive staff, with an average caseload of more than 220 borrowers per loan officer.

The Caucasus

The Caucasus is the smallest microfinance market in the region - only 5 per cent of the gross loan portfolio is utilized here, serving 6 per cent of ECA borrowers. However, given the fact that this sub-region spans only three countries with a total population of 16 million, the outreach of MFIs here is sufficient for 1.7 per cent of coverage among the economically active population. The majority of the 186,000 active borrowers are served by

Figure 7.3: Gross Loan Portfolio in the Caucasus by Institutional Type**Figure 7.4: Number of Active Borrowers in the Caucasus by Institutional Type**

NGOs/NBFIs. These are mostly small institutions with loan portfolios not exceeding US\$5 million, providing very small loans to mostly urban microentrepreneurs, both women and men.

Table 7.3: Average Loan Balance and Depth of Outreach of Different Institutional Types in the Caucasus

	Avg. loan balance	Depth of Outreach	03/04 Depth of Outreach Change
Downscaling banks	3,660	357%	-40%
Microfinance banks	2,535	248%	33%
NGOs/NBFIs	544	54%	1%

Microfinance and downscaling banks serve both micro and SME clients and were active in all three countries. However, compared to the previous year, downscaling banks noticeably deepened their outreach, as opposed to microfinance banks, which turned to disbursing higher loans.

Most of the NGOs/NBFIs in this sub-region were financially self-sustainable, even though the average profitability was slightly negative. They are financed from grants as they have very limited access to borrowing. For the average institution, the debt-to-equity ratio does not exceed 0.5. Their productivity was quite outstanding compared to other sub-regions as the loan officer caseload averaged 200 borrowers.

Table 7.4: Financial Performance of Different Institutional Types in the Caucasus

	Avg. OSS	Avg. AROA	Avg. Financial Revenue Ratio	Avg. Financial Expense Ratio	Avg. PAR > 30 days
NGOs/NBFIs	126%	-1.3%	38%	38%	3%
Microfinance banks	120%	0.3%	24%	22%	1%

Central and Eastern Europe

CEE holds the biggest share of ECA microfinance, with 41 per cent of gross loan portfolio and 50 per cent of borrowers active there. The sub-region is dominated by credit unions in terms of the number of institutions and the volume of operations. Microfinance banks are the second most important player in terms of loan portfolio size; they also served more active borrowers than NGOs/NBFIs. They were the fastest growing institutions in this sub-region.

Figure 7.5: Gross Loan Portfolio in CEE by Institutional Type

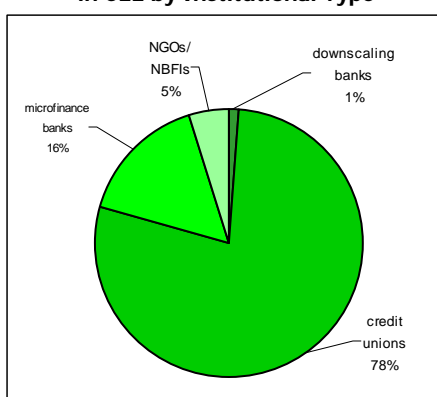
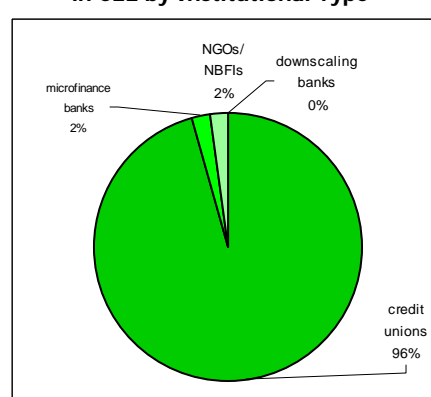


Figure 7.6: Number of Active Borrowers in CEE by Institutional Type



Commercial banks focus mainly on the SME sector, not reaching down to the niche microfinance market. As CEE is the most economically advanced market, the average loan balance (ALB) is the highest compared to other sub-regions. However, the depth of outreach of credit unions is quite low due to the fact that they serve mostly consumer loans. Although both commercial and microfinance banks exceed the regional definition of the microfinance market with their depth of outreach, they downscale their activities on a yearly basis.

Table 7.5: Average Loan Balance and Depth of Outreach of Different Institutional Types in CEE

	Avg. Loan Balance	Depth of Outreach	03/04 Depth of Outreach Change
Credit unions	454	16%	45%
Microfinance banks	6,425	228%	-20%
Microfinance banks -loans < \$10,000	2,651	93%	-18%
Microfinance banks -loans < \$5,000	1,003	36%	na
NGOs/NBFIs	2,729	117%	-1%

More than half the NGOs/NBFIs in this sub-region are not sustainable financially. Although they have been operating for some time on the market, they have developed slowly, reflected by a weak level of profitability. Staff productivity in the sub-region is also low, with a caseload of 40 borrowers per staff member.

