Microfinance and the Poor in Central Asia

Challenges and Opportunities

ECSSD Microfinance Team
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Cover Art

Women selling fresh fruit and vegetables in a city market. Courtesy of World Bank Photo Library.
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<tr>
<th>Acronym</th>
<th>Full Form</th>
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</thead>
<tbody>
<tr>
<td>ACDI/VOCA</td>
<td>Agricultural Cooperative Development International and Volunteers in Overseas Cooperative Assistance</td>
</tr>
<tr>
<td>ACLEDA</td>
<td>Association of Cambodian Local Economic Development Agencies</td>
</tr>
<tr>
<td>AKFED</td>
<td>Aga Khan Fund for Economic Development</td>
</tr>
<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
</tr>
<tr>
<td>APR</td>
<td>Annual Percentage Rate</td>
</tr>
<tr>
<td>ATMs</td>
<td>Automatic Teller Machines</td>
</tr>
<tr>
<td>BN</td>
<td>Banco do Nordeste</td>
</tr>
<tr>
<td>BRI</td>
<td>Bank Rakyat Indonesia</td>
</tr>
<tr>
<td>BWA</td>
<td>Business Women Association</td>
</tr>
<tr>
<td>CAMFA</td>
<td>Central Asia Microfinance Alliance</td>
</tr>
<tr>
<td>CARD</td>
<td>Center for Agricultural and Rural Development</td>
</tr>
<tr>
<td>CEE</td>
<td>Central and Eastern Europe</td>
</tr>
<tr>
<td>CGAP</td>
<td>Consultative Group to Assist the Poorest</td>
</tr>
<tr>
<td>CIS</td>
<td>Commonwealth of Independent States</td>
</tr>
<tr>
<td>CVECAs</td>
<td>Caisses villageoises d’epargne et de credit autogenerées</td>
</tr>
<tr>
<td>DFID</td>
<td>Department for International Development, United Kingdom</td>
</tr>
<tr>
<td>DGRV</td>
<td>Der Deutsche Genossenschafts- und Raiffeisenverband e. V.</td>
</tr>
<tr>
<td>EBRD</td>
<td>European Bank for Reconstruction and Development</td>
</tr>
<tr>
<td>ECA</td>
<td>Europe and Central Asia</td>
</tr>
<tr>
<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>FCCU</td>
<td>Financial Company for Support of Credit Unions</td>
</tr>
<tr>
<td>FINCA</td>
<td>Foundation for International Community Assistance</td>
</tr>
<tr>
<td>FX</td>
<td>Foreign Exchange</td>
</tr>
<tr>
<td>GAPI</td>
<td>Portuguese acronym for “Office for the Support of Small Industries”</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
</tr>
<tr>
<td>GNI</td>
<td>Gross National Income</td>
</tr>
<tr>
<td>GOK</td>
<td>Government of Kazakhstan</td>
</tr>
<tr>
<td>GOKR</td>
<td>Government of the Kyrgyz Republic</td>
</tr>
<tr>
<td>GOU</td>
<td>Government of Uzbekistan</td>
</tr>
<tr>
<td>GTZ</td>
<td>German Development Cooperation Agency</td>
</tr>
<tr>
<td>IDA</td>
<td>International Development Association</td>
</tr>
<tr>
<td>IDB</td>
<td>Inter-American Development Bank</td>
</tr>
<tr>
<td>IFAD</td>
<td>International Fund for Agricultural Development</td>
</tr>
<tr>
<td>IFC</td>
<td>International Finance Corporation</td>
</tr>
<tr>
<td>IPC</td>
<td>International Projekt Consult</td>
</tr>
<tr>
<td>IFI</td>
<td>International Finance Institution</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>K</td>
<td>thousand</td>
</tr>
<tr>
<td>KAFC</td>
<td>Kyrgyz Agricultural Finance Corporation</td>
</tr>
<tr>
<td>KCLF</td>
<td>Kazakhstan Community Loan Fund</td>
</tr>
<tr>
<td>KfW</td>
<td>Development Bank, Government of Germany</td>
</tr>
<tr>
<td>KGS</td>
<td>Kyrgyz Som</td>
</tr>
<tr>
<td>KZT</td>
<td>Kazakh Tenge</td>
</tr>
<tr>
<td>MCA</td>
<td>Microcredit Agency</td>
</tr>
<tr>
<td>MCC</td>
<td>Microcredit Company</td>
</tr>
<tr>
<td>M-CRIL</td>
<td>Microcredit Ratings and Guarantees India Ltd</td>
</tr>
<tr>
<td>MCWMC</td>
<td>Mercy Corps Women’s Microcredit</td>
</tr>
<tr>
<td>MDF</td>
<td>Microenterprise Development Fund</td>
</tr>
<tr>
<td>MDGs</td>
<td>Millennium Development Goals</td>
</tr>
<tr>
<td>Acronym</td>
<td>Full Name</td>
</tr>
<tr>
<td>---------</td>
<td>-----------</td>
</tr>
<tr>
<td>MEB</td>
<td>Microenterprise Bank</td>
</tr>
<tr>
<td>MFC</td>
<td>Microfinance Center</td>
</tr>
<tr>
<td>MFC</td>
<td>Microfinance Company</td>
</tr>
<tr>
<td>MFI</td>
<td>Microfinance Institution</td>
</tr>
<tr>
<td>MIS</td>
<td>Management of Information Systems</td>
</tr>
<tr>
<td>NABW (T)</td>
<td>National Association of Business Women (of Tajikistan)</td>
</tr>
<tr>
<td>NBKR</td>
<td>National Bank of the Kyrgyz Republic</td>
</tr>
<tr>
<td>NBRK</td>
<td>National Bank of the Republic of Kazakhstan</td>
</tr>
<tr>
<td>NCAT</td>
<td>Network Capacity Assessment Tool</td>
</tr>
<tr>
<td>NSIF</td>
<td>National Social Investment Fund of Tajikistan</td>
</tr>
<tr>
<td>NGO</td>
<td>Nongovernmental organization</td>
</tr>
<tr>
<td>NIS</td>
<td>Newly Independent States</td>
</tr>
<tr>
<td>PAR</td>
<td>Portfolio at Risk</td>
</tr>
<tr>
<td>PFI</td>
<td>Participating Financial Institutions</td>
</tr>
<tr>
<td>PRODEM</td>
<td>Promotion and Development of Microenterprise</td>
</tr>
<tr>
<td>Q1</td>
<td>Quarter 1</td>
</tr>
<tr>
<td>RFP</td>
<td>Rural Finance Project</td>
</tr>
<tr>
<td>ROA</td>
<td>Return on Assets</td>
</tr>
<tr>
<td>ROSCA</td>
<td>Rotating Savings and Credit Association</td>
</tr>
<tr>
<td>SEEP</td>
<td>Small Enterprise Education and Promotion Network</td>
</tr>
<tr>
<td>SHARE</td>
<td>Society for Helping Awakening Rural Poor through Education</td>
</tr>
<tr>
<td>SIDBI</td>
<td>Small Industries Development Bank, India</td>
</tr>
<tr>
<td>SME</td>
<td>Small and medium enterprises</td>
</tr>
<tr>
<td>SMEC</td>
<td>Small- and Medium-Size Enterprise Credit</td>
</tr>
<tr>
<td>SMFC</td>
<td>SIDBI Foundation for Micro Credit</td>
</tr>
<tr>
<td>SN</td>
<td>Sitorai Najot</td>
</tr>
<tr>
<td>SWOT</td>
<td>Strengths, Weaknesses, Opportunities, Threats</td>
</tr>
<tr>
<td>TACIS</td>
<td>Technical Assistance for the Newly Independent States</td>
</tr>
<tr>
<td>TASIF</td>
<td>Tajikistan Social Investment Fund</td>
</tr>
<tr>
<td>UN</td>
<td>United Nations</td>
</tr>
<tr>
<td>UNDP</td>
<td>United Nations Development Programme</td>
</tr>
<tr>
<td>US</td>
<td>United States</td>
</tr>
<tr>
<td>USAID</td>
<td>United States Agency for International Development</td>
</tr>
<tr>
<td>VAT</td>
<td>Value-Added Tax</td>
</tr>
<tr>
<td>WB</td>
<td>World Bank</td>
</tr>
<tr>
<td>WOCCU</td>
<td>World Council of Credit Unions</td>
</tr>
<tr>
<td>Y1</td>
<td>Year 1</td>
</tr>
</tbody>
</table>
Acknowledgments

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Preface

This study was created in response to a question from the World Bank Country Director for Central Asia about how the Bank could provide strategic and operational support to effectively and efficiently expand microfinance and microcredit in Central Asia, while contributing to the Bank’s institutional mandate for poverty alleviation.

This study describes the current status of the microfinance system in Central Asia and identifies practical and reality-based operational interventions to support the expansion of services. The goal is to enable these countries to take fuller part in the growing microfinance movement for the betterment of their mostly poor rural populations and their overall economies. Specifically, the study attempts to articulate possible short-term interventions for possible donor support over the next two to three years, which could have significant and visible impacts. It also provides an analytical platform for continuing debates on longer term development challenges and options on this important topic among governments, NGOs, key donors, practitioners, and the World Bank.

This is the first comprehensive attempt by the Europe and Central Asia Region of the World Bank to fully catalog what is going on in terms of active microfinance institutions (MFIs) and donor programs to support development of microfinance markets. This study focuses on delivering microfinance services to those who do not have access to mainstream banking sector and does not attempt to evaluate or address the overall banking sector or issues relating to small and medium enterprise development. The operations covered in the study are ongoing, so the data is changing rapidly; however, the microfinance market structure, institutions, current constraints, and issues will remain valid for some time. Addressing the priority constraints and gaps identified in this report will be necessary before Central Asia can significantly scale up their microfinance programs to reach more people, particularly in remote rural areas.

The study is based on data collection and interviews covering four Central Asian countries, the Kyrgyz Republic, Kazakhstan, Uzbekistan, and Tajikistan completed in February 2003. Initial offsite efforts included reviewing existing information, documentation, and literature, and interviewing microfinance experts at large. Onsite information gathering included questionnaires and follow up field interviews with selected MFIs and commercial banks, as well as visits with officials of the Central Bank and government, donors, and microfinance clients.

In order to tap into the relatively rich microfinance experiences around the world and provide a consistent framework based on a combination of best practices and an understanding of the special constraints in Central Asia, the study augmented existing information through:

- **Field interviews and inventory-taking of microfinance operations in each country.** The team carried out a country-level inventory of MFIs and microfinance operations. A comprehensive questionnaire was used;

- **Interviews and inventory-taking of donor programs.** The team contacted key donors and compiled their microfinance activities in Central Asia;

- **Search of global “good practice” microfinance operations for possible replication in Central Asia.** The team interviewed task managers and practitioners of microfinance operations;
The Bank’s own experiences with microfinance projects. The study drew upon the lessons learned with the Moldova Savings and Credit Associations, Kyrgyz Rural Finance Project, Albania Microfinance Project, Tajikistan Pilot Poverty Alleviation Project, and IFC FINCA in the Kyrgyz Republic, for broader application in Central Asia. Furthermore, the study relied on beneficiary surveys and social assessments already carried out for various Bank projects in Central Asia to reflect perspectives of beneficiaries.

Reference to existing materials. The study provided user-friendly links to key information sites and comprehensive reference materials on broad range of topics.

The researchers presented the initial results of this study in Almaty, Kazakhstan in April 2-3, 2003 at a conference on Expanding Access to Microfinance in Central Asia, which the Aga Khan Foundation, Asian Development Bank, European Bank for Reconstruction and Development, Open Society Institute, USAID, and the World Bank cosponsored.
Executive Summary

In developing countries, microfinance has demonstrated its potential for delivering a full range of commercial financial services to a large group of low-income people to achieve economic development, social cohesion, and poverty reduction. It offers mechanisms for serving sectors of the economy that the formal financial system usually considers unbankable due to high transaction costs, perceived risks, low margins, and also because they lack traditional collateral.

As it pushes the frontiers of the overall financial sector and allows for inclusion of low-income people in the development process, microfinance has seen tremendous growth worldwide in the last decade, supported both by the governments of developing countries and by international donors. The ECA region is no exception. Microfinance has been growing rapidly at more than 30 percent a year, and now serves some 1.7 million borrowers and 2.3 million depositors in ECA. Collapse of state ownership in the economies of the region produced a dramatic rise in small businesses and self-employment, while very few commercial banks have shown a strategic interest in providing financial services to these micro and small enterprises. Most micro and small businesses in the region have neither a track record of borrowing nor the amount of collateral required by banks. This prevents the use of the collateral and credit technology applied by commercial banks, i.e. credit scoring.

In Central Asia, with poverty rates still high (ranging from 28 percent in Kazakhstan to 83 percent in Tajikistan.\(^1\)) and formal financial sector still underdeveloped, microfinance has yet to play a major role in economic development and poverty reduction. The combined microfinance portfolio in Central Asia is about US$193 million. The microfinance industry has been growing rapidly both in terms of clients and portfolio, for instance, the portfolios for the MFIs reviewed in this study grew 73 percent from 2001 to 2002; however, the current outreach is still limited to about 191,315 clients, less than 0.5 percent of more than 50 million people living in the four countries studied.

Following on from “The State of Microfinance in CEE and the NIS”, a study carried out by the MicroFinance Center for Central and Eastern Europe and the Newly Independent States in Poland, this study examines four main types of organizations that provide microfinance services in Central Asia:

- **Nongovernmental Microfinance Institutions (NGO MFIs).** These are nonprofit organizations that specialize in lending to the self-employed and microenterprises but are not licensed to take deposits. This category includes nonprofit associations and foundations, as well as those MFIs registered as private or public companies that operate on a nonprofit basis. NGO MFIs have been successful in reaching the poorest clients. The Kyrgyz Republic has the most advanced network of NGO MFIs led by Kyrgyz Agricultural Finance Corporation (KAFC), which is the largest MFI in the region with US$30 million portfolio in 2003 and the only one with a sizable rural portfolio.\(^2\) The second largest NGO MFI in the region, Kazakhstan Community Loan Fund (KCLF), has issued over US$20 million in 70,000 credits since beginning its operations.

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\(^1\) For this study, Central Asia refers to four countries: Kazakhstan, The Kyrgyz Republic, Tajikistan and Uzbekistan.

\(^2\) This category includes Kyrgyz Agricultural Finance Corporation (KAFC), which was established under a World Bank project and is owned by the Government of Kyrgyz Republic. Although government-owned, KAFC shares many of the same constraints, problems, and issues faced by NGO MFIs.
Credit unions. These are member-owned and member-governed organizations that provide deposit and lending services to their members only. Donor financed credit unions have increased significantly in Central Asia, but the slow capital growth of savings-based institutions in poor areas have limited their outreach. At the time of the study, the Kyrgyz Republic was the most advanced with 350 CUs; Uzbekistan had just initiated the process; Tajikistan had no CUs; and the Government of Kazakhstan had created another type of membership-based financial organization, credit partnerships, which differ from traditional credit unions.

Microfinance banks. These banks are fully regulated, for-profit, commercial banks that offer a broad range of products and services. Unlike commercial banks, lending to micro and small enterprises has been their primary business since their inception. There were no microfinance banks in Central Asia at the time of the study, but the first one was established in Tajikistan in July 2003.

Commercial banks. These are mainstream banks that began by offering traditional banking services and added microfinance services targeted to micro and small enterprises at a later point. While some commercial banks in Central Asia are implementing SME credit lines under donor-funded programs, the high cost of servicing SME clients limits their coverage to locations with high concentrations of such clients. The most successful program is being implemented in Kazakhstan. It builds on the strong capacity of the banking sector and has disbursed about US$400 million in 65,000 credits to small businesses since the inception of the program.

Below is a summary information on all institutions involved in microfinance identified by the Study in Central Asia:

<table>
<thead>
<tr>
<th>MFI Type</th>
<th>Number</th>
<th>Outstanding Portfolio (US$ mln)</th>
<th>Active Borrowers (000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit Unions</td>
<td>384</td>
<td>12</td>
<td>30</td>
</tr>
<tr>
<td>NGO MFIs</td>
<td>81</td>
<td>67</td>
<td>182</td>
</tr>
<tr>
<td>Commercial Banks with microfinance operations</td>
<td>23</td>
<td>143</td>
<td>24</td>
</tr>
<tr>
<td>Microfinance Banks</td>
<td>1</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>All MFIs</td>
<td>489</td>
<td>200</td>
<td>201</td>
</tr>
</tbody>
</table>

Source: Central Asia microfinance team.

This report examines the state of microfinance in Central Asia, drawing on a survey of 59 NGO MFIs and 23 banks involved in microfinance, and follow-up detailed interviews of 21 NGO MFIs.

NGO MFIs in Central Asia

In terms of outreach and depth, NGO MFIs have made the most progress. Of the four organizational types, this study focuses on NGO MFIs because they are the second largest in terms of number of institutions (81) but the largest in terms of outstanding portfolio and outreach as measured by the number of active borrowers, serving 71 percent of the current microfinance clients. MFIs are uniquely positioned to fill the demand for microfinance of the low-income population because of their innovative delivery mechanisms and their unique focus on the client’s character, commitment to repay a loan, and estimated

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3 It is estimated that these institutions represent over 90 percent of the microfinance industry in the region.
cash flow rather than on collateral or business experience. This report therefore analyzes their current status and recommends short-term and long-term options for improving their sustainability, capital structure, performance, and outreach based on available international experience. The most important measures are summarized here, with the understanding that any of them will need collaboration by all donors as well as efforts from national governments to develop an enabling legal framework.