Table 7.6: Financial Performance of Different Institutional Types in CEE

	Avg. OSS	Avg. AROA	Avg. Financial Revenue Ratio	Avg. Total Expense Ratio	Avg. PAR >30 days
Microfinance banks	107%	0.1%	16%	15%	0%
NGOs/NBFIs	111%	-6%	25%	33%	3%

Central Asia

Microfinance in Central Asia has developed most recently, with the average MFI being in existence for only 3.5 years. It also hosts the second smallest (after the Caucasus) share of total gross loan portfolio and active borrowers,

Figure 7.7: Gross Loan Portfolio in Central Asia by Institutional Type

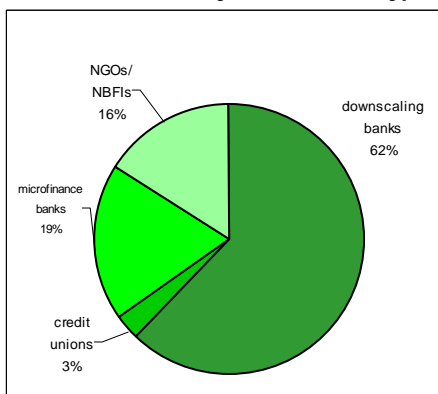
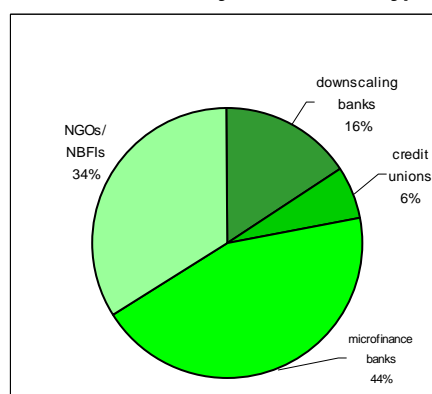


Figure 7.8: Number of Active Borrowers in Central Asia by Institutional Type



accounting for 11 per cent of the whole ECA sector. One-third of all borrowers in Central Asia are served by one microfinance bank – Khan Bank – the largest institution in terms of outreach in the whole ECA region. The other microfinance bank – XAC Bank - has a much smaller share, but with over 30,000 borrowers has the second largest client base in Central Asia.

After microfinance banks, the group with the biggest outreach were NGOs/NBFIs, representing the most diversified group in terms of their size and types of clients served. The scale of outreach ranged from over 20,000 borrowers to less than 100, and the four largest institutions served more than half of the whole NGO/NBFI clientele.

Downscaling commercial banks were less numerous but also served a fair share of borrowers. Credit unions were far less active as they were quite a new structure introduced a few years ago. The largest network of credit unions operated in Kyrgyzstan, with over 300 entities.

The clientele of Central Asian NGOs/NBFIs were probably the most diversified in the whole ECA region. There were institutions that served very low-income clients with loans below 20 per cent of GNP per capita, which was quite rare in ECA, and other institutions serving SMEs with far more shallow depth of 500 per cent of GNP per capita. This drove up the average loan size for the whole group and made it higher than average for microfinance banks, which concentrate on microenterprises and small farmers.

Table 7.7: Average Loan Balance and Depth of Outreach of Different Institutional Types in Central Asia

	Avg. Loan Balance	Avg. Depth of Outreach	03/04 Depth of Outreach Change	Avg. Share of Rural Borrowers	Avg. Share of Women Clients
Downscaling banks	2,999	364%	-14.6%	29%	52%
NGOs/NBFIs	600	87%	-0.6%	57%	66%
Microfinance banks	515	107%	-1.5%	78%	52%

The majority of Central Asian borrowers were located in rural areas, partly because the largest institutions like Khan Bank, XAC Bank and KAFC operated there. The remaining NGOs/NBFIs also had quite a high share of rural clients – above 50 per cent, which in other sub-regions was only observed in the Balkans.

More than 60 per cent of borrowers in Central Asia were women and this stood true for all institutional types. For NGOs/NBFIs, the share of women clients reached as high as 72 per cent and for the average institution, women constituted 66 per cent of all borrowers. The average downscaling and commercial bank also served more women than men.