NGO MFIs in Central Asia are still in the early stage of development, but they are already positioning themselves as strategic and important members of financial industry. However, they do face many constraints to realizing their full potential. Most of Central Asia’s successful NGO MFI’s are large, internationally supported or managed organizations, and their client base is mainly urban. Most MFIs focus on short-term working capital loans based on social collateral with very high interest rates. Many depend donor grants for lending capital and operational costs, and they face limited competition due to the fragmented microfinance industry in the region. As a result, NGO MFIs have had little incentive to diversify their products or markets, and they have enjoyed high margins on their lending. High yields afforded by high interest rates (as high as 72 percent per year in some cases) have allowed these institutions to maintain high administrative costs while reaching operational self-sufficiency of 172 percent on average. In some cases, they have expanded rapidly, although accounting, financial reporting, and portfolio monitoring quality remain weak.

Some commercial banks are now beginning to compete with NGO MFIs for the same clientele, primarily urban traders, so NGO MFIs need immediate strategic assistance to compete. Some will have to merge, others will need to diversify into niche market that banks cannot reach, and others will ultimately go out of business.

**Critical Challenges**

While the number of microfinance clients is increasing at about 30 percent per year, MFIs still have limited geographical coverage and depth of outreach across the countries in the region, with penetration of the total poor population estimated at less than two percent. There are still significant unserved or underserved segments of these countries, especially in rural areas where the incidence of poverty is higher. Various surveys and social assessments show that more than 40 percent of respondents among the rural poor cited lack of access to funds as the main impediment to economic development, while up to 80 percent were confident they would increase production if they had access to loans for inputs.

The critical challenges facing MFIs are the low current outreach of existing MFIs and the limited penetration of MF services in rural areas. By far the most important constraint for expanding the outreach of NGO MFIs according to the survey and field interviews in this study is the limited sources of funds, especially for developing and offering new products and services, and a high dependence on a single source (mostly donor grants). This is also part of the reason why MFIs charge high interest rates on their credits while their cost of the funds is zero or near zero, as interest income is often the only means to increase capital for on-lending. Other constraints for expanding outreach include uncertainty about their legal status, tax requirements, and other regulatory implications; and low sustainability due to high costs, high risks, and limited risk mitigating ability.

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4 The exception is the largest MFI in the region, the Kyrgyz Agricultural Finance Corporation (KAFC), a nonbank financial institution created by World Bank projects and owned by the Government of the Kyrgyz Republic. KAFC’s portfolio is entirely rural and most of the credits are for individuals.
Governments, with the assistance of international finance institutions and donors, need to set the framework for overcoming these challenges in ways that will help establish a sustainable microfinance industry in the region run by mature and efficient institutions.

**Short Term Interventions**

In the short term, scaling up the provision of microfinance to satisfy the unmet demand from existing clientele for existing products is feasible by supporting institutional building of NGO MFIs, and enhancing their access to commercial sources of funds for onlending capital.

*Linking with Banks and Access to Commercial Funds.* NGO MFIs themselves have repeatedly identified limited sources of funds for developing and offering new products as the most important constraint for expanding their outreach. NGO MFIs are relatively young and have been predominantly supported by donor grants. Just like their clients, who are excluded from the banking sector, NGO MFIs face exclusion due to perceived high risks and lack of a track record as a credit client. This is also part of the reason why NGO MFIs charge high interest rates on their credits when their cost for the funds is zero, as interest income is often the only source of on-lending capital. With the exception of Kazakhstan’s banks that are beginning to serve a low-income urban clientele, banks in the region have proved reluctant to take a long-term strategic view of the poor as credit-worthy clients. Links between NGO MFIs that have the flexibility and expertise needed to serve poor clients, and banks that have financial resources and a broader range of financial services, including savings, could be encouraged. Such linkages between NGO MFIs and banks are already being explored, especially in Kazakhstan where two MFIs have obtained loans from local banks, and one MFI has been contracted to act as a microfinance Front Office for a bank. Nevertheless, these are still isolated cases and much remains to be done to scale-up such experiences. The following intermediate steps are necessary for NGO MFIs to successfully link with the banking sector:

- **Developing Benchmarks And Standards For Financial Performance.** In order to gain access to commercial funds, NGO MFIs need to develop transparent financial systems as well as measurable performance indicators, and they need to get rated by international agencies. Bosnia’s “Local Initiative Project”, a World Bank project, is a good example of effective support for MFIs. It established a clear set of performance targets, under which only qualified MFIs received funding, and those who failed to achieve the targets were required to immediately repay funds received.

- **Bridge Financing.** While NGO MFIs need to eventually gain access to commercial funds and link with the banking sector in order to build a sufficient portfolio, international finance institutions (IFIs) can play a role in overcoming the initial vicious cycle of MFIs not having a credit history by providing loan funds to MFIs. In parallel, technical assistance could be provided to help commercial banks acquire the capacity to evaluate the portfolio quality of NGO MFIs that lend using character and cash flow approaches rather than the collateral approach typically used by banks. In addition, governments, with the assistance of IFIs, could review the provision requirements of National Banks that pose additional difficulties for bank lending to MFIs.

*Diversification of products, services and geographical reach.* MFIs should be encouraged to broaden their product mix, moving beyond loans providing short-term working capital for petty trade to loans for medium-term investments for production. They should also be assisted in extending their outreach to rural areas. MFIs in general serve less than one percent of the total poor population and less than one percent of the rural poor population in each of the countries, except the Kyrgyz Republic where the outreach is 3 percent and 3.9 percent respectively. While MFIs do understand the need to diversify, they refrain from
entering new markets and developing new products without assistance from an experienced international organization. Branching out into rural areas and into agricultural credits is a special challenge, as this sector is considered highly risky and non-profitable. It requires different types of lending products, usually with longer maturity and adjusted payment schedules based on cash flow estimates. Nevertheless, available best cases from around the world suggest that microfinance services can be delivered sustainably and profitably to the rural poor. These include the Bank’s experience with KAFC in the Kyrgyz Republic, GAPI in Mozambique, PRODEM in Bolivia, and CVECAS in West Africa.

**Medium and Long-term Interventions**

*Introducing new products.* New products, such as microsavings, insurance, leasing, ATMs, and Smart Cards require development of an adequate legal and institutional framework in the countries involved. While such products take time to develop and require the collaboration of donors as well as commitments from governments, they are essential to providing full-scale services to the segments of population that remain excluded from the formal financial sector. Technological innovations such as Smart Cards and ATMs have also proven to assist in reducing transaction costs in other regions and also be introduced at a later stage. In Bolivia, PRODEM, a licensed nonbank financial intermediary, is delivering its microfinance services through smart cards that are linked to ATMs. This strategy has allowed for a large agricultural loan portfolio (21 percent of the total) with good financial standing.

*Transformation.* Currently, as in most countries and regions, MFIs in Central Asia can neither mobilize savings nor offer other financial services such as transfers, payments, and foreign exchange operations. Stronger MFIs with established clients and market shares could benefit from becoming regulated, formal financial institutions that can offer a greater variety of services to their clients. Although transformation from an NGO into a bank is difficult, there are now a number of organizations that have done this successfully. The Bank could support a transformation of KAFC, based on the lessons provided by international experience on transformation of NGO MFIs into banks, for example, XAC Bank in Mongolia, ACLEDA in Cambodia, and CARD Bank in the Philippines.

**Conclusion**

The microfinance sector in Central Asia is less than 10 years old, so outreach and impact are still limited; however, the initial results are promising. Several MFIs are both operationally and financially sustainable, and a few are ready to be transformed into formal financial institutions. Donors have actively supported the Central Asian microfinance sector with grants and technical assistance, but they need to do more. Additional donor support is necessary to solidify past achievements and move forward towards developing a more sustainable and diversified microfinance sector.

Several fundamental problems must be addressed for microfinance to fulfill its potential of helping the poor and contributing to overall economic development in Central Asia. These problems include the limited outreach of MFIs among urban traders and small businesses; large numbers of whom still do not have access to financial services. Another problem is the relative absence of effective microfinance services in rural areas, and there is also a compelling need to develop microfinance services that specifically serve poor rural farmers and small agribusinesses. World Bank and other donor resources need to be firmly oriented toward furthering these objectives.

This study finds that much more could and should be done to expand microfinance services to the poor. The results to date provide valuable lessons as well as the initial foundation upon which to build. The key
issues and constraints identified during the study are not necessarily unique to Central Asia, but this first comprehensive review of the Central Asia microfinance sector does provide an assessment of specific constraints at each country level. Internationally successful microfinance operations provide actual experiences from which Central Asian countries can learn, and from which they can adopt selective interventions that are relevant for Central Asia, with governments, MFIs, and donors as key partners in this important but still not yet fully realized development agenda. The recommendations of this study are geared to meet the specific constraints that each country is facing today, with several operational options for further exploration by donors.

This study is divided into three primary sections. The first characterizes the microfinance industry in general and the state of microfinance in Central Asia. The second section presents an overview of the microfinance sector in each Central Asian country. It also describes the main types of institutions and active donors in the region, focusing particularly NGO MFIs. The third section analyzes current constraints to expanding the microfinance industry and recommends short-term and long-term actions for improving the sustainability and performance of MFIs.
1. Characteristics of Microfinance

Microfinance often provides microentrepreneurs and poor families the critical access they need to credit and other financial services. By providing financial services to the economically active poor, MFIs expand the frontier of the financial sector, drawing previously excluded groups of people (often a vast proportion of the population) into active participation in the financial system, increasing the economy’s financial depth, and generating more broad-based economic growth. Microfinance has been shown to be positively correlated with:

- Reducing poverty and improving welfare by allowing poor people to protect, diversify, and increase their sources of income and assets;
- Safeguarding poor households against extreme vulnerability by smoothing income fluctuations and maintaining consumption levels;
- Improving family expenditures on education, thereby contributing to improving the human capacity of poor families; and
- Reducing family expenditures on health, through improvements in housing, water, and sanitation, and ensuring food security. (CGAP 2003b)

All these achievements are consistent with the development strategy of the World Bank Group based on the Millennium Development Goals (see box 1).

Some studies find impressive increases in income after accessing microfinance, while others find a less-than-clear relationship (Pitt and Khandker, 1996; Hulme and Mosley 1996). These and more recent studies—such as, Cohen and Sebstad, 1999—find that microfinance gives the economically active poor the ability to manage the uncertainties and cushion them from economic and social vulnerability. Uncertainties such as illness of a wage earner, seasonal fluctuations in incomes, unemployment, natural disasters, and theft, can place enormous stress on the limited financial resources of poor households, which, in the absence of effective financial services, can drive them deeper into poverty. By enabling poor people to manage their money productively, microfinance not only helps poor families to improve their economic condition, but also provides a way to maintain or raise their quality of life in the face of uncertainties.

Microfinance also plays a role in the social dimension of poverty. Very often, gaining access to financial services is a critical stepping-stone in connecting a poor person (particularly women) to a broader economic life and in building the confidence needed to play a role in the larger community.

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**Box 1. Millennium Development Goals**

The Millennium Development Goals (MDGs), agreed at the Millennium Summit in September 2000, reaffirm the commitment of UN member states to sustainable development and poverty reduction. MDGs seek to:

- Eradicate extreme poverty and hunger.
- Achieve universal primary education.
- Promote gender equality and empower women.
- Reduce child mortality.
- Improve maternal health.
- Combat HIV/AIDS, malaria, and other diseases.
- Ensure environmental sustainability.
- Develop a global partnership for development.

Source: MDG Web site (www.developmentgoals.org)
Microfinance also has its limitations. Extremely poor people who do not have any stable income, such as the destitute and the homeless, should not be microcredit clients.\textsuperscript{5} In fact, empirical evidence and experience of MFIs indicate that a great number of poor, especially the extremely poor, exclude themselves from microcredit. This finding is not surprising, given that credit will only push these people further into debt and poverty with loans that they cannot repay. Extremely poor people need social safety net programs that can help them with basic needs rather than financial services for money that they barely have.

Microcredit, in particular, best serves those who have identified an economic opportunity and who are in a position to capitalize on that opportunity if they are provided with a small amount of ready cash. By supporting small-scale economic activities, microfinance helps generate income and employment, build local businesses, develop human capital, fosters market competition, and promote broad economic participation.

Poor people need microfinance services for the same reasons as everyone else: to save small amounts of money in a secure manner, to invest in their businesses or homes, to meet large expenditures, and to insure against risk. Typically, formal financial intermediaries, such as commercial banks, do not serve poor households because of the high cost of small transactions, the lack of traditional collateral, geographic isolation, perception of high risks, and sometimes out of social prejudice.

Early efforts to provide financial services to the poor were tied to the end use of the service. For example, between the 1950s and the 1970s, governments and donor agencies focused on providing subsidized agricultural credit to small and marginal farmers in hopes of increasing productivity and incomes. During the 1980s and early 1990s, micro-enterprise credit (or microcredit) concentrated on providing loans to poor entrepreneurs to invest in tiny businesses, enabling them to generate and accumulate assets, to raise household incomes, and to improve family welfare. A large percentage of the clients were women, and microcredit was found to be an especially effective mechanism for improving the social and economic status of women.

Continual experiments with product design, delivery methodologies, and institutional structures, carried out mainly by practitioners in developing countries, led to the emergence of specialized financial institutions that specifically serve the poor called microfinance institutions (MFIs); “micro“ because of the relatively small size of the transactions (loans as small as US$50 or savings deposits as small as US$5) and “finance“ because these institutions provide financial services.\textsuperscript{6}

\textit{Rapidly expanding microfinance market}. Microfinance is one of the fastest growing segments of financial markets in emerging economies. In 1999, on the basis of systematic sampling and review of publications and technical manuals, the International Policy Research Institute (IFPRI) compiled a database of 1,500 MFIs from 85 developing countries (790 institutions worldwide plus 688 in Indonesia) supported by international organizations (Lapenu and Zeller 2001). In a discussion paper published in June 2001, IFPRI estimated that these MFIs alone reached 54 million members, 44 million savers, and 23 million borrowers. The total volume of outstanding credit was at US$18 billion; the total savings volume at US$12 billion. MFIs had at least 46,000 branches and employed approximately 175,000 staff.

\textsuperscript{5}“Building Financial Systems for the Poor”, CGAP Presentation in Almaty, Kazakhstan, April 2, 2003.

\textsuperscript{6} Unless otherwise specified, all money figures are given in US dollars.
Client groups served by different types of MFIs exist along a continuum from the poorest to the less poor to middle income and SMEs. In Central Asia, like other parts of the world, different types of MFIs tend to service clients at different points along the continuum (see figure 1).

Globally, the increasing interest and growing focus on microfinance in recent years have placed significant pressure on donors to do more in this sector. And donors have responded enthusiastically: they spend an estimated US$500 million a year on microfinance, and continue to be the single largest source of funds for most microfinance institutions worldwide. But one of the key problems facing the donor community is that there is no consolidated inventory of MFIs or systematic assessment of their performance and effectiveness. Microfinance professionals have noted that taking the step to analyze what has been achieved as well as the range of institutional types, clients, and performance, is highly useful. The first such step was taken in 1996 when CGAP carried out the first Worldwide Inventory of Microfinance Institutions (World Bank 1996). The survey contained nearly 1,000 MFIs, but there were none from Central Asian countries. More recently, in 2001, the Microfinance Center in Poland carried out a survey of MFIs in 22 countries, including Central Asia, as part of the State of Microfinance in CEE and the NIS study (Forster, Greene, and Pytowska 2003). The ECA study identified about 5,581 MFIs, of which 30 are in Central Asia. The current study is designed to augment the preceding work by carrying out more comprehensive sampling and analysis of MFIs in Central Asia.

**Diversity of MFIs.** The global microfinance industry is far from homogeneous. MFIs vary in size, types of services, and financial performance. The Microbanking Bulletin Issue No. 8 reports on 147 MFIs worldwide that are collectively reaching over nine million borrowers. The five largest are all in Asia and are reaching seven million borrowers, while the remaining 142 together only reach two million of these clients. Though the figures in the Bulletin represent only a portion of the total number of MFIs, this finding reinforces the anecdotal evidence that a handful of MFIs dominate the sector in terms of outreach.

**Regional variations.** The microfinance sector also varies quite significantly among regions. Credit unions are one of the most important sources of credit for microenterprises in Latin America, providing US$2.6 billion in loans to microenterprises, followed by NGO MFIs, finance companies, and commercial banks amounting to about US$800 million (Westly and Branch 2000). In West Africa and Eastern Europe, credit unions and other member-based financial cooperatives are also the biggest and most commonly found MFIs. By contrast, in East and South Asia, NGO MFIs are the predominant players, with the notable exceptions of BRI in Indonesia and Grameen Bank in Bangladesh. Credit unions are intrinsically

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7 The MicroBanking Bulletin is a benchmarking source for the microfinance industry that collects and analyzes financial and portfolio data provided voluntarily by MFIs. Performance is reported for peer groups of similar institutions, enabling MFIs to compare their own performance with that of their peers.
savings-driven institutions, whereas NGO MFIs are credit-focused. In Central Asia, three different types of MFIs are operating: NGO MFIs, credit union, and commercial banks. One microfinance bank has been just licensed in Tajikistan but has not begun its operation.

*Financial sustainability still a challenge.* In terms of financial performance, roughly one-third of the 147 MFIs reporting to the Microbanking Bulletin are currently or nearly financially sustainable. Although it would be hard to extrapolate this result to the entire world of MFIs, this finding is in line with common observations that a large number of MFIs active today are not financially sustainable. In the future, some mergers and consolidations among MFIs are likely, allowing those that are stronger in terms of client satisfaction and financial performance to prevail over those that are not.

The existence and operations of financially sustainable microfinance institutions depend on the business environment and infrastructure within which MFIs and their clients operate. Some important determinants of the successful delivery of microfinance include the overall economic growth, availability of economic opportunities for microfinance clients, and legal framework within which MFIs must operate.