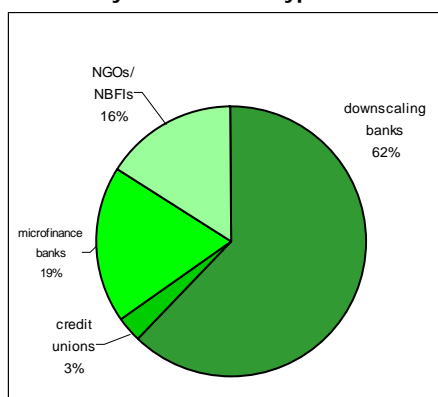
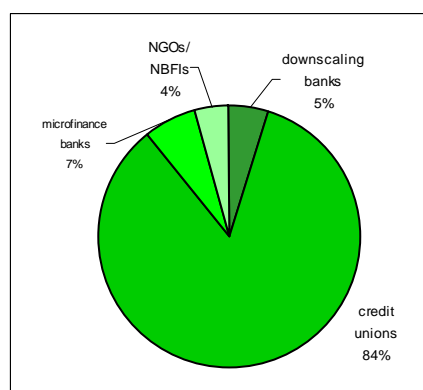
Performance information was not available for many institutions, particularly small NGOs/NBFIs, but a sample of five leading institutions revealed that they were quite profitable as they were able to generate high portfolio yields that were more than enough to cover the costs of operations. The reasons for that were a strong motivation to achieve good results that would attract more investors, as well as the need to grow the portfolio from reinvested profits in view of the scarcity of funding. The average Central Asian NGO/NBFI received 60 per cent of financing from donors and 14 per cent from borrowed funds, and had the lowest leverage compared to other sub-regions.

Table 7.8: Financial Performance of Different Institutional Types in Central Asia

	Avg. OSS	Avg. AROA	Avg. Financial Revenue Ratio	Avg. Total Expense Ratio	Avg. PAR >30 days
NGOs/NBFIs	154%	13%	49%	33%	1.4%
Microfinance banks	120%	1.2%	25%	22%	2.5%

Russia/Belarus/Ukraine

Geographically this is the largest sub-region with the biggest population. Even though its microfinance sector is the second largest in terms of number of borrowers, it is the least penetrated with only 4 in 1,000 inhabitants using microfinance services.

Figure 7.9: Gross Loan Portfolio in Russia/Belarus/Ukraine by Institutional Type**Figure 7.10: Number of Active Borrowers in Russia/Belarus/Ukraine by Institutional Type**

Credit unions are the dominant form of MFI. They are quite widespread and provide loans for consumer needs as well as business and agricultural loans. However, it is hard to assess what share of the loans disbursed are utilized for business purposes as often household loans are used to support entrepreneurial activities. Except for a rural credit cooperative network in Russia, the majority of credit unions operated in urban areas. The same was observed for other institutional types, which had far more limited outreach and also concentrated on serving urban clientele. Among NGOs/NBFIs, women borrowers prevailed.

Table 7.9: Average Loan Balance and Depth of Outreach of Different Institutional Types in Russia/Belarus/ Ukraine

	Avg. Loan Balance	Depth of Outreach	03/04 Depth of Outreach Change
Downscaling banks	5,027	262%	-18%
Credit unions	642	25%	-14%
Microfinance banks	6,234	298%	-18%
Microfinance banks - loans < \$10,000	2,316	122%	-16%
Microfinance banks - loans < \$5,000	574	29%	n/a
NGOs/NBFIs	1,142	46%	-7%

Russian and Ukrainian NGOs/NBFIs had the most difficult access to funding, which resulted in the lowest leverage (debt-to-equity ratio of on average 0.3) and also very limited use of concessional loans. Those MFIs that were using borrowed funds sourced them from commercial banks.

Both microfinance banks and NGOs/NBFIs were operationally sustainable, however many of them did not have positive returns after adjustments. They also had quite low productivity of 45 borrowers per staff person – half the ECA average.

Table 7.10: Financial Performance of Different Institutional Types in Russia/Belarus/Ukraine

	Avg. OSS	Avg. AROA	Avg. Financial Revenue Ratio	Avg. Total Expense Ratio	Avg. PAR >30 days
Microfinance banks	111%	-0.2%	19%	19%	0.3%
NGOs/NBFIs	126%	-2%	38%	38%	0.7%

Annex III. List of Participating MFIs

Balkans

Country	NGOs/NBFIs	Microfinance banks	Downscaling commercial banks	Credit unions and cooperatives
Albania	BESA Foundation Mountain Areas Finance Fund PSHM	ProCredit Bank Albania		ASC Union Jehona National Union of SCAs
Bosnia&Herzegovina	Benefit EKI Zdrado da Ste LOKmicro MI-BOSPO Mikra MIKRO ALDI Mikrofin SINERGIJApus Partner Prizma Sunrise Women for Women	ProCredit Bank BiH		
Croatia	MikroPlus			DEMOS NOA
Kosovo	Agency for Finance in Kosovo Beselidhja/Zavet MicroFinance FINCA Kosovo Kosovo Enterprise Program KRK Ltd.	ProCredit Bank Kosovo		
Macedonia		ProCredit Bank Skopje	IK Banka Investbanka KIB Tutunska Banka	FULM Savings House Moznosti Savings House
Serbia and Montenegro	AGROINVEST Alter Modus Micro Development Fund MicroFinS	Opportunity Bank Montenegro ProCredit Bank Serbia Stedionica Opportunity International		