### The State of Microfinance in Europe and Central Asia

The study carried out by the Microfinance Center in Poland “The State of Microfinance in CEE and the NIS“ shows that the ECA region, despite being relatively new to microfinance compared to other world regions, has grown rapidly during the past 10 years with an average growth in number of clients of about 30 percent a year. This dramatic growth in clients, along with the corresponding growth in loan portfolios and savings deposits, provides evidence that there is strong demand for microfinance services in the region. The ECA study identified four main types of organization in CEE and NIS as microfinance service providers:

- **Credit unions.** Credit unions are financial institutions owned and governed by their members. Services are provided only to members, who typically have a common bond, which may be geographic or professional. Traditionally, credit unions have not been considered microfinance providers, because of their focus on deposit services and consumer lending. With the new consensus that microfinance includes a broader range of services, credit unions and other types of member-based institutions are acknowledged providers.

- **Nongovernmental microfinance institutions (NGO MFIs).** NGO MFIs are nonprofit organizations that specialize in lending to the self-employed and microenterprises. NGO MFIs are not licensed to take deposits. Within this category, the ECA study includes nonprofit associations and foundations, as well as the MFIs registered as private or public companies that operate on a nonprofit basis. Because only a small number of MFIs that are registered as public companies, these were not treated by the ECA study as a separate category. It should be noted that the same definition of NGO MFIs was used in this study on Central Asia.

- **Commercial banks with microfinance operations.** Banks that provide microfinance are mainstream commercial banks that, at some point after their inception, introduced Specialized lending services for micro and small enterprises.\(^8\) This approach is often referred to as “commercial-bank downscaling.”

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\(^8\) The ECA study identifies commercial banks “microlending” as involving loans less than $5,000.
- Microfinance banks. These banks are fully regulated, for-profit, commercial banks that offer a broad range of products and services. Greenfield microfinance banks are newly established banks that focus on the provision of services to micro and small enterprises from their inception. Other microfinance banks, such as Banco Sol in Bolivia and K-REP Bank in Kenya, transformed from NGO MFIs into banks.

The ECA survey covered about 5,581 MFIs: credit unions (5,447), commercial banks with microfinance operations (24), microfinance banks (10), and NGO MFIs (100). According to the ECA study, some 1.7 million borrowers and 2.4 million depositors are served by these MFIs in 28 countries (see table 1). At the time of this mapping, these institutions had collected some US$674 million in deposits from small depositors, and had lent out to small borrowers an outstanding loan portfolio of about US$800 million. This represents an estimated five percent of the potential demand for services, a remarkable accomplishment since few countries in the world, even with much longer microfinance experience, have been able to reach more than five percent of the poor households with such services.

Table 1. Europe and Central Asia mapping results, 2001

<table>
<thead>
<tr>
<th>MFI Institution</th>
<th>Number</th>
<th>Portfolio Outstanding (US$ mln)</th>
<th>Active Borrowers (‘000)</th>
<th>Total Deposits (US$ mln)</th>
<th>Active Depositors (‘000)</th>
<th>Average Loan Size (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit Unions</td>
<td>5,447</td>
<td>408</td>
<td>1,453</td>
<td>455</td>
<td>2,244</td>
<td>545</td>
</tr>
<tr>
<td>NGO MFIs</td>
<td>100</td>
<td>108</td>
<td>197</td>
<td>1</td>
<td>17</td>
<td>1,501</td>
</tr>
<tr>
<td>Commercial Banks with microfinance</td>
<td>24</td>
<td>125</td>
<td>23</td>
<td>-</td>
<td>-</td>
<td>7,741</td>
</tr>
<tr>
<td>Operations</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Microfinance Banks</td>
<td>10</td>
<td>158</td>
<td>42</td>
<td>218</td>
<td>96</td>
<td>5,123</td>
</tr>
<tr>
<td>Total</td>
<td>5,581</td>
<td>800</td>
<td>1,715</td>
<td>674</td>
<td>2,356</td>
<td></td>
</tr>
</tbody>
</table>


Perhaps even more impressive is the rapid expansion of financial services in the ECA region. While the number of clients served is increasing at about 30 percent per year, the outstanding loan portfolio of the institutions is increasing at an average of 54 percent per year.

The ECA MFIs serve distinct segments of the population. Based on average loan size, credit unions appear to serve a much poorer segment of the population than NGO MFIs, whose average loan size was nearly three times that of the average credit union. The authors of “The State of Microfinance in CEE and the NIS” noted that such findings should be interpreted with caution because credit unions typically make consumer loans rather than enterprise loans; therefore, loan size may not be an accurate proxy for poverty levels. Microfinance bank loans were targeted at a much wealthier segment of the population because their average loan size was three times larger than NGO loans and nine times larger than credit union loans. Commercial bank loans were targeted at the wealthiest clients, with an average loan size five times larger than NGO MFI loans and 14 times larger than credit union loans.

Credit Unions are concentrated in Eastern Europe. Being the most numerous MFI type, credit unions have the broadest outreach with 1.5 million active borrowers (85 percent of all microfinance borrowers) and over 2.2 million active depositors (95 percent of all depositors), mainly serving micro-entrepreneurs and
low-income clients in rural areas (49 percent).\textsuperscript{9} Besides savings and credit services, credit unions increasingly offer a wider and more sophisticated range of products, such as small enterprise and consumer loans, life insurance, and electronic payments (including ATM). While the strength of credit unions in ECA varies widely with the best credit unions in Poland, the credit unions in Central Asia are generally considered to be weak, particularly in terms of governance and management, and have limited outreach and services.

NGO MFIs in ECA reach the second-largest number of borrowers (around 200,000). With depth of outreach ratio of 125 percent on average, they reach a broad clientele at the lower end of the microenterprise continuum including informal-sector businesses. Many NGO MFIs adopt an institutional approach aiming to transform into sustainable MFIs that can offer long-term financial services to low-income clients. These institutions were quick to learn and apply the best practice of microfinance standards with a strong focus on maintaining high portfolio quality and efficiency so as to achieve financial sustainability. Several NGO MFIs had already achieved financial sustainability which made them the most profitable MFIs among all types in this region.

Commercial bank involvement in microfinance was initially envisioned as a means to scale-up microfinance by leveraging branch networks to deliver microcredit to massive numbers of clients. Currently, commercial banks lend to a limited number of borrowers (about 23,308) from among high-end micro and small enterprises in urban areas (93 percent), providing much larger loans than any other type of MFIs. Microlending operations are mainly donor-driven with EBRD being a major promoter of downscaling in the ECA region.

Microfinance banks are the second largest MFI type in terms of volumes of lending (US$158 million) and savings (US$218 million). The International Project Consult GmbH (IPC), a German consulting firm, developed the model for greenfield microfinance banks to specifically cater to micro and small businesses—mostly urban-based (69 percent)—that usually fall between those of NGO MFIs and commercial banks. Besides working capital loans, microfinance banks offer a wide variety of services such as investment and consumer loans, time and demand deposits, money transfers, and foreign currency exchange. Compared to other MFIs in ECA, microfinance banks have high rates of profitability driven by larger loan sizes and high revenues from nonlending services (40 percent of total revenue).

\textsuperscript{9} \textit{Breadth of outreach} measures the number of clients that participate in the program.
2. Microfinance in Central Asia

Regional Overview

The concept of microfinance first arrived in Central Asia around the mid 1990s—much later than elsewhere. Like in other emerging markets, it is a fast growing market with an annual portfolio growth of about 40 percent and with the number of clients growing at around 20-30 percent annually (see box 2). Compared to the ECA region, microfinance markets in Central Asia have just started to take hold; outreach is still limited and savings mobilization has not yet started (except for compulsory savings in group lending programs).

The survey conducted in Central Asia identified about 489 MFIs. It used the same classification system as “The State of Microfinance in CEE and the NIS”, separating the identified MFIs into four main types (see table 2). Similar to the ECA region, credit unions are the largest in terms of number of institutions (384) but they are still a minor player in Central Asia in terms of outstanding microfinance portfolio and active borrowers, and mainly concentrated in the Kyrgyz Republic. NGO MFIs, including government-owned nonprofits, were led by the Kyrgyz Agricultural Finance Corporation (KAFC). They are the second largest in terms of number of institutions (81) but the largest in terms of outstanding portfolio and outreach, as measured by the number of active borrowers. About 23 commercial banks have begun to engage in providing microcredit and SME lending. Since the survey was completed, one microfinance bank has been licensed in Tajikistan but has not yet initiated its operations. The MFIs in Central Asia serve some 201,000 borrowers with a combined outstanding loan portfolio of US$200 million.

Central Asian MFIs mainly serve clients in urban and peri-urban areas, unless the MFI specifically targets rural clients. Based on average loan size, NGO MFIs in Central Asia served a much poorer segment of the population than any other type of MFIs with an average depth of outreach of 39 percent, which is much lower than the overall average for the ECA NGO MFIs. The microloans from commercial banks were targeted at the wealthier clientele mainly engaged in petit trade, with an average depth of outreach of 831 percent more than 20 times the size of NGO MFIs’ loans. The commercial bank average credit exceeded the conventional definition (provided in the MicroBanking Bulletin) of microfinance as provision of loans below 250 percent of per capita GNI. At the time of the study, consistent data was not available on credit unions and the newly-created microfinance bank.

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Box 2. Europe and Central Asia vs. Central Asia: main indicators

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans</td>
<td>US$800 million in outstanding loans.</td>
<td>US$200 million in outstanding loans.</td>
</tr>
<tr>
<td>Microfinance portfolio growing at 54 percent per year.</td>
<td>Microfinance portfolio growing at 40 percent per year.</td>
<td></td>
</tr>
<tr>
<td>Microfinance clients growing at 30 percent per year.</td>
<td>microfinance clients growing at 20-30 percent per year.</td>
<td></td>
</tr>
<tr>
<td>1.7 million current borrowers.</td>
<td>0.2 million current borrowers.</td>
<td></td>
</tr>
<tr>
<td>2.4 million depositors.</td>
<td>No savings mobilization except for compulsory guarantee funds.</td>
<td></td>
</tr>
<tr>
<td>US$674 million in deposits.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Forster et al., 2003, and Central Asia microfinance team.

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10 KAFC is a nonbank financial institution owned by the Government of the Kyrgyz Republic; created under the World Bank Rural Finance Project, it has grown to be the largest financial institution in this country.
Table 2. Types of MFIs in Central Asia, 2002

<table>
<thead>
<tr>
<th>MFI Type</th>
<th>Number</th>
<th>Outstanding Portfolio (US$ mln)</th>
<th>Active Borrowers (000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit Unions</td>
<td>384</td>
<td>12</td>
<td>30</td>
</tr>
<tr>
<td>NGO MFIs</td>
<td>80</td>
<td>45</td>
<td>147</td>
</tr>
<tr>
<td>of which KAFC</td>
<td>1</td>
<td>22</td>
<td>.35</td>
</tr>
<tr>
<td>Commercial Banks with microfinance operations</td>
<td>23</td>
<td>143</td>
<td>24</td>
</tr>
<tr>
<td>Microfinance Banks</td>
<td>1</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>All MFIs</td>
<td>489</td>
<td>200</td>
<td>201</td>
</tr>
</tbody>
</table>

Source: Central Asia microfinance team.

Despite existing shortcomings because of the fact that microfinance in Central Asia is a nascent sector, it has potential to mature and contribute significantly towards more widely shared economic growth provided that there is an appropriate business and legal environment. The credit culture is slowly but surely emerging as indicated by repeated borrowers and high repayment rates (see box 3). Some MFIs are reaching operational and financial sustainability, in part due to high effective interest rates, and there is opportunity and need to scale up. As a result, much more needs to be done in Central Asia to expand outreach, improve depth of outreach, and provide savings and other financial services.

Box 3. The role of microfinance in Central Asia: summary of results, 2002

- Microfinance works . . .
  - Microfinance helps the poor.
  - Includes the excluded.
  - 65 percent repeat borrowers.
  - More than 97 percent repayment rate.

- However . . .
  - Much more to be done.
  - Outreach is 1 percent of the poor.
  - No significant savings, mostly credit.
  - No other financial services.

Source: Central Asia microfinance team.

Table 3. Poverty indicators for Central Asia, 2001

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Kazakhstan</th>
<th>The Kyrgyz Republic</th>
<th>Tajikistan</th>
<th>Uzbekistan</th>
</tr>
</thead>
<tbody>
<tr>
<td>GNI per capita (US$)</td>
<td>1,350</td>
<td>280</td>
<td>180</td>
<td>550</td>
</tr>
<tr>
<td>Total Population (mln)</td>
<td>14.8</td>
<td>4.9</td>
<td>6.2</td>
<td>25.1</td>
</tr>
<tr>
<td>Poverty Incidence (%)</td>
<td>32</td>
<td>48</td>
<td>83</td>
<td>28</td>
</tr>
<tr>
<td>Total No. of Poor (mln)</td>
<td>4.7</td>
<td>2.4</td>
<td>5.2</td>
<td>7.0</td>
</tr>
<tr>
<td>Rural/ Total Poor (%)</td>
<td>57</td>
<td>75</td>
<td>82</td>
<td>67</td>
</tr>
</tbody>
</table>

Source: World Bank data.

Relevance of microfinance for poverty alleviation in Central Asia. The study did not intend to assess the impact of microfinance on the poor and poverty reduction. Nevertheless, as main microfinance clients are still “working” poor people, who can become economically sustainable, the study did review the relevance of microfinance in the context of poverty. The study also measures the poverty outreach of various MFIs throughout the report to illustrate the current limited outreach and potential for the microfinance industry at large.
Microfinance is important for the countries of Central Asia as they struggle to deal with the dual challenges of economic growth and poverty reduction. Central Asian countries have the lowest per capita income in ECA, with a GNI as low as US$180 in Tajikistan. The percentage of the population living in poverty is very high, as high as 83 percent in Tajikistan and 48 percent in the Kyrgyz Republic. Even in Kazakhstan and Uzbekistan, both relatively high-income countries, between 28 percent and 32 percent of the total population are living in poverty. Furthermore, as table 3 indicates, the incidence of poverty is much worse for rural populations in all of the Central Asian countries. Some of the characteristics of poor people considered when designing viable microfinance interventions with appropriate loan sizes and terms, application procedures, repayment schedules, or borrower groups, are described below:

- **Country dimension.** Within the Central Asia region, Uzbekistan has the highest number of poor (approximately seven million), accounting for 35 percent of all the poor people in the region, followed by Tajikistan which accounts for 27 percent of these poor;

- **Rural dimension.** In all five countries, a higher share of the population lives in rural areas, and poverty is more widespread in rural than in urban areas.

- **Regional dimension.** There are substantial differences in poverty rates across the regions of each of the Central Asian countries: the poorest areas of Kazakhstan and Uzbekistan are in the south, they are in Naryn and Talas Oblasts in the Kyrgyz Republic, and in Gorno-Badakhsan Autonomous Region in Tajikistan.

- **Employment dimension.** Although the unemployed are at a higher risk of being poor, employment does not necessarily guarantee a higher living standard because even when poor people work, they are employed in lower paying and less secure positions than the nonpoor and so are overrepresented in sectors with low wages.

- **Sectoral dimension.** Agriculture is the most important source of income for 50 percent of poor people.

**Limited impact on the poor to date.** Reaching the poor, especially the rural poor, has proved an elusive and costly endeavor for Central Asian governments. The rural infrastructure and subsidy system that existed under the Soviet Union have disappeared, leaving a void in support to the rural sector. The rural poor have been especially hard hit by the changes. As mentioned earlier, microfinance can play an important role in expanding the frontier of the financial sector to include larger segments of population in the economic development efforts. In Central Asia the microfinance industry, while still having a limited outreach, has been relatively successful in targeting the poor. To measure whether microfinance services actually reach the poor, the microfinance industry often uses the ceiling of 250 percent for the ratio of loan size over per capita income. The respective figures illustrated in table 4 show that the average size of loans provided was below this 250 percent benchmark, indicating that MFIs were able to target the poor, even though penetration rates (number of people reached) are still low.

**Table 4. Poverty outreach by MFIs in Central Asia, 2002**

<table>
<thead>
<tr>
<th>Outreach indicator</th>
<th>Kazakhstan</th>
<th>Kyrgyz Republic</th>
<th>Tajikistan</th>
<th>Uzbekistan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Microfinance clients as percent of total poor</td>
<td>0.4</td>
<td>3.0</td>
<td>0.8</td>
<td>0.1</td>
</tr>
<tr>
<td>Microfinance clients as percent of rural poor</td>
<td>0.7</td>
<td>4.0</td>
<td>1.0</td>
<td>0.1</td>
</tr>
<tr>
<td>Depth of Outreach (percent)</td>
<td>17</td>
<td>154</td>
<td>41</td>
<td>17</td>
</tr>
</tbody>
</table>

Source: Central Asia microfinance team.
Successful targeting of services to poor people is necessary but not sufficient for microfinance to be an effective tool to reduce poverty. Further investigations should show that the microfinance services in Central Asia help improve the living conditions of poor clients. Additionally, the coverage of microfinance services in Central Asia would need to be expanded further to have a real impact on poverty reduction in the region.

Distinctive country variations. In Central Asia, the degree of development of microfinance services varies from country to country. In the smaller countries like Tajikistan and the Kyrgyz Republic, there are reasonably strong MFIs with relatively large numbers of clients. In Kazakhstan and Uzbekistan, the institutions are smaller and have limited outreach, especially in relation to their larger populations. In all four countries, the number of microfinance clients currently served is very small compared to the total potential client base.

**Kazakhstan**

Kazakhstan’s financial industry is represented by three main types of institutions: 38 commercial banks, 30 nonbank financial institutions, and 34 NGO MFIs.

The country has one of the most advanced, liquid, and vibrant financial systems among NIS countries with high domestic lending rates, which are supported by the presence of large corporate borrowers and agricultural producers. Nevertheless, SME and microfinance lending is still underdeveloped as the sector has a limited outreach and a narrow clientele focus (see box 4). As a result, the institutions that participated in the study provide microfinance to about 28,770 people, only about 0.4 percent of the poor population or 0.74 percent of the rural poor. As the commercial banks’ definition of microcredit in Kazakhstan includes loans of up to US$50,000, the majority of the banks’ clients are above the poverty line. The banks’ average loans are US$13,241—almost 10 times the per capita GNI. While accounting for 92 percent of the reported microfinance portfolio, banks only serve 27 percent of the current microfinance clients in the country, almost all of whom are traders or service providers in towns or cities. Microfinance services provided are limited mainly to microcredits.

**Box 4. Microfinance in Kazakhstan, 2002**

- Outreach is less than one percent of the total poor.
- About two million rural poor are excluded from financial support.
- Three percent of commercial bank outstanding loans considered “micro” up to $50,000.
- But GOK subsidized credit creates challenges.
- MFI capacity varies widely and has the highest administrative cost (47 percent) in Central Asia.
- Microfinance urban market for short-term trade almost saturated.
- MFIs want to develop innovative products and delivery schemes.
- KazPost (post office) active in remote areas but focusing on reinvesting in Government securities.

Source: Central Asia microfinance team.

Credit Partnerships are relatively new member-based financial institutions. Only 27 credit partnerships have been established so far, with about 35 members in each on average. They provide a mechanism for small numbers of larger rural producers to access Government subsidized loan programs. NGO MFIs

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11 This number can actually be higher if it is calculated only for microloans lent from the banks’ own resources. The average loan size is lower because of the effect of the EBRD Small Business Credit Line.
serve more clients than any other type of MFI, accounting for 70 percent of microfinance borrowers with the lowest depth of outreach at 17 percent.

Established by international institutions, NGO MFIs have substantially matured, and the country has the most developed network of local NGOs. Although the microfinance industry has been growing rapidly, both banks and NGO MFIs are largely focusing on urban/town clients, providing microfinance to small traders and service providers. One exception is Microcredit NGO, which was created by the government to assist rural poor people. But the institution’s funding has been provided in a form of a one-time budget transfer, and it is rapidly decapitalizing with the number of loans issued each year dropping significantly.

**The Kyrgyz Republic**

This country’s financial sector consists of 20 commercial banks with total assets of US$139 million, 350 nonbank financial institutions (credit unions), and 17 NGO MFIs, all of which provide microfinance services to varying degrees. Combined, these institutions provide microfinancing to about 100,000 people, about two percent of the entire population or three percent of the poor population. MFIs in the Kyrgyz Republic have the broadest outreach among Central Asian countries serving about three percent of all poor (see box 5).

Due to a relatively underdeveloped banking sector, most of the on-lending funds available in the country from various international sources were channeled through institutions established by IFIs for specific purposes. In order to facilitate this process and improve the understanding of the importance of MFIs to include the poor in the economic activities, the Government has made a significant effort to build a favorable environment for the microfinance industry. To date, the Kyrgyz Republic has the most comprehensive legal and regulatory framework in Central Asia for microfinance activities with laws on microfinance institutions and credit unions. It has several relatively mature MFIs, one of which is considering transformation into a rural bank.

NGO MFIs have both the largest microfinance portfolio (76 percent) and the largest number of clients (70 percent of total), almost half of which come from one institution, the Government-sponsored KAFC. The country also has the most advanced credit union network in the region, developed with the assistance of an on-going ADB/GTZ program and is currently serving about 29,000 rural people. Credit unions have much lower depth of outreach, about 96 percent, compared to the country average of 142 percent. The most significant feature of the credit union movement is that it has succeeded in leveraging donor-provided funds by attracting compulsory member savings, and it is the only type of institution that has been able to grow its portfolio significantly. The credit union

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**Box 5. Microfinance in the Kyrgyz Republic, 2002**

- Outreach is 3 percent of the poor (highest in Central Asia).
- Most advanced legal framework in Central Asia.
- Most developed NGO MFIs in Central Asia with the largest NGO portfolio in Central Asia (US$30 million).
- Most developed credit unions in Central Asia serving 29,000 clients, with total portfolio of US$8 million.
- Over 70,000 active borrowers.
- Exceptional support for rural sector and agriculture.
- Interest rates range between 20 percent and 54 percent.
- KAFC, the largest MFI in Central Asia, has around US$22 million portfolio and over 35,000 clients.
- FINCA, the first MFI in Central Asia, started 8 years ago.
- Some MFIs ready for transformation.
- Most MFIs seek commercial funding.

Source: Central Asia microfinance team.
experience has demonstrated that the rural poor are capable of savings deposits, but little information was available at the time of study to review the repayment rate and other performance indicators of the credit unions.

**Tajikistan**

The financial sector of this country is still weak as represented by 14 undercapitalized and underperforming commercial banks (the largest four control 85 percent of total bank assets) and about 20 microfinance institutions stemming from early humanitarian efforts of donor organizations (see box 6). Lending to SMEs by commercial banks is limited, and estimated to be less than US$300,000 total. In the absence of a strong banking sector, most of the financial assistance to the poor is channeled through specialized NGO MFIs serving 99 percent of microfinance clients in the country. There are no credit unions currently operating. Tajikistan is the first country in the region to create a microfinance bank by merging and transforming two NGO MFIs.

**Box 6. Microfinance in Tajikistan, 2002**

- Outreach is less than one percent of the poor.
- Commercial banks only begin to engage in microfinance.
- NGO microfinance industry rapidly expands (47 percent per year).
- US$3 million outstanding microfinance loans.
- Relatively strong NGO MFIs but limited overall impact.
- First MFI coalition for increased voices of MFIs and information sharing.
- First microfinance bank in Central Asia.
- Most MFIs operate under bilateral legal agreements and protection of international NGOs.
- New microfinance legislation was enacted in 2003.

Source: Central Asia microfinance team

**Uzbekistan**

The overall financial industry in this country is extremely segmented and underdeveloped with the Government controlling 96 percent of the banking sector’s assets with a number of subsidized programs channeled through the banks. MFIs are the mostly undercapitalized and smallest ones in the regions and together with emerging credit union movement are operating under an inadequate legal and institutional framework (see box 7). There are about 36 banks, 10 NGO MFIs, and seven newly established credit unions providing microfinance services in the country. The banks and the NGO MFIs currently have around 21,119 microfinance clients, which comprise only 0.1 percent of the poor population. The average microcredit from banks is more than four times the GNI per capita. While NGO MFIs have a low depth of outreach, their combined portfolio is at around US$550,000. Although a few credit unions have recently emerged, no data was available on their activities at the time of the study.
Box 7. Microfinance in Uzbekistan, 2002

- Outreach is less than 0.1 percent of the poor.
- Commercial banks account for less than 1 percent of microcredit.
- Government imposes interest rate caps (currently at negative real interest rates).
- Strong Government control on cash transactions.
- But certain donor programs exempted.
- NGO MFIs at very early stage of development (total portfolio below US$0.6 million).
- Ten active NGO MFIs, of which four are quite strong.
- Starting from low base UZ still fastest growing microfinance market in Central Asia.
- The Law on Credit Unions adopted in April 2002.
- Seven registered credit unions but limited operations.

Source: Central Asia microfinance team.

Types of Microfinance Institutions

As mentioned above, the microfinance clients in Central Asia are serviced by four main types of microfinance providers. These different organizational models are analyzed below.

Credit unions

The development of credit unions, which are the most successful in reaching out to the poor rural population elsewhere in the Eastern and Central Europe, is still limited in Central Asia. Currently, credit unions hold six percent of the total microfinance portfolio, and serve about 16 percent of the total microfinance clients in the region (see table 5 for more details on credit unions).

Table 5. Credit union portfolio in Central Asia, 2002

<table>
<thead>
<tr>
<th>Country</th>
<th>Portfolio (US$ mln)</th>
<th>Current Clients ('000)</th>
<th>Average Loan Size (US$)</th>
<th>Depth of Outreach (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kazakhstan</td>
<td>4.0</td>
<td>1</td>
<td>3,960</td>
<td>293</td>
</tr>
<tr>
<td>The Kyrgyz Republic</td>
<td>7.8</td>
<td>29</td>
<td>269</td>
<td>96</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>NA</td>
<td>0.4</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>Total</td>
<td>11.8</td>
<td>30</td>
<td>NA</td>
<td>NA</td>
</tr>
</tbody>
</table>

Source: Central Asia microfinance team.

The Kyrgyz Republic is leading Central Asian countries in the credit union coverage, mainly due to a large ADB/GTZ assistance program that provides US$12 million for matching equity funding to individual Credit Unions. An APEX, Financial Company for Support of Credit Unions (FCCU), was created to manage the matching grant program, channel ADB funds, and supervise credit unions, while technical assistance is being provided to the credit union system by GTZ with advisors from DGRV, the German credit union development agency. To date, 350 credit unions, including 313 fairly strong, have been formed with 29,000 members, with an average of about 80 members per credit union. Credit unions serve about 31 percent of the total MFI clients in the country. Credit unions are currently not empowered to collect voluntary savings. The compulsory deposits that are collected are rather paid-in capital required
for credit union membership. Credit unions do not offer any savings products to its members or nonmembers.

In Kazakhstan, there are no traditional s yet. Nevertheless, the Government is supporting the creation of Credit Partnerships which are also membership-based financial institutions, but credit partnerships significantly differ from credit unions in regards to membership and management, sources of funds, and nature of organization. The Ministry of Agriculture takes 35-50 percent equity positions in such partnerships established by larger agro-producers. After establishment of such a credit partnership, the Agricultural Credit Corporation (ACC), owned by the Government, makes concessionary loans to leverage credit partnerships equity at 4:1 ratio with loans at 3 percent to 5 percent annual interest rates. ACC has been established by Ministry of Agriculture to support credit partnership development, with more than US$5 million in assets, mainly in the form of interest free credits. Credit Partnerships are licensed institutions supervised by Ministry of Finance. To date, 27 credit partnerships have been established that lend to their members for up to five years at around 10 percent annual interest rate, with maximum loan size of US$300,000.

Credit unions are new to Uzbekistan financial markets, with only seven registered credit unions by February 2003. An ADB loan is supporting the development of credit unions. A recent law allows credit unions to accept deposits and make loans to its members. A credit union must have at least 50 members with US$10,000 share capital and be supervised by the Central Bank. It is premature to evaluate efficiency of credit unions at this stage. There are no active credit unions in Tajikistan.

Commercial banks

The commercial banks in Central Asia are at various stages of development. Kazakhstan has 37 commercial banks and has the most advanced banking sector in the region and has been experiencing significant growth since 2000. While banking assets are about 29 percent of GDP and by far highest in Central Asia, the level of broad money and bank credit in proportion to GDP is still much lower than that in other emerging markets.

The banking sector in the Kyrgyz Republic is relatively small and underdeveloped. Total banking assets represent approximately nine percent of GDP, which is the lowest among the transition economies. Here, consolidation of the banking sector is needed since the country is overbanked, with 20 banks in operation currently, of which the top five control more than 49 percent of this sector’s assets.

Similar to the Kyrgyz Republic, Tajikistan’s banking sector is also very small, highly concentrated, fragile, and undercapitalized, with only about four percent deposit to GDP ratio. There are 14 commercial banks, four of which control 85 percent of banking assets and the quality of the loan portfolio is poor.

The banking system in Uzbekistan consists of 13 state owned banks, 16 private banks, and five joint venture banks. In real terms, however, the sector is stagnant, with shrinking total assets, loans, and capital. It is also highly dominated by the state through its direct and indirect ownership and its lending guarantee.

Commercial banks’ involvement in microfinance. The Central Asian commercial banks have started to get more active in providing microcredit beyond SME lending (see table 6). Currently, the banks in general:

- Provide small loans with maturities of one year or less (except for Uzbek banks) because of funding constraints and limited experience, except for the existing donor supported SME credit lines;
- Do not lend to the rural sector, as rural lending is seen as both high-cost and high-risk. Rural finance has not been fully integrated into the overall business strategies of commercial banks;
- Rely more on full collateralization, rather than sound business concepts and cash flows, and they have weak capacity in appraising and supervising smaller loans, so the banks still prefer to lend to large-scale borrowers.

**Table 6. Microfinance portfolio of commercial banks, 2002**

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>The Kyrgyz Republic (4)</th>
<th>Tajikistan (5)</th>
<th>Uzbekistan (7)</th>
<th>Total (23)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Loan Portfolio (US$ mln)</td>
<td>3,258</td>
<td>142</td>
<td>2,864</td>
<td>6,280</td>
</tr>
<tr>
<td>% of Total Banking Portfolio</td>
<td>68</td>
<td>81</td>
<td>93</td>
<td></td>
</tr>
<tr>
<td>Microfinance Portfolio (US$ mln)</td>
<td>102</td>
<td>2</td>
<td>0.3</td>
<td>38.4</td>
</tr>
<tr>
<td>Microfinance as % of Total Loan Portfolio</td>
<td>3</td>
<td>10</td>
<td>0.2</td>
<td>1</td>
</tr>
<tr>
<td>Number of microfinance Clients ('000)</td>
<td>8</td>
<td>1</td>
<td>0.3</td>
<td>15</td>
</tr>
<tr>
<td>Average microfinance Loan Size (US$ '000)</td>
<td>13</td>
<td>2</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Average Interest Rate (%)</td>
<td>22</td>
<td>25</td>
<td>25</td>
<td>24</td>
</tr>
<tr>
<td>Average Maturity (months)</td>
<td>11</td>
<td>8</td>
<td>12</td>
<td>21</td>
</tr>
</tbody>
</table>

Source: Central Asia microfinance team.

Commercial banks’ own definitions and understanding of microfinance (or rather microcredit) also vary widely as are their methodology for providing “micro“ loans. Out of seven commercial banks that provide microcredit in Kazakhstan, three define microfinance as loans up to US$30,000. One bank has a higher limit of US$50,000. In the Kyrgyz Republic, the commercial banks consider loans from US$1,500 to US$10,000 as microcredit while Uzbek banks use a definition of US$5,000 to US$10,000. Of the five banks interviewed in Tajikistan, two define microcredit as loans up to US$2,000, while one bank limits microcredit to US$1,000 and another bank allows loans as high as US$50,000.

With active donor support, provision of microcredit by commercial banks has started to emerge in Central Asia. In Kazakhstan, mainly due to the active support of EBRD and IFC, several commercial banks are now engaged in individual microlending. In general, private commercial banks still consider rural lending as high cost and high risk and do not lend their own resources to the rural sector. Exceptions are large collateralized loans to large corporate agro-producers and uncollateralized credits of up to US$3,000 mainly to tobacco growers in which case the repayment is secured by payments from cigarette producers (Philip Morris). Generally, the commercial banks are hesitant to lend below US$5,000.

In the Kyrgyz Republic, most banks lack specific sector specialization and skills. They are not actively lending and the level of intermediation is very low. Aside from existing donor supported SME credit lines, almost no banks provide loans with maturities greater than one year because of funding constraints and limited experience. Microcredit lending by commercial banks is even lower. The surveyed banks reported 10 percent of their lending portfolio was microcredit with an average loan size of about US$2,300 or 8 times the per capita GNI. The average interest rate was around 25 percent with average maturity of about 8 months. Given the structural weaknesses in the banking sector, it is envisaged that for
a foreseeable future, the gap in rural microcredit lending will continue to be filled largely by nonbank institutions such as KAFC, which is currently the largest agricultural lender in the country by volume and number of clients.

In Tajikistan, in light of many challenges in the banking sector, banks’ share of microcredit loans to total loans is only about 0.2 percent, which is the lowest among the Central Asian countries. Microcredit loans are short term (up to 12 months) and range from US$200 to US$2,000 with an average size of US$1,050 mostly for trade and working capital. The annual interest rates range between 22-25 percent on foreign currency loans and 26-30 percent on national currency loans. Given the problems of capitalization in the banking sector as well as their general misunderstanding about microfinance, it is unlikely that commercial banks will be significantly engaged in microlending activities in the near future.

Commercial banks in Uzbekistan generally consider microcredit as anything less than US$10,000, with average microcredit at about US$2,500. Banks offer the longest maturity (an average of 21 months) and an average interest rate of up to 24 percent. In addition, the banks also channel various Government funds to SMEs. In 2002, the Employment Fund issued US$1.4 million in microcredit to 1,700 poor families, with an average loan size of US$848 (at five percent annual interest). Notable exception for Uzbekistan is that many banks have a sizable rural portfolio. Two largest banks in the country, National Bank of Uzbekistan (NBU) and Pakhta Bank, have a combined microcredit portfolio of US$28 million, of which about US$13 million is for agriculture, mainly for cotton and annual crops.

Microfinance banks

The first microfinance bank in Central Asia has been recently created in Tajikistan. It received its license from the National Bank of Tajikistan in July 2003 but has not started operations at the time of the study. Two NGO MFIs, Enterprise Support Facility (ESF) and Mountain Societies Development Support Program (MSDP), with a significant outreach of about 30,000 clients have been merged and transformed in the microfinance bank. The main investors supporting this transformation are Aga Khan Fund for Economic Development (AKFED) and International Finance Corporation (IFC is not a donors). The bank will offer a wide range of services including savings and credits to individuals and groups. It will open branches in the provinces, primarily in remote rural areas. In addition, services will also be provided via mobile communications. Currently, there are no other microfinance banks in Central Asia.

NGO MFIs

It should be noted, that, similar to the ECA study, the NGO MFI group refers not only to NGOs, but also to three government owned and/or run MFIs such as KAFC, a nonbank financial institution in the Kyrgyz Republic, and two MFIs in Kazakhstan, Microcredit NGO and National Fund for Support of Poor Citizens. All of these institutions have been grouped together as there are certain characteristics that separate them from credit union, commercial banks, and microfinance banks, such as nonprofit objective of their businesses and similar nature of their operations and management to NGO MFIs.