Central and Eastern Europe

Country	NGOs/MFIs	Microfinance banks	Private commercial banks	Credit unions and cooperatives
Bulgaria	Mikrofond EAD USTOI	ProCredit Bank Bulgaria		Nachala Cooperative
Latvia				Latvian Cooperative Credit Union Association (LKKSS)
Lithuania				Association of Lithuanian Credit Unions
Moldova	MicroInvest ProCredit Moldova			Savings and Credit Associations of Citizens
Poland	FDPA Fundusz Mikro Inicjatywa Mikro Rural Development Foundation			SKOK
Romania	CAPA Finance CHF Romania Economic Development Center (CDE) FAER Integra Romania LAM OMRO Romcom	ProCredit Bank Romania	Banca Romanesca	Caselor de Ajutor Reciproc (CARs)
Slovakia	Integra Foundation			

Caucasus

Country	NGOs/NBFIs	Microfinance banks	Private commercial banks	Credit unions and cooperatives
Armenia	ECLOF Armenia FINCA Armenia Horizon Fund MDF KAMURJ SEF International UMCOR/AREGAK	ACBA	Anelik Bank Armeconom Bank Converse Bank Ineco Bank	
Azerbaijan	ADRA Kredit Azeri Star Microfinance Cred-Agro DAYAG - Credit Finance for Development FINCA Azerbaijan IOM MADAD Credit Normicro UMID Viator Microcredit Fund WV AzerCredit	Microfinance Bank of Azerbaijan	Bank of Baku Bank Respublika PARABank Unibank Azerdemiryol-Bank Azerigazbank	
Georgia	BAI BBK Constanta Foundation Crystal Fund FINCA Georgia GRDF SBDF Social Fund for Development Society Development Association UOT VF Credo Foundation	ProCredit Bank of Georgia	Bank of Georgia Tbiluniversalbank United Georgian Bank	Credit Unions of Georgia

Central Asia

Country	NGOs/NBFIs	Microfinance banks	Private commercial banks	Credit unions and cooperatives
Kazakhstan	Asian Credit Fund Baspana Bereke Kazakhstan Fund for Support of Entrepreneurs Kazakhstan Loan Fund MCO „Sator” North Kazakhstan Credit Fund		ATF Bank KazakhCenterCredit Bank KazkommertzBank Narodny Bank Temir Bank Tsesna Bank TuranaAlem Bank	
Kyrgyzstan	Bai Tushum Financial Fund FMCC (former FINCA Kyrgyzstan) KAFC Kompanion Financial Group MCO Joldosh Group		KyrgyzAKB Bank KyrgyzDemir Bank KyrgyzEnergo Bank KyrgyzInexim Bank KyrgyzKKB Bank	Credit Unions of Kyrgyzstan
Mongolia		XAC Bank Khan Bank		
Tajikistan	OXUS Micro-Finance (former ACTED) ASTI Humo (former CARE Int) Development Fund Supporting Farmship and Entrepreneurship FINCA Tajikistan Fund "Rosvitiye" Gender and Development IMON (former NABWT) Fund Jovid Millennium Development Partners Microinvest (former MDTM) Imkoniyat (former Sitoraj Najot) Mehrangez	First Microfinance Bank	Eskhata Bank Tajprombank Tojiksodirotbank	

	Nargis TASPR ZAR (former Fund Oila)			
Uzbekistan	Business Women Association Kashkadarya FINCA Uzbekistan FV MARD (ACDI/VOCA) MFP Barakot NGO Daulet PAD SABR		Hamkorbank Ipak Yuli Bank Pakhta Bank Uzjilsberbank	Credit Unions of Uzbekistan

Russia/Belarus/Ukraine

Country	NGOs/NBFIs	Microfinance banks	Private commercial banks	Credit unions and cooperatives
Belarus			Belgazprombank Prior Bank	
Russia	Counterpart Enterprise Fund FINCA Samara FINCA Tomsk FOR A Fund Russian Women's Microfinance Network Voronezh State Fund for Support of SMEs	KMB Bank	Chelindbank Far East Bank NBD Bank Sberbank Sibacadembank UralSib Bank Uraltransbank	Rural Credit Cooperatives KS Alternativa CU Sodejstvie Russian Credit Union League
Ukraine	HOPE-Ukraine	ProCredit Bank Ukraine	Agjobank Aval Bank Forum Bank Nadra Bank Privat Bank	National Association of Ukrainian Credit Unions



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

**Microfinance Centre for Central and Easter Europe
and the New Independent States**

ul. Koszykowa 60/62 m 52
00-673 Warsaw, Poland
tel: (48-22) 622 34 65
fax: (48-22) 622 34 85

**e-mail: microfinance@mfc.org.pl
www.mfc.org.pl**