At present, NGO MFIs are the dominant player in Central Asia in terms of outstanding portfolio, active borrowers, and outreach. While there are many NGO MFIs operating under various legal forms, about 81 NGO MFIs are considered to be “serious” MFIs with total outstanding portfolio of about US$45 million and serving about 150,000 borrowers. Some have established themselves as leading financial organizations for serving the low-income population and have the greatest impact on the poor. Consistent with global experiences, some NGO MFIs in Central Asia have reached operational and financial sustainability and are ready for scaling up and transforming themselves into more formal financial
Institutions. Mergers and transformation of NGO MFIs have already started to take place. In the context of Central Asia where banking sector is still undergoing restructuring and consolidation and credit unions are yet to find their market niches, NGO MFIs are well positioned in the short- to medium-term to fill the unmet demand for microcredit services from low-income population. However, over the longer term, if NGO MFIs wish to offer a broad range of financial services, including savings, they must transform into shareholding entities. This transformation will also make it easier for them to access commercial sources of funding and enable them to seek private equity. Donor grants will never be large enough to enable successful NGO MFIs to dramatically increase their outreach; thus, access to private capital is essential.

Like their predecessors in Latin America and Asia, NGO MFIs in Central Asia have local offices that are close to their clients and base their lending decisions on the client’s character, commitment to repay a loan, and estimated cash flow rather than on collateral.

**Portfolio Analysis of NGO MFIs**

The majority of the NGO MFI portfolio and active clients in Central Asia belongs to the large internationally supported or managed and mainly urban-oriented NGO MFIs that have been touted as the region’s success stories. There are a number of smaller NGO MFIs supported by international donors that serve smaller markets within targeted regions or populations. Several locally-based NGO MFIs are also emerging, but their operations so far are limited. The Government of Kazakhstan has initiated a few large state programs either targeting the poor population or supporting small and medium enterprise development.

Globally, as well as in Central Asia, many NGO MFIs have demonstrated through innovative delivery mechanisms and focus on the client’s character and commitment to repay a loan that they can serve poor clients while maintaining sustainability. The main product of these institutions is short-term working capital loans based on social collateral with very high interest rates. Supported by donor grants for lending capital and operational costs, and facing limited competition due to the fragmented microfinance industry in the region, NGO MFIs have had little incentive to diversify their products or markets, and have enjoyed high margins on their microcredits. The high yields afforded by high interest rates (as high as 72 percent per year in some cases) have allowed these institutions to reach impressive operational self-sufficiency of 172 percent on average, despite high administrative costs.

The quality of accounting, financial reporting, and portfolio monitoring remains weak. Very few have transparent accounting and reporting systems, and most, especially those with direct or quasi-government support are very reluctant to share data. Many are nontransparent.

In some cases, NGO MFIs in Central Asia have expanded rapidly. However, most are very small, with limited outreach and significance, and are highly dependent on cheap donor funds. Few have ties to capital markets. Short-term scaling up is feasible for many NGO MFIs only if they continue to receive donor funding. Those that have been able to demonstrate sustainability are beginning to diversify their sources of funds through commercial sources. However, there are limits to the growth of NGO MFIs, mainly due to their unclear ownership structures. Because they do not have shareholders, they are unable to attract private capital. Capital can only be acquired through donor grants and retained earnings. Access to liabilities that could fund growth is also limited, as they are unable to offer deposit products. This is principally because there are no real owners with capital at stake. Therefore, massive scaling up is feasible only through a process of transformation of institutional structure. Most NGO MFIs that have transformed into formal financial institutions have done so through creation of a private shareholding
structure. Transformation into a member-based institutional structure is also possible, but growth is this case – especially if a significant portion of the members are poor – would be dependent on an increase in the size of the membership.

To sum up, NGO MFIs have shown that they can initiate microfinance services for segments of the population excluded by the formal financial sector. These institutions are also capable of developing and providing a range of innovative products and delivery mechanisms and achieving operational and financial sustainability. In Central Asia, NGO MFIs are still at an early stage of development. Unless they actualize their potential to transform into more formal financial intermediaries (demonstrated in figure 2), they will remain small and relatively insignificant. Other types of financial intermediaries, especially commercial banks and credit unions, do play an essential role in the formation of a mature microfinance industry in Central Asia. These institutions are receiving adequate and productive assistance from EBRD and ADB in each country. EBRD supports the commercial banks in promoting SME loans and microcredit and ADB is a main player in credit unions’ development.

The following sections are based on the detailed analyses of 21 NGO MFIs that represent about 90 percent of the total outstanding MFI portfolio in the region, including their outreach, portfolio, operational and financial results, interest rates, and source of funds (table 7).

**Table 7. Credit union portfolio in Central Asia, 2002**

<table>
<thead>
<tr>
<th>Country</th>
<th>Number of MFIs</th>
<th>Total Borrowers (000)</th>
<th>Current Portfolio (US$mln)</th>
<th>Average Loan Size (US$)</th>
<th>Depth of Outreach</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kazakhstan</td>
<td>6</td>
<td>20</td>
<td>4.5</td>
<td>226</td>
<td>17</td>
</tr>
<tr>
<td>The Kyrgyz Republic</td>
<td>5</td>
<td>70</td>
<td>30</td>
<td>431</td>
<td>154</td>
</tr>
<tr>
<td>Of which KAFC</td>
<td>1</td>
<td>35</td>
<td>22</td>
<td>624</td>
<td>223</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>6</td>
<td>42</td>
<td>3.0</td>
<td>73</td>
<td>41</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>4</td>
<td>6</td>
<td>0.5</td>
<td>95</td>
<td>17</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>21</strong></td>
<td><strong>137</strong></td>
<td><strong>38.0</strong></td>
<td><strong>-</strong></td>
<td><strong>-</strong></td>
</tr>
</tbody>
</table>

Source: Central Asia microfinance team.

**Sources of funds**

The majority of the surveyed NGO MFIs in Central Asia are donor funded mostly through grants. KAFC borrows –loans from the Ministry of Finance under two World Bank rural finance credit lines. There are, however, a few attempts to diversify and borrow from commercial lenders such as Blue Orchard Finance. IDA and ADB have also provided loans to NGO MFIs. Out of 21 NGO MFIs surveyed, only six indicate that some part of their funds come from sources other than grants. Of these six, four receive both interest-free and interest-payable loans, and three receive funds as capital. On average, eight percent of funds are
interest-free loans and 46 percent are interest-payable loans. Sixty-four percent of funds are received as capital. Two NGO MFIs indicate that they pay 10 percent interest for the funds received.

**Outreach**

The surveyed NGO MFIs managed to achieve deep but not necessarily broad outreach. In terms of breadth or geographical coverage, the penetration is low across the countries in the region at an estimate of less than 1 percent of the total poor population (excluding KG that reaches three percent of the total poor). A total of 222,873 people are recorded as borrowers of NGO MFIs, and of them, about 137,000 have active loans. The total outstanding portfolio amounts to about US$40 million, with average loan sizes ranging from US$73 to US$431. Tajikistan has the smallest average loan size, while the Kyrgyz Republic has the largest. However, these NGO MFIs have achieved significant depth of outreach ranging from 17 percent to a still very effective depth rate of 154 percent. NGO MFIs have a repeat borrower ratio on average 60 percent. The highest number of borrowers returning for another loan is in Tajikistan with 76 percent of all borrowers returning, closely followed by Kyrgyz Republic with 71 percent and Uzbekistan, where 55 percent are repeat borrowers. The lowest number of returning borrowers is in Kazakhstan with 27 percent.

**Financial products and services**

The NGO MFIs provide loan products; they are not legally allowed to mobilize savings although some MFIs require “forced savings“ as security or guarantee funds. A few MFIs are incurring foreign exchange mismatch by offering dollar savings and making local currency loans. The majority of MFIs concentrate their activities in urban and peri-urban areas, unless an institution specifically targets rural clients. Most loans are provided through solidarity groups based on social collateral and are for short-term petty trade available only at very high interest rates. A major problem is that the available loans do not match the clients’ needs: especially in the rural areas in relation to the agricultural product cycle; and in the urban areas, in relation to the relatively long gestation period of business. KAFC is a major outlier with over 80 percent of its loan portfolio in agricultural sector. KAFC also offers medium-term production credit and some credit for purchasing assets.

**Loan terms, interest rates, and performances**

As shown in table 8 from which KAFC is excluded, the typical loan terms are 3–4 months with repayment of principal in equal installments. The typical interest rates in most cases were 4–5 percent per month flat rate where the monthly rate is charged to the entire original loan amount until the full principal is repaid, which results in a large difference between a nominally stated rated and an actual APR. For example, a nominal interest rate of 4.5 percent per month (54 percent a year) would translate into an annualized APR of 84 percent if the repayment is done once a month, and 93 percent APR with weekly repayment. KAFC provides working capital and medium-term financing at nominal interest rates averaging 20–21 percent annually. Kazakhstan had the most subsidized microfinance loans at a nominal rate as low as 5 percent per year, while the highest nominal annual interest rate of up to 72 percent was noted in Uzbekistan. Competition among MFIs is very limited, which is reflected in the wide range of interest rates coexisting in a single market.
Table 8. Terms of loans per country, 2002

<table>
<thead>
<tr>
<th>Country</th>
<th>Range of Loan Terms (months)</th>
<th>Interest rate per year (percent)</th>
<th>PAR over 30 days (percent)</th>
<th>Provision Level (percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kazakhstan</td>
<td>3 - 16</td>
<td>5 – 55</td>
<td>12.1</td>
<td>0.4</td>
</tr>
<tr>
<td>The Kyrgyz Republic*</td>
<td>4 - 12</td>
<td>35 – 54</td>
<td>0.7</td>
<td>1.3</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>2 - 12</td>
<td>16 – 48</td>
<td>1.6</td>
<td>1.3</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>4 – 6</td>
<td>35 – 72</td>
<td>1.5</td>
<td>0.0</td>
</tr>
<tr>
<td>Average</td>
<td>-</td>
<td>-</td>
<td>2.2</td>
<td>0.5</td>
</tr>
</tbody>
</table>

*KAFC is excluded. Source: Central Asia microfinance team.

Portfolio at risk (PAR). In terms of loan portfolio quality, the regional average is about 2.2 percent for PAR over 30 days. Kazakhstan has the highest PAR over 30 days, which is primarily due to government owned or socially-oriented microfinance operations. Except for KAFC, where the PAR was six percent, other MFIs that reported this indicator in the Kyrgyz Republic, Uzbekistan and Tajikistan had impressively low PAR rates. Some apparent inconsistencies in the reported PAR and provision rates suggest that accounting, financial reporting, and portfolio monitoring quality are still weak. Of all MFIs analyzed, only a few create provisions, on average one or two MFIs in each country. In most cases, the provision level is not related to the portfolio-at-risk ratio, and MFIs with the highest PAR do not create provisions at all, with exception of KAFC, which fully provisioned its PAR. The analysis of MFI operations seems to suggest that low PAR is a combination of several factors, most typically:

- A conservative loan portfolio growth rate (below 40 percent).
- Investment in staff, especially in terms of training and remuneration;
- A modest number of borrowers per loan officer (typically from 180 to 250).
- A manageable average loan portfolio size per loan officer (US$30,000 to US$70,000).

Operational performance. With relatively high interest rates, MFIs have achieved high operational sustainability with the regional average of about 172 percent (see table 9), although administrative efficiency and productivity of loan officers are about average for microfinance norms. Among the four Central Asian countries, most efficient MFIs are in Uzbekistan (16 percent average administrative efficiency), followed by the Kyrgyz Republic (27 percent), Tajikistan with 39 percent and Kazakhstan with 47 percent average administrative efficiency. However, inclusion of KAFC in the calculation can bring the Kyrgyz Republic to a leader position (14 percent average administrative efficiency ration), mainly due to the dominant position of KAFC and its high administrative efficiency of only eight percent.

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12 Administrative efficiency: personnel and administrative expenditures as a percentage of the average loan portfolio.
### Table 9. Operational performance of NGO MFIs, 2002

<table>
<thead>
<tr>
<th>Country</th>
<th>Operational Sustainability (%)</th>
<th>Administrative Efficiency (%)</th>
<th>Staff Productivity (number of loans)</th>
<th>Loan officer productivity (number loans)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kazakhstan</td>
<td>83</td>
<td>47</td>
<td>87</td>
<td>132</td>
</tr>
<tr>
<td>Kyrgyz Republic*</td>
<td>215</td>
<td>27</td>
<td>110</td>
<td>235</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>139</td>
<td>39</td>
<td>340</td>
<td>157</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>249</td>
<td>16</td>
<td>78</td>
<td>223</td>
</tr>
<tr>
<td>Average</td>
<td>172</td>
<td>33</td>
<td>108</td>
<td>216</td>
</tr>
</tbody>
</table>

* KAFC is excluded. Source: Central Asia microfinance team.

**Financial performance.** All NGO MFIs have received grants for making loans. Only two MFIs have borrowed from commercial banks including one from a socially responsible investor for a limited amount. Most MFIs interviewed reported that access to additional loan funds is one of their biggest challenges. As a result, most MFIs are trying to maximize the earned profits by levying the highest interest rates that the market will accept. This practice results in significant financial returns. Most of MFIs are relending earned profits as their ability to mobilize additional loan funds is currently limited. As seen in table 10, the weighted average microfinance portfolio yield for all four countries is 27 percent, with Uzbek MFIs achieving as high as 68 percent, and Tajik MFIs reaching 59 percent. However, the situation with Kyrgyz MFIs warrants special attention, as financial indicators are one area where such outlier as KAFC can significantly change the picture.

While the portfolio yield of Kyrgyz MFIs of 34 percent is fairly low, it has been significantly influenced by KAFC’s dominant portfolio position in the market. Excluding KAFC with its 23 percent yield on portfolio from the calculation, the average yield of MFIs in the Kyrgyz Republic can rise up to 70 percent, the highest in Central Asian countries. The average portfolio yield for the whole of Central Asia consequently increases to 43 percent. Excluding KAFC with its 4.2 percent cost of funds also reduces the cost of funds paid by MFIs to less than 1 percent, leaving impressive margins. Removing KAFC from AROA calculation reduces it by seven tenths of a percent, to 6.4 percent. The top five MFIs with the highest adjusted portfolio yield in the Central Asia are illustrated in figure 4.

**Top NGO MFIs.** A number of NGO MFIs have several years of track records that provide interesting insights into the potential for expanding microfinance markets. The largest NGO MFI in each of the Central Asian country is listed in table 11.

The top two largest NGO MFIs in Central Asia, based on their outstanding portfolio size, are KAFC and FINCA, both in the Kyrgyz Republic, followed by KCLF in Kazakhstan (regionally 3rd) and NABWT in Tajikistan (regionally 4th). The largest NGO MFI in Uzbekistan, Barakot, with the largest potential market for microfinance comes only seventh regionally (see table 11).

### Table 10. Financial performance of NGO MFIs, 2002

<table>
<thead>
<tr>
<th>Country</th>
<th>Portfolio Yield (%)</th>
<th>Average Cost of Funds (%)</th>
<th>Average Margin (%)</th>
<th>AROA (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kazakhstan</td>
<td>22</td>
<td>0.0</td>
<td>22</td>
<td>-8.9</td>
</tr>
<tr>
<td>Kyrgyz Republic*</td>
<td>34</td>
<td>4.1</td>
<td>30</td>
<td>14.4</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>59</td>
<td>0.6</td>
<td>58</td>
<td>4.9</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>68</td>
<td>0.0</td>
<td>68</td>
<td>3.0</td>
</tr>
<tr>
<td>Average</td>
<td>27*</td>
<td>N/A</td>
<td>N/A</td>
<td>7.1</td>
</tr>
</tbody>
</table>

Source: Central Asia microfinance team. *weighted average.
The largest five MFIs illustrated in the figure 3 all have operational sustainability of above 200 percent, which means that they are able to cover their operational costs more than twice with their own internally generated funds. Of 12 MFIs that have published audited financial statements, four are not operationally self-sufficient, with the operational sustainability ratio as low as 58 percent. In most cases, they receive donor subsidies to cover their operational costs.

**Sustainability**

There is direct correlation between operational and financial sustainability and the level of interest rates charged by MFIs. While the returns look impressive for many MFIs, they also mask institutional inefficiencies in some cases. Due to localized market segmentation, limited number of MFIs are competing in the same markets, and there is also some degree of interest rate colluding. The top five performers in terms of operational sustainability are Barakot and Daulet in Uzbekistan, KAFC and FINCA in the Kyrgyz Republic and SMF in Kazakhstan (figure 3).

**Returns on assets and equity**

The top five MFIs with the highest adjusted portfolio yield are illustrated in figure 4. Although NGO ownership status is still not clear for some, returns on assets and equity of these NGOs are very impressive. FINCA has achieved one of the highest financial returns, but it also charges one of the highest interest rates in Central Asia. Some MFIs in KZ suffer from negative returns mainly due to the well below-market interest rate they charge of 5–10 percent.

### Table 11. Largest NGO MFIs in each Central Asian country, 2002

<table>
<thead>
<tr>
<th>Institution</th>
<th>Loan Portfolio (US Smln)</th>
<th>Active Clients (‘000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>KAFC, the Kyrgyz Republic</td>
<td>22</td>
<td>35</td>
</tr>
<tr>
<td>KCLF, Kazakhstan</td>
<td>1.5</td>
<td>5</td>
</tr>
<tr>
<td>NABW, Tajikistan</td>
<td>1</td>
<td>6</td>
</tr>
<tr>
<td>Barakot, Uzbekistan</td>
<td>0.3</td>
<td>3</td>
</tr>
</tbody>
</table>

Source: Central Asia microfinance team.

**Figure 3. Top five NGO MFIs on operational sustainability, 2002**

**Figure 4. Top five NGO MFIs on portfolio yield, 2002**

Source: Central Asia microfinance team.
Kyrgyz Agricultural Finance Corporation

KAFC is a government-owned nonbank rural finance institution created under a World Bank project to partially and temporarily fill the gap in rural financial services following the closure of Agroprombank. It has grown to be the largest financial institution in the Kyrgyz Republic, with a loan portfolio equal to nearly 30 percent of the entire financial system (see box 8).

**Box 8. Kyrgyz Agricultural Finance Corporation (KAFC)**

The Kyrgyz Agricultural Finance Corporation (KAFC) has been successfully providing considerable support to the growth of the rural economy, providing broad outreach to the rural poor, and maintaining strong financial results. Since its creation in December 1996, KAFC has:

- Amassed the largest microfinance portfolio and number of clients in the region.
- Maintained the lowest operational costs.
- Achieved financial and operational sustainability.
- Earned public trust and positive name recognition.

At the time of KAFC creation, the existing commercial banks considered lending to rural clients too risky and unprofitable and did not have an adequate branch network to accommodate rural clients. While initially created to serve as a financial intermediary for World Bank credit lines, KAFC has been working with other international donors such as IFAD, Asian Development Bank, and bilateral agencies. KAFC serves the emerging private farmers and rural entrepreneurs by providing local currency short and medium-term loans of two types: individual collateralized loans and social-collateral based group loans. At the end of 2002, KAFC has grown to 11 branches and 43 representative offices throughout the country mostly in rural areas and has a total staff of 212, of which 99 are loan officers. It has serviced a total of 43,500 individuals, 34,840 of which continue to be active clients of KAFC (52 percent borrow as group members). Its average loan size is small, about US$1,196 for individual loans and US$86 per group member. Although created as a “stop-gap” measure, KAFC is here to stay. While its annual net loan portfolio has been growing by 125 percent on average, it still serves less than 20 percent of the total number of private commercial farmers who have adequate collateral and the need for credit.

**Lessons from KAFC experience:**

- KAFC has successfully demonstrated that rural finance can be commercially viable.
- KAFC maintained good portfolio quality, with 95 percent of portfolio in unclassified loans; and a recovery rate (measures the payments made over the payments due) of 94 percent, which indicates good timeliness of loan repayment.
- KAFC operates in an efficient manner, as substantiated by the improving administrative expense ratio, which at the end of 2002 had fallen to 8.1 percent vs. almost 30 percent at the beginning of operations.

Source: Central Asia microfinance team.

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13Another institution, the “Settlements and Savings Corporation”, was created to provide savings services. KAFC may not take deposits at the present time.
Another notable example of MFI in Central Asia is Kazakhstan Community Loan Fund (KCLF). KCLF is one of the first MFIs in Central Asia to be rated by an international rater, and also first to receive commercial loans from a commercial bank and an institutional investor (see box 9).

**Donor Support for Microfinance**

Donors have played a key role in carrying microfinance to its present status in Central Asia. Most of the microfinance institutions that are currently operating were established by international NGOs financed by the international donors. Donors have been the pioneers, promoting microfinance and microfinance institutions in the face of general government disinterest. However, coverage and involvement have varied widely across the countries.

### Box 9. Kazakhstan Community Loan Fund (KCLF)

Kazakhstan Community Loan Fund (KCLF) created in 1996, mainly operates in the poor areas with high population concentration and favorable business climate. KCLF is considered one of best development successes, as it has proven that lending to the poor can be done on a sustainable basis. It has received extensive support from USAID, the Soros Foundation, and the Eurasia Foundation, and has developed into the largest NGO MFI in Kazakhstan, and among the five biggest in the Central Asia, with the average loan size of US$318 (24 percent depth of outreach ratio).

KCLF’s target clients are women (83 percent) involved in petty trade. Since the beginning of its operations, KCLF has serviced almost 10,000 clients. Currently KCLF has 4,500 active clients and about US$1.42 million loan portfolio. While group loans constitute 91 percent of the total loan portfolio, the share of individual loans, both for production purposes and consumption purposes for clients successfully graduating from group loans is increasing. The portfolio quality is very good, the cumulative repayment rate amounts to 99.9 percent and only 1.3 percent of the portfolio are considered at risk.

While the KCLF portfolio is still very limited, it should be noted for:

- Being the first NGO MFI to borrow from a commercial lender, such as the Blue Orchard Finance. This is still quite a unique experience for microfinance institutions in Central Asia;
- Being the first NGO MFI in the region to be reviewed and rated by an independent rating agency, M-CRIL, receiving an alpha rating for low risk and good systems;
- Having a highly developed corporate culture and human resources, including strong management, qualified staff, rigorous staff training programs, advanced MIS and loan tracking system.

The interest rates charged by KCLF are high and could be anticompetitive in the long run. The main reasons for high rates are the need to finance the rapid expansion of KCLF and to retain a relatively large in-house training capacity to maintain the good performance.

Source: Central Asia microfinance team.

**U.S. Agency for International Development (USAID)**. USAID has supported a variety of microfinance initiatives in the region, including FINCA (in the Kyrgyz Republic), ACDI/VOCA (in the Kyrgyz Republic and Kazakhstan) and Winrock (in Kazakhstan). USAID efforts in Tajikistan and Uzbekistan have not resulted in on-the-ground microfinance activities. Currently, USAID is supporting a regional
technical assistance activity called CAMFA (through FINCA and ACDI/VOCA), and a project that promotes business centers in Kazakhstan, the Kyrgyz Republic and Uzbekistan (through Pragma Corporation).

**European Bank for Reconstruction and Development (EBRD).** EBRD has financed a major program (US$175 million in two separate credit lines) through the commercial banks of Kazakhstan to introduce financial products and services for smaller clients. Though these would not normally be characterized as microfinance because the average loans size is around US$4,000, this does represent a major down-market activity for these banks. The technical assistance is being provided by IPC. EBRD has recently initiated similar activities in the Kyrgyz Republic and Uzbekistan, with funding of US$15 million and US$20 million respectively, and is planning a similar activity in Tajikistan.

**Asian Development Bank (ADB).** ADB has financed a program to create credit unions in rural the Kyrgyz following the collapse of Agroprombank. Technical assistance is financed and provided by GTZ. This program currently has 350 registered credit unions serving 29,000 members with a portfolio of some US$7.8 million in loans outstanding. The credit unions have mobilized US$2.75 million in paid-in capital required for credit union membership from their low-income rural members. Four regional associations and one national association, all financed by credit union dues, have been established. ADB is also planning to implement a credit union project in Uzbekistan.

**Aga Khan Fund for Economic Development (AKFED).** AKFED started its operations in Tajikistan in 1992 with supporting two programs that primarily targeted the most remote rural areas. The Enterprise Support Facility (ESF) provided business development support including microcredit and the Mountain Societies Development Support Program (MSDP) offered mainly microcredit to its clients. Both programs reached over 30,000 clients with an average loan size of US$60. With the involvement of IFC, these two programs were transformed into the first microfinance bank in Tajikistan and the Central Asia region. AKFED plans to initiate a microfinance program in the Kyrgyz Republic.

**International Finance Corporations (IFC).** IFC has partnered with EBRD to cofinance small business support initiatives in Kazakhstan, the Kyrgyz Republic, and Tajikistan, and in cooperation with EBRD and SECO (State Secretariat for Economic Affairs of Switzerland) established a Small Business Capacity Building Facility to support the growth of small and medium enterprises and to improve the business-enabling environment in Central Asia. IFC has provided direct funding to financial institutions in Kazakhstan, Uzbekistan, and the Kyrgyz Republic (including FINCA) for small enterprise support activities. Drawing upon its experience in developing the leasing market in Russia, IFC, through its Private Enterprise Partnership arm, has been actively involved in developing the leasing concept in the Central Asia region. IFC is also involved in developing microfinance legislations in the Central Asian countries, through its Microfinance Legislation Development project. Previously, it supported the development of the Kyrgyz Republic MFI law issued in 2002. IFC is developing new microfinance legislation in Tajikistan in partnership with USAID to promote financially sustainable NGO MFIs. It is providing support to the National Bank of Tajikistan to strengthen its MFI regulatory and supervisory capacity. Additionally, IFC is supporting AKFED in transforming two Tajik NGO MFIs into a microfinance bank.

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14As of December 31, 2002.
The World Bank (WB). The World Bank has supported the Kyrgyz Agricultural Finance Corporation (KAFC) with two large loans totaling US$20 million for smallscale lending to the rural sector. This microfinance activity includes both group lending (with group formation activities performed by UNDP) and individual lending. KAFC has approximately 34,840 active clients with an average loan size for individuals of US$1,196, and US$86 per group loan client. The World Bank also financed a pilot project in Tajikistan with a US$200,000 portfolio and is currently disbursing funds through the Poverty Alleviation Project II that includes about US$1.4 million for microfinance. Other donors. Many other programs have financed microfinance initiatives in the region. One of the major organizations has been the U.S. Department of Agriculture, which has made surplus agricultural commodities available to Mercy Corps to fund its activities, which have included a major microfinance activity for women petty traders and a small SME line. The petty trader product works through 4 NGOs that have recently been certified by the National Bank of the Republic of the Kyrgyz Republic as microcredit agencies (MCAs), and it has reached some 20,000 women.

3. Challenges and Opportunities

Current Challenges for Microfinance in Central Asia

What MFIs and borrowers are saying. The study questionnaires identified and the field interviews reaffirmed that the most frequently cited problems by MFIs themselves are: (a) limited sources of funds and a high dependence on a single source (mostly donor grants); (b) uncertainty about their legal status, tax requirements, and other regulatory implications; and (c) low sustainability due to high costs, high risks, and limited risk mitigating ability. In parallel, MFIs want to improve basic accounting and financial skills of the staff and the MIS capacity. By far the most important constraint for expanding the outreach of NGO MFIs is the limited sources of funds, especially for developing and offering new products and services. This is also part of the reason why MFIs charge high interest rates on their credits while their cost of the funds is zero or near zero, as interest income is often the only means to increase capital for on-lending.

While the number of microfinance clients is growing by about 30 percent per year, MFIs still have limited geographical coverage and depth of outreach across the countries in the region, with penetration of the total poor population estimated at less than two percent. There still exist significant unserved or underserved segments of the economies of these countries, especially in rural areas which have a higher incidence of poverty. Various surveys and social assessments show that more than 40 percent of respondents among the rural poor cited lack of access to funds as the main impediment to economic development, while up to 80 percent were confident they would increase production if they had access to loans for inputs. Other most often cited constraints by the rural population are lack of access to information, markets, and business development services, as well as state bureaucracy and land market issues.

The field survey results show several critical gaps that need to be addressed for expanding microfinance in the region. These are discussed in detail below.
Policy, legal, and regulatory framework

Lack of government commitment for microfinance development. Governments in general, and national banks to a lesser extent, are unfamiliar with the microfinance concept and therefore, remain generally disinterested. Dissemination of information, such as this study, and continuous dialogue with government and national bank officials would be necessary to overcome the current resistance to or disinterest in proactively supporting development of microfinance operations. In cases where a government does support microfinance programs, it generally sees microfinance as a means for social assistance and consequently, targets unsustainable interventions for the poorest segments of society that are not viable business clients. As a result, while these programs show the lowest depths of outreach (e.g. Kazakhstan Fund for Support of Poor Citizens), they have high ratios of loan portfolios at risk.

Legislation and regulation. The current state of the legal and regulatory frameworks for microfinance in Central Asia varies considerably among countries. While they share similar legal roots, each country has proceeded with different approaches. Since MFIs come in various forms, a legal framework should ideally permit a variety of institutional and legal forms. Having an enabling legal and regulatory framework is a prerequisite for achieving sustainability, improving capacity and outreach. Since the microfinance sector is relatively young throughout Central Asia, any legal framework should consider the long-term needs of the sector, such as legal access to various forms of capital as donor funds dwindle. Ideally, these legal frameworks will be flexible towards foreign ownership and maximum share percentage while encouraging the existing financial institutions to offer microfinance services.

Three countries (the Kyrgyz Republic, Kazakhstan, and Tajikistan) have already decided to develop specialized legislation governing the microfinance sector. Within each country, the numerous laws and regulations that do affect MFIs are often ambiguous and inconsistent with one another. Considerable efforts have been made, some of which are still ongoing, by policymakers (with support from donors, mainly USAID and IFC) to improve the legal and regulatory frameworks for MFIs. These efforts will need to be augmented through further policy dialogue as well as specific legal and institutional development.

The Kyrgyz Republic has taken the lead in policy making with a reasonably comprehensive microfinance law issued in July 2002 and it is now in the early stages of implementation. The law on microfinance is uniquely designed to permit an orderly transition from nonprofit, donor-assisted, credit-only institutions to a special category of nonbank financial intermediaries, called microfinance companies established as open or closed joint stock companies, that are allowed to take deposits and hence, are regulated by the National Bank. According to this law, an MFI can apply for a deposit-taking license if it was in operation for at least two years providing microcredits. Law recognizes MFIs as being still one tier below banks, due to their limited activities and less stringent requirements. The law, however, does not have special provisions for a microfinance bank. In February 2003, Kazakhstan also finalized a new MFI law that provides the legal basis for nondeposit taking MFIs and expands the access of small entrepreneurs to financial resources. As the law in Kazakhstan limits an individual loan size to US$5,000 and does not contain similar provisions for allowing NGO MFIs to become eligible to take deposits, the systemic risk of NGO MFI failure is minimized, and the legal requirements for NGO MFIs were substantially lowered. Thus, NGO MFIs in Kazakhstan are not expected to be supervised as banks are. Tajikistan is currently preparing a new MFI law and public debates on the draft law are on going. Microfinance operations in Uzbekistan are governed by the presidential decree signed in August 2002 that stipulates to limit microfinance loans up to US$3,000. Nonprofit MFIs are exempt from income tax on income earned as a
result of microlending. This allows MFIs to retain more resources to cover operational costs, increase their assets and use them for on-lending.

In countries where specific MFI law has not been issued, that is, in Tajikistan and Uzbekistan, a clear system that confirms the legality of microlending activities is not yet in place. As such, a large number of MFIs in these countries operate without clear legal status, thereby being vulnerable to claims of “illegal” operations and to ad-hoc harassment. Many MFIs also complain about their limited ability to pursue institutional capacity building due to uncertainty regarding their future legal status.

Also lacking in all countries is a uniform tax code that provides a tax-exempt status for nonprofit entities and a level playing field in the treatment of expenses. For example, in Kazakhstan, MFIs without the National Bank license will not get a tax exemption on loan loss provisions while licensed/regulated financial institutions benefit from it. Furthermore, the 16 percent VAT proposed on microlending will further increase the cost of doing business. The ambiguities in the taxation treatments of certain financial transactions create an uneven playing field for MFIs to compete with other financial institutions, such as commercial banks. These issues need to be clarified further before MFIs can expand and become financially sustainable.

**Absence of savings deposits.** Another challenge is expanding the ability of NGO MFIs to raise funds through savings/deposits, for which they would need to undergo an institutional reformation and change their legal status and ownership structure, which can only be afforded by mature NGO MFIs in the long run. With the exception of the Kyrgyz Republic, where MFIs may be allowed to take deposits after a period of two years, deposit-taking activities in the region are currently restricted to commercial banks. Credit unions in Uzbekistan can take deposits but they have a limited coverage (only seven credit unions are operating). Credit unions in the Kyrgyz Republic take only compulsory deposits from members, for paid-in capital. Deposit-taking activities need to be supervised properly, but the central banks’ supervisory capacities are still limited. Clearly, the institutional capacity in supervising MFIs needs to be developed in order to enable MFIs to diversify their funding sources and ensure sustainable development.

**Supervision varies widely within the region.** The new law in the Kyrgyz Republic provides for minimal supervision of institutions that provide only credit using donor-supplied funds, while requiring nearly full banking supervision for those MFIs that are allowed to take deposits. Credit unions are nominally supervised in the Kyrgyz Republic, but the organization responsible for supervision lacks the resources to do so effectively and may also have inherent conflicts of interest. The proposed microfinance law in Kazakhstan removes most MFIs from any form of supervision since they are not allowed to mobilize deposits.

**Microfinance industry gaps**

Certain elements of a vibrant microfinance industry, such as industry associations, have proved invaluable in other countries but are notably lacking in Central Asia. The microfinance industry is in its infancy in Central Asia, so there is a limited understanding of the business by commercial banks. The unclear ownership structure of NGO MFIs also limits MFIs’ access to commercial funds.

**Absence of associations.** Associations provide a way to continue the development of an industry and advance common interests and causes. Except for the regional and national associations of credit unions in the Kyrgyz Republic, there are no associations of MFIs in Central Asia. The associations of credit unions in the Kyrgyz Republic may be premature since advisors to the credit union system fear that the
institutions are becoming somewhat politicized and may not develop into the technically-oriented support groups that are needed. However, these institutions represent a start in the formation of interest groups.

No credit bureau or credit rating system. There are no credit bureaus providing information on client quality to MFIs in any of the countries and there are very few arrangements to share what information there exists. ACDI/VOCA, Mercy Corps and FINCA do share information informally in the Kyrgyz Republic. Currently, EU-TACIS is supporting the initial conceptualization of a formal credit bureau in the Kyrgyz Republic, and USAID is providing assistance to the National Bank of Kazakhstan with drafting a new Law on Credit Bureau. As the industry expands and matures, especially among urban oriented institutions providing credit to petty traders, sharing information will become increasingly important to minimize risk and prevent fraud. Functioning credit bureaus can also serve to lower the risk of noncollateralized lending and reduce the cost of attracting new clients.

Access to commercial bank loans. As mentioned earlier, limited sources of funds for MFIs is one of the main current constraints for development of microfinance industry in the region. In more developed markets, such as those in Latin America, many MFIs are borrowing from commercial banks to on-lend to their clients. In Central Asia, most banks do not wholesale funds to MFIs since they do not understand microfinance as a business that can generate high returns. The lack of standard performance measurements and transparent reporting of MFI operations only adds to banks’ reluctance, as does the unclear ownership structure of NGOs. Lending to MFIs engaged in agriculture and rural activities is considered even more risky. Banks also do not have appropriate loan products and risk appraisal methodology for MFIs. Only one commercial bank has lent to an MFI in Central Asia, and that was with USAID funding support. In order to increase MFIs’ access to commercial loans, MFIs’ credibility needs to be enhanced through transparent, consistent performance monitoring, development of clear ownership and governance structures, and established track records based on strong cash flows and financial sustainability.

Credit unions and savings and credit associations. Central Asia is behind the rest of the ECA region in terms of development of viable credit unions. There are over 5,000 credit unions in ECA, and the World Bank has supported credit union development projects in Moldova, Albania, Georgia, and Bosnia. The Asian Development Bank is the leading donor that supports the development of credit unions in this region. The credit unions in the Kyrgyz Republic are the only such institutions in Central Asia, although ADB has recently committed to a similar program in Uzbekistan. These institutions have demonstrated that poor rural members can commit substantial cash savings to their organizations and can manage their own local institutions successfully.
Limited market coverage

Microfinance services have a limited coverage in the region as all MFIs currently serve about 200,000 out of more than 50 million people living in the four countries studied (around 0.4 percent).

Limited rural outreach. There is a relative absence of microfinance services in rural areas and small communities. With the exception of the credit unions and KAFC in the Kyrgyz Republic, and the Microcredit NGO in Kazakhstan, virtually all other MFIs are focused on reaching urban or peri-urban clients. Those MFIs that do operate in rural areas tend to be very small and insignificant. While majority of the active MFI clients are urban traders, there are an estimated 5.3 million small farms in Kazakhstan and Uzbekistan alone that could benefit from access to financial services. Box 10 provides more details on issues that prevent rural outreach.

In general, NGO MFIs do not provide savings services, the savings mobilized in rural areas by formal financial institutions are mostly transferred and invested in urban areas, further depleting the availability of financial resources in rural communities and hence creating further dependence on external funding to meet local credit needs. In the Kyrgyz Republic, rural savings are mobilized by the “Settlements and Savings Corporation” which is a state-owned institution that holds a banking license but has no lending operations. In Kazakhstan rural savings are collected by KazPost, a postal savings facility.

Limited products and services

MFIs in the region provide a rather standard, undifferentiated single loan product consisting of high-cost, short-term working capital loans mainly for trade activities. Medium- and long-term investment credit for production purposes is virtually nonexistent, except for KAFC. MFIs do not offer revolving lines of credit. Inventory credits and credit based on receivables are virtually unknown in this market. NGO MFIs are legally restricted from taking deposits for savings and services such as money transfers, leasing, and insurance are virtually unavailable. There are limited client business development services provided to potential microfinance clients. The limited variety of products offered by MFIs creates additional difficulties for rural borrowers as loans are not adjusted for seasonal or cyclical cash flows typical for agricultural production, and are of short duration that makes borrowing for assets, including livestock and farm equipment, impossible (see box 11).

Box 10. Problems of rural microfinance

Even in cases where microfinance services are accessible to the rural population, a number of specific problems prevent the rural poor from applying for rural credits:

- High interest rates.
- Term structure of loans.
- Typically small loan size.
- High transaction costs.
- Lack of reliable information.
- Low evaluation of collateral.
- Lack of trust in financial institutions.

Source: Central Asia microfinance team.
Box 11. Simplified farm investment model

The graph shows a simplified livestock investment model, based on average prices in the region. The model is for a purchase of a milk cow for US$300 (microloan) that produces about 2 tons of milk, of which 1.5 tons is sold as milk, butter, and cheese, yielding about US$42/quarter net profit. The cow also produces one calf a year, which is sold at the end of a year, when reaching 150kg weight, at about US$0.80/kg. The graph depicts a periodic payment of accrued interest (30 percent/year), a periodic payment of small fraction of a principle (US$10/quarter), and two balloon payments at the end of each year from the sale of calf (accrued interest plus US$120). The model illustrates that:

- It would take a farmer almost 3 years to repay the US$300 microloan at 30 percent using the entire cash flow from milk.
- If the microcredit is adjusted specifically for the purposes of the farmer, he can afford to pay 30 percent annual interest, and US$10 each quarter towards the principal, with two balloon payment at the end of each year from the proceeds selling the calf, and repay the microcredit in 24 months, while also earning disposable income.
- Longer term loans, loans with irregular payments, and loans that do not automatically increase with each cycle should all be assessed on the basis of cash-flow analyses in order to meet the needs of rural borrowers, and especially farmers.

Source: Central Asia microfinance team.

Credit only. Existing microfinance-related legislation in each Central Asian country, as in many other part of the World, allow NGO MFIs to only provide credit, and savings are limited to “involuntary” savings as a form of collateral; the principal without interest earned is returned when the loan is fully repaid. Savings, as a microfinance service, are notably lacking in the region. Some of the village banking programs that have not been introduced in other regions, address this problem by having an “internal” savings component, that are usually used for short-term loans to members.

Most loans are provided through groups based on social collateral. The group lending methodology often works well in rural settings where social cohesion is high. It is also highly effective in cases where the client is relatively unfamiliar with formal financial or institutional transactions and the group helps overcome confidence issues on the borrowers‘ side while providing some reassurance to the MFI on recovering the loan. However, some experience show that in cases of lesser concentration of businesses that have similar product cycles, individual loans are better suited and better accepted in rural areas than group loans. This applies especially to rural areas with low population density.

Need to develop individual lending. In urban areas where social cohesion is not strong, with slightly better off clients, or with clients who may have begun in groups but now find the restrictions of the group limiting, the group methodology is not very effective. In these cases, products that match individual needs more closely are necessary. With increasing competition among MFIs (as is the case in Latin America), MFIs will have to offer diversified loan products to reach and keep their clients. While a majority of NGO MFIs is still mainly offering group loans, some have started offering individual loans for clients who have “graduated“ from group lending with good credit history.

Human resource capacity, as well as regulatory constraints and ownership/governance structures, is one of the chief reasons that so many MFIs provide only credit services. Designing and instituting a savings

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15 See the presentations for the “Paving the Way Forward for Rural Finance“ conference sponsored by the U.S. Agency for International Development on June 2-4, 2003.
product requires a higher skill level in finance relative to a credit-only operation. The administrative complexity, financial sophistication, and costs in managing voluntary savings can prove prohibitive for MFIs.

**Weak capacity and inefficiency of MFIs**

With a few notable exceptions, most NGO MFIs are weak. Most depend on donor funded grants and external subsidies. Most lack adequate accounting, loan management, internal control, and transparent reporting. Many would not be sustainable without the support of external funding. Since MFIs lack scale and outreach, they face relatively high fixed costs, which cannot be sustained except for serving clients with a rapid turnover of high value-added products.

**Limited competition and high cost of doing business.** MFIs are normally dispersed throughout urban and peri-urban areas and, with the exception of key urban areas, there is a limited competition among MFIs. Weak capacity and lack of competition among MFIs have led to high administrative costs and high interest charges. The Central Asia regional average of administrative cost is about 24 percent, which is higher than ECA average of 18 percent (from ECA study), and global average of 19 percent (from Microfinance Bulletin).

**Interest rates of NGO MFIs.** The interest rates charged by MFIs are usually high everywhere in the world, which is a reflection of high transaction costs per small size loans, inherent high risk of investments, and need to provide some nonfinancial services (e.g. group development services) to their clients. Effective interest rates are often double the quoted nominal rate because interest is charged on the amount disbursed rather than on the amount outstanding at any point in time. Although the cost of funds is essentially zero for most NGO MFIs and since their lending capital is mainly formed by grants from international organizations, this low cost is not transferred to the ultimate borrower.

The interest rates are similarly high in Central Asia. In addition to the common reasons noted above, the high interest rates in the region are also driven by the following: (i) absence of other alternatives for capital growth forcing MFIs to charge high rates to increase their lending capital; (ii) high administrative costs because MFIs have not yet reached economies of scale and have a low ratio of credit officers to borrowers; (iii) the need for young MFIs to recover sunk costs when their client base is still small; and (iv) absence of competition for some MFIs due to market fragmentation allows them to charge high rates to maximize their profits.16

In order for the MFI interest rates to drop (relative to current rates), a number of developments should take place in the industry, including improving the efficiency of MFIs, assistance in reaching operational and financial sustainability, increase of competition, and access to whole-sale commercial funds for on-lending capital. It is evident that even currently, as competition grows for the same clientele in urban areas (e.g., MFIs that compete with commercial banks’ microfinance programs, run through EBRD’s SME Program), some MFIs that are already sustainable have started cutting their interest rates.

MFIs with a relatively long history, however, have already begun to recognize that ultimately only the fittest will survive in the face of increasing competition. They also realize that grant funding will disappear sooner or later, and in order to access commercial loans, MFIs will have to demonstrate their operational and financial sustainability as well as a strategic vision and commitment for serving the poor.

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16 For each Central Asian the average interest rates country are as follows: 30% in KZ, 31% in KG, 31% in TJ, and 55% in UZ.
In addition, NGO MFIs that want to access equity investment will need to transform from an NGO to a shareholding structure. Because of these trends, the timing is right to provide technical and financial assistance to those MFIs with strategic vision to become important players in the Central Asian microfinance markets.

**Strategic Choices and Proposed Actions**

With the rapidly increasing demand for microfinance and with some MFIs reaching operational and financial sustainability, there are both the opportunity and the need to scale up microfinance services in Central Asia. With their current scale of operations, the MFIs are barely scratching the surface of the overall demand. In the short term, scaling up the provision of microfinance to satisfy the unmet demand from existing clientele for existing products is feasible by supporting institutional building of NGO MFIs, and enhancing their access to commercial sources of funds for on-lending capital. Putting in money for lending is dangerous. Medium-and-long-term scaling up is feasible through further institutional building, new product development, and the process of maturing and transforming the existing MFIs.

There are three groups of key players in the microfinance sector: (a) governments, (b) MFIs, and (c) donors. The Almaty Conference on Expanding Access to Microfinance in Central Asia (April 2-3, 2003) provided an excellent opportunity to bring representatives of these groups together and to engage them in productive discussions on microfinance issues. Preliminary results of this study were also presented at the conference and received fruitful feedback. Key recommendations of the study for priority actions by governments, donors, MFIs, and the World Bank in the following sections reflect these discussions.

**Priority actions for governments**

Governments hold the key to growth of the microfinance industry in the region. Raising awareness of policymakers is especially important in the region where weak legal and supervisory frameworks open opportunities for misinterpretation, *ad hoc* harassment, and threats to existing MFIs. Governments, central banks, and tax officials all must understand better what microfinance is and how it can contribute to the national economy and welfare. These officials need to know different institutional models for the delivery of microfinance services, different products available for specific populations, and how the performance of MFIs can be monitored. Additionally, they should differentiate between social assistance programs and sustainable microfinance operations, and understand that interest subsidies do not reach the targeted poor but instead ultimately undermine the financial sustainability of MFIs. For instance, Armenia Credit Forum has been very effective in informing officials and lobbying for favorable changes in the legal and regulatory framework. A similar network is also active in Tajikistan but is absent in Kazakhstan, the Kyrgyz Republic, and Uzbekistan.

Recommended priority actions for governments are to:

- Develop a supportive policy and legal environment that facilitates the entry of new MFIs, including simplification of regulatory, supervisory and tax requirements.
- Design a regulatory framework that accommodates different institutional structures, recognizing that there is no one correct system for microfinance.
- Strengthen the capacity of relevant government bodies to regulate and supervise MFIs.
- Be mindful of the costs of supervising MFIs when developing supervisory structures.
Reduce contradiction in laws and regulations to minimize misinterpretation or abuse by rent seeking public authorities.

Establish a taxation regime that is fair, transparent, and applied uniformly. Introduction of tax breaks for new institutions, MFIs that operate as nonprofit institutions, and institutions that fill critical gaps in the current coverage have proved to be an effective catalyst for emerging MFIs.

Develop industry performance standards and insist on a clear financial reporting system that encourages sound management and financial responsibility of MFIs.

At the same time, governments need to refrain from engaging in activities or programs that discourage the development of the sector, which include:

- Injecting subsidized credit.
- Setting interest rate ceilings.
- Engaging in debt forgiveness or other programs that could reduce the discipline of both lenders and borrowers.
- Providing targeted credit.

Priority actions for donors

The donors have extremely important roles to play in the development of the microfinance system in Central Asia. Achievements to date in the region are mainly attributed to and driven by donors, with many successful outcomes. Particularly notable is that Central Asia has a small but impressive share of successful NGO MFIs, reflecting the well focused and continued support of donors for these particular MFIs. In the region, NGO MFIs will continue to play a significant role in providing access to banking services and credit for the lower income spectrum of clients who do not currently have this access.

One of the most important roles donors can play, among others, is to help governments recognize the importance of an effective microfinance sector, by encouraging and supporting government efforts to establish the legal and policy frameworks that facilitate the entry of new MFIs, foster sustainable growth, and encourage the gradual evolution of MFIs to formal, regulated financial institutions. Donors also need to support government efforts to develop effective systems to regulate and supervise MFIs based on sound reporting systems to monitor the performance of MFIs (see box 12 for proposed guiding principles for donor support to MFIs).

During the aforementioned Almaty 2003 conference, there was unanimous agreement among donors about the need for better coordination. Donors have agreed that it would be beneficial to:

- Know what other donors are doing in the same country.
- Share common visions and outcomes for the microfinance industry in Central Asia.
- Develop a common position with respect to the priorities and required changes in the policy and legal environment.

**Box 12. Guiding principles**

In order to effectively and significantly scale up the microfinance outreach and depth of penetration, we propose the following guiding principles for the donors’ support in the field of microfinance in Central Asia:

- Be consistent in project designs and financial intermediation options.
- Be persistent in quality and financial sustainability requirements.
- Be effective by showing results.

Source: Central Asia microfinance team.
- Promote healthy competition among sustainable MFIs.
- Facilitate MFI access to commercial funds and wean MFIs away from donor grants.
- Support the transformation of NGO MFIs into shareholding entities when appropriate.
- Build capacity among local service providers to supply business development services that are more accessible and affordable by local MFIs.

**Priority actions for MFIs**

MFIs should commit to financial and operational sustainability and transparency. Grant support from donors is drying up, and future support is more likely to be in the form of technical assistance for institutional capacity building rather than for injecting loan funds or topping off operational budgets. It is clear that long-term growth in the microfinance sector requires MFIs to evolve from their dependence on donor funding to become either deposit-taking institutions or institutions with regular and sustained access to significant amounts of commercial loan or equity funds. In order to achieve this goal, MFIs agree that the following priority actions need to be taken:

- Develop a strategic plan for transforming the MFI into a regulated financial intermediary or some other type of financial institution.
- Start diversifying products and market orientation as the concentration on a single product, credit for short-term traders, will sooner or later reach a saturation point, as is becoming the case in urban Kazakhstan.
- Go beyond the cursory supervision by founding international NGOs, which often does not include rigorous evaluation of portfolio and operational quality, by having audits done by qualified external auditors.
- Seek funding support for ratings by internationally accredited rating agencies, which could also serve as baselines for continued performance monitoring.
- Establish formal associations or networks of MFIs to represent the industry.
- Develop common standards and transparent performance indicators for all MFIs to enable regular supervision by donors, potential creditors, and, in the future, regulators.
- Learn from successful cases around the world where diversified services are provided through innovative delivery mechanisms such as ATMs and smart cards. And technological innovations are used to reduce transaction costs PDA sets.
- Start moving away from the current excessive reliance on social collateral group lending, as clients are becoming more diverse with different needs and scales of operation. Develop new products to enable successful clients to graduate from group lending.

Not all MFIs will want to become involved in serving rural clients. For those that do intend to serve this market, in addition to the above, they need to:

- Think innovatively to increase rural outreach and to understand rural clients’ needs, risks, and opportunities.
- Actively pursue niche markets and do much more proactive marketing of services.
- Develop specialized products.
Opportunities for Expanding Microfinance

This study is a strategic exercise to develop an overall approach for expanding microfinance support programs in Central Asia and to identify potential operational intervention opportunities. Debt sustainability pressures, limited local capacity, and limited lending slots for Central Asian countries make it necessary for donors, including the World Bank, to be more selective in their support. The focus of future donor activities needs to be on supporting microfinance systems in the various countries to achieve significant scale and outreach within the framework of sound financial system development.

Future lending programs in the field of microfinance also need to be based on the synergies between other existing and planned operations in Central Asia. They should be designed to establish overall economic growth, to reduce poverty, and, in particular, to foster an improved local business environment.

As competition is sharpening and donor funds for onlending are becoming more scarce, NGO MFIs will need to carefully consider their sustainability and scaling up strategies. Those that cannot cover their costs will need to become more efficient or go out of business. Those that wish to scale up will need to find commercial lenders, transform into deposit-taking financial intermediaries and/or change their institutional structure so that they can attract private equity. Those that wish to tap new markets, such as rural areas, will need to diversify their products. Reluctance to disclose their financial performance is no longer acceptable or feasible since full disclosure will be a prerequisite for access to commercial funds. In addition, participation in World Bank operations will require an external audit, demonstrated institutional and financial management capacity, and the ability to manage assets and liabilities.

As MFIs continue providing essential financial services to the poor that are excluded from the formal financial sector, the donors can provide assistance in Central Asia in several areas described below.

Establish and institutionalize microfinance operational and financial standards

Establish standards based on international best practices and consistently apply them. This will take consistent eligibility criteria and performance indicators for accessing loan funds and consistent principles for designing financial intermediation options, with financial sustainability as the core objective. Donors should set the example in their projects and sharing international best practices.

The interviews revealed that very often either no monitoring criteria were used, or the criteria were process-oriented rather than results-oriented. A good example of the type of support that can be effective is Bosnia’s “Local Initiative Project,” funded by the World Bank, which established a clear set of performance targets, under which only qualified MFIs received funding and those who failed were required to immediately repay funds received. In Central Asia, Tajikistan’s Second Poverty Alleviation Project has identified the initial set of criteria, but it is not yet clear whether the National Social Investment Fund of Tajikistan (NSIF) has adequate capacity to carry out the due-diligence assessment as well as to on-lend funds and monitor portfolio quality, although it is the agency mandated to carry out these functions. Clearly, a consistent and systematic approach to microfinance operations that on-lend World Bank funds would be beneficial.

Establish a baseline for benchmarking and tracking MFI performance. Help MFIs access various funds and technical assistance that can allow them to purchase independent rating and assessment services from professional rating agencies and specialized firms; and by establishing a baseline and performance indicators.
As an attempt to enhance financial accountability and transparency, in May 2001 the Inter-American Development Bank (IDB) and CGAP jointly launched an initiative, the “Microfinance Rating and Assessment Fund,” which aims to cofinance the cost of professional rating of MFIs to improve the quality, reliability, and availability of information on the risks and performance of MFIs. As of May 2003, 36 MFI operations have been assessed and rated, and 30 more are scheduled. For Central Asia, only two MFIs have been rated: KCLF in Kazakhstan and Bai Tushum in the Kyrgyz Republic. Clearly, more MFIs in Central Asia could benefit from this important exercise. The Rating Fund prequalified several international rating agencies such as ACCION international, M-CRIL of India, Microfinanza of Italy, Micro Rate, PlaNet Finance and WOCCU among others.

**Diversify microfinance**

*Encourage diversification of products, services, and market orientation.* This can be done by providing funding for the development and piloting of new products and services, such as the following:

- Branching out beyond urban petty trading to fill the gaps in limited rural outreach by reconfiguring current microfinance loan terms.
- Expanding beyond smaller loans for short term working capital to larger loans for medium term investments.
- Moving from simple group lending to more diversified individual lending products.

These are the most immediately possible measures for MFIs to expand their scope and outreach, especially into remote rural areas, where MFIs face much less competition, if any, from commercial banks. While MFIs do recognize these needs, they are hesitant to start new initiatives without guidance and assistance from international organizations with relevant experience, capacity, and knowledge. Donors need to design operations that specifically include measures to proactively achieve these goals.

To branch out into rural areas and to provide agricultural credits is a special challenge, which MFIs consider very risky and non-profitable. Many urban-oriented MFIs will decide not to enter this sector. Nevertheless, available best practices from around the world including KAFC in the Kyrgyz Republic suggest that microfinance services can be delivered sustainably and profitably to the rural areas. GAPI in Mozambique is one of the leading nationwide institutions providing business and financial development assistance to rural SMEs and acting as financial intermediary for donor funds. GAPI has developed an innovative delivery mechanism for providing microfinance to the rural poor through federations of small farmer associations (fors). Each forum on-lends to its member associations, who collect the produce from their individual members and other area farmers, and deliver it to the forum as loan repayment. PRODEM, a licensed nonbank financial intermediary in Bolivia, has identified another innovative delivery mechanism for its microfinance services through the introduction of smart cards that are linked to ATMs. Loan repayment is based on the cash flows of the borrowers. This strategy has allowed PRODEM to develop a large agricultural loan portfolio (21 percent of the total) with good financial standing. CVECAs are village-based savings and credit organizations, established in parts of West Africa and recognized for serving remote rural areas sustainably through community-based microfinance. They have a highly decentralized structure and run at low cost. In 2001, the Niono network of CVECAs in Mali had over 9,100 active borrowers and 9,400 savers.

*Develop and test new products and services.* Some innovative options include: longer-term loans for capital equipment purchases; loan terms and payments that conform to the rural business cycle; microleasing (possibly with IFC); micro-insurance especially for livestock (Africa provides some
insights); micropensions and microretirement savings to take some pressure off of undercapitalized pension systems; and savings services that keep capital circulating in local communities.

The introduction of new products implies development of an adequate legal and institutional framework in the countries involved, which would, for example, allow MFIs to collect microsavings from the population. While such products take time to develop and require the collaboration of donors and commitments from governments, new microfinance products are essential for providing full-scale service to the segments of population, which remain excluded from the formal financial sector.

Facilitate institutional strengthening and transformation of MFIs

Donors can provide long-term assistance and resources to develop sound and sustainable local organizations that can survive without continued donor support, including an exit strategy so as to reduce MFIs’ dependency on cheap external funds for loans or subsidized operational support. Specifically, donors can improve MFI efficiency and sustainability by:

- Providing technical assistance, in coordination with other active donors.
- Establishing due-diligence appraisal capacity at local levels through technical assistance.
- Training MFI staff in risk appraisal, accounting, financial management, internal control, auditing, and reporting.
- Training management for effective monitoring and an enhanced sense of fiscal responsibility.
- Improving MIS.
- Considering the feasibility of technological innovations such as the introduction of Personal Digital Assistant (PDA)-based local loan appraisal systems.

To date, MFIs in the region have been able to charge high interest rates, which adequately covered their operational expenses. As discussed earlier in this report, MFIs in Central Asia suffer from high administrative costs, most of them are not properly provisioned and therefore underestimate their costs. Many, even the most successful ones, rely on donor funds for operational budgets.

If the microfinance market is to grow in Central Asia, it needs to go beyond the limited market of a few high-priced organizations focused on urban petty traders with a number of smaller MFIs holding insignificant portfolios. The market needs to have more mature actors serving a broader spectrum of the population, which would increase competition among MFIs, foster efficiency and reduce the cost of services.

Donors can support the transition of NGO MFIs from social-oriented credit grantors to operationally and financially sustainable financial institutions. They can begin by focusing on well-developed NGO MFIs into formal, deposit-taking, and regulated MFIs such as microfinance banks. They can also create networks or federations of credit unions or savings and credit associations, or they can strengthen existing federations. Donors will also need to help central banks develop a regulatory and supervisory framework that is appropriate for different types of institutional forms.

As in the rest of the world, NGO MFIs in Central Asia can neither mobilize savings nor offer other financial services—such as transfers, payments, and foreign exchange operations, among others. Stronger MFIs with established clients and market shares could benefit from becoming regulated, formal, financial institutions that can offer a greater variety of services to their clients. A good example is the merger of two NGO MFIs supported by AKFED (Mountain Societies Development Support Program and Enterprise
Support Facility) in Tajikistan; the resulting entity has become a licensed microfinance bank with support from IFC.

Successful transformation of NGO MFIs into licensed banks was also achieved in Mongolia, when an NGO MFI, XAC, was merged with Govin Ekhel (Mercy Corps) to become a finance company; then it became the XAC Bank. The Association of Cambodian Local Economic Development Agencies (ACLEDA) in Cambodia has transformed from a NGO MFI into a bank with the extensive support of donors. As an NGO MFI, it was able to quickly expand its network while making a profit. The original NGO transferred its assets and on-lent its liabilities (long-term loans from donors) to the new ACLEDA Bank. At the time of transformation, the NGO retained 45 percent of equity and foreign investors purchased 49 percent of shares on the new bank. Transformation has allowed ACLEDA to significantly expand its outreach, and it now serves more than 85,000 clients.

Another known successful case is an MFI, CARD, in Philippines. After operating successfully for six years as an NGO MFI, the Center for Agricultural and Rural Development (CARD) was the first in the Philippines to transform into a rural bank. This became possible due to long-term support by donors and persistent efforts of CARD to educate the Government that eventually facilitated such transformation. After only one year of operation as a transformed institution, active members increased by 90 percent, total number of active loans increased by 70 percent, and gross loan portfolio grew significantly (134 percent). In spite of this rapid growth, repayment rates remained high, averaging 98-99 percent.

**KAFC.** In Central Asia, KAFC is an immediate possible candidate for the transformation discussed above. KAFC and the Government of the Kyrgyz Republic are actively seeking options to diversify sources of funding as well as identify strategic private investors. This will enable KAFC to benefit from better corporate governance and management support, so that KAFC can continue to grow and perform well. Currently, KAFC is seeking to obtain a license to become a rural bank.

**Scale up MFIs by merging and consolidating.** MFIs generally focus on communities where they are physically located and generally leverage their activities in the communities with which they are familiar. This has led to fragmentation of microfinance markets. Small-scale MFIs operating with very low levels of capitalization in most cases cannot last without on-going subsidies. Consolidation by mergers or alliances of smaller insignificant MFIs, where fixed cost elements such as overhead, staffing, facilities, and training can be shared, would result in stronger institutions.

Effective mergers based on shared objectives could expand geographical coverage and client base, enhance cash flows and access to capital, and capture economies of scale, thereby reducing fixed costs through shared facilities and staff. Mergers can be in a form of a legal merger, a program merger or an affiliation formation, each requiring different legal procedures and having different implications for asset and liability management. While the sample size is still small, in ECA and also in Central Asia, successful mergers have taken place. A good example of a successful merger comes from Armenia where Catholic Relief Services and Save the Children/US were merged and formed the Micro-enterprise Development Fund (MDF) Kamurj in 2000. MDF makes loans to groups of women in amounts ranging from US$50-US$250 and is sustainable. In the Kyrgyz Republic, Bai Tushum was created in 2000 by merging ACDI/VOCA and Caritas credit programs.

**Expand the roles of commercial banks in microfinance**

Banks can become engaged in microfinance through either down-scaling efforts or linkage with MFIs. The linkage between MFIs and banks can take different forms: financial linkage, contractual linkage for
specific services provided and paid for, and ownership linkage where commercial banks either wholly or partially own MFIs. Different types of linkage require different sets of preconditions. For the Central Asia context, the most feasible and likely interventions would be to:

- Restructure state-owned banks, particularly in Uzbekistan.
- Create operational linkage through contractual agreements where MFIs can benefit from various banking service.
- Enable the MFIs to access commercial banks as clients through wholesaling of funds for MFIs to on-lend.

Restructure state banks for outreach to underserved markets. Down-marketing through state banks has been successfully achieved in Indonesia (BRI’s Unit Desa) and Brazil (Banco Do Nordeste). In well-designed and executed cases, turning around state banks has proven to be an effective means of achieving significant outreach. With support from the World Bank and significant efforts and cooperation of the Government, Banco do Nordeste (BN) launched its pilot microfinance program, CrediAmigo, which immediately benefited from the large pre-existing BN branch network. Local loan officers were contracted for the microfinance activities. Only after three years of operations, CrediAmigo was already among the top MFIs in Latin America in terms of geographical penetration (358 municipalities in the Northeast Brazil), number of clients (55,000) and depth of outreach (six percent).

The Agricultural Bank of Mongolia and National Microfinance Bank in Tanzania are good examples of World Bank and donor funded technical assistance contributing to transformation of state-owned banks. External management teams through management contracts, protected from political interference, were brought in to run these institutions, to restructure them, and in the case of Mongolia, to help with privatization. In these specific cases, with support from the World Bank and USAID, the state banks’ extensive networks were effectively used, enabling new products and banking services to be made available to rural clients. Around the world, dozens of state-owned banks make valuable contributions to their economies but are in difficult financial straits. With technical assistance, many of these institutions could provide viable financial services to underserved markets.

Link MFIs and commercial banks. Linking MFIs to banks allows each organization to utilize its respective comparative advantages. MFIs’ comparative advantages include a well-developed methodology for delivering credit services to the poor. Banks’ comparative advantages include access to larger financial resources and availability of diversified financial products, such as savings, payments, transfers, settlements, handling of disbursements, repayments, or remittances, among others. Until MFIs have adequate capacity and the enabling legal and regulatory framework and supervisory capacity are in place, they are not likely to be able to offer the varied services that their clients need. Many will never be able to offer these services, as they would have to transform into a formal financial institution to do so. Linking MFIs to banks can offer MFI clients access to the full range of bank services. MFI-bank linkage could be contractual or ownership-based. They could share facilities (branches, MIS, other banking infrastructure), benefit from banks’ front or back office support, refer better MFI clients to banks, etc. The operational linkage could be based on an arrangement whereby an MFI acts as an agent or subsidiary to a bank. This would encourage banks to move into microfinance with manageable risks. This opportunity needs to be further explored for Central Asia.

A good example of MFI-bank linkage is Constanta in Georgia where an MFI shares the branch network of a bank. Constanta identified and successfully implemented an innovative cost reduction strategy that included (i) using part-time officers, known as service-points, to enter underserved secondary rural
markets and (ii) partnering with banks that have extensive branches to rent their facilities. Constanta is a very profitable MFI with financial self-sufficiency of 124 percent (as of May 2002) while providing very small loans of US$125 (depth of outreach of 22 percent). The portfolio quality is very good with reported portfolio at risk (>one day) below two percent.

Enhance access of MFIs to commercial funds by facilitating access to commercial (investment) funds. While the section above focused on possible operational linkages between MFIs and commercial banks, financial linkage represent a more immediate opportunity as it addresses the biggest gap of microfinance industry in Central Asia, which is the limited access to commercial funds. Provision of microfinance can increase significantly only if MFIs become able to access commercial funds on their own merit to on-lend to their clients.

Channeling commercial funds to clients that previously did not have access to bank finance is already taking place in Central Asia, mainly under EBRD supported programs. This support, however, is likely to remain concentrated in areas where the banks have a competitive advantage and a sufficient concentration of clients. The commercial banks are beginning to recognize the potential for lending to small enterprises but the size of microfinance lending by banks remains substantially higher than other MFIs. Loan sizes give a useful indication of the clients that each type of MFI is serving: an average of US$280 for NGO MFIs and US$6,000 for commercial bank downscaling programs.

The MFIs have very limited success in attracting equity and loan funds. MFIs are relatively young and have been predominantly supported by donor grants. Just like their clients who are excluded from the banking sector, MFIs themselves face exclusion due to lack of credit history, perceived high risks, and lack of track records. The donors can play a role in overcoming the initial vicious cycle of not having such credit history by bridging financing loans. In such a case, the donors could provide funds to be on-lent through eligible financial institutions for wholesale lending to MFIs. In ECA, about one fifth of the total funding for MFIs comes from commercial banks. In contrast, only two MFIs in Central Asia have been able to borrow very limited amounts from banks so far. Access to commercial credit would accelerate MFI graduation from donor dependence.

Donors may consider supplementary risk mitigating options to kick-start the loan access process. One such example is when donors have successfully provided loan guarantees enabling NGO MFIs to borrow from commercial banks or signed letters guaranteeing cash flows. Another option could be for donors to help NGO MFIs obtain loans from commercial sources by providing matching technical assistance package for managing the specific commercial loans. In addition, since most NGO MFIs do not have licenses from the National Bank, they face uncertainties regarding whether they may borrow funds and use the proceeds for on-lending, technical assistance can be provided for clarifying the legal rights of nonlicensed NGO MFIs to remedy this kind of uncertainties.

A foreign exchange (FX) cover should be provided for loans for MFIs and clients who cannot manage and bear FX risks. Another area where the donors could contribute significantly (as the World Bank has done in many other countries) is to give governments the options and flexibility to offer local currency loans to MFIs through creating FX premiums to cover FX risk. The MFIs should not be exposed to mismatches due to FX currency risks. In reality, MFIs simply do not have the FX hedging capacity.

Donor grants and loans should be pooled together in order to maximize the synergy and benefit to clients. The limited availability of funds, both for on-lending and technical assistance, continues to be a major problem. Pooling limited donor funds could maximize the synergy between grants for technical assistance and institution building and funds for on-lending. An APEX (possibly CAMFA) could be established and
utilized for coordinating and providing technical assistance, for monitoring MFIs, and for on-lending a blend of funds from multiple sources based on consistent criteria and methodology.

**Strengthen local capacity for microfinance market development**

*Support local associations and networks.* MFIs would benefit from organizing themselves to provide a forum for MFIs to meet, share their problems and experiences, and discuss potential solutions. Furthermore, a national MFI association could be a forum to empower its members to more effectively lobby the governments and cultivate donors. It could also facilitate common training, sharing of information, access to various technical assistance, conference information, etc. Only Tajikistan has such an association today.

The Small Enterprise Education and Promotion Network (SEEP) provides technical assistance for MFIs to strengthen their networks. SEEP has developed the Network Capacity Assessment Tool (NCAT) to perform organizational assessments of “lateral learning networks“ devoted to microenterprise development. The assessments provide, among other outcomes, strategic planning tools (SWOT Analysis) and recommendations for organizational improvements, including developing the network, and identification of technical assistance and training needs. The assessments also serve as a baseline to track change over three years.

*Support training for Central Asian MFIs.* With support from CGAP, USAID, and other donors, a Microfinance Center for Central and Eastern Europe and the New Independent States (MFC) was created in Warsaw, Poland, in 1997. It is a membership-based network and provider of training to promote the development of a strong and sustainable microfinance sector in the region that will contribute to poverty reduction, employment creation, and development of micro-enterprises. At present, the center has 79 members but only 12 are from Central Asia. Many MFIs in Central Asia indicate that while the annual fee of US$350 is not exorbitant, the cost benefit ratio for the center’s training and consulting services is too high. This could be an area where donor subsidies would be well justified to attract new members from Central Asia and to provide opportunities for them to engage in training, information, conferences and workshops to share best practices, lessons learned, etc. which the center is well situated to offer. Alternatively, a regional training center could be established on the basis of national MFI associations.

*Knowledge sharing and access to international best practices*

Microfinance in Central Asia is less than a decade old, one of the most nascent microfinance markets in the world. Compared to Latin America, Asia, and the ECA region, Central Asia has significant room to further improve and expand its microfinance system. Rather than re-inventing the wheel, there is much to be gained from the experiences (both successes and failures) of other microfinance operations. This study has examined numerous microfinance operations around the world, and prepared a selected list of microfinance operations that can provide relevant lessons to Central Asian MFIs.
4. Conclusion

The microfinance sector in Central Asia is less than 10 years old. Because of its relatively short tenure, outreach has been limited in terms of the number of the poor people served. Despite its relatively limited impact to date, the initial results are promising. There are several MFIs that are both operationally and financially sustainable. A few MFIs are even ready to be transformed into formal financial institutions. Donors have actively supported the Central Asia microfinance sector with grants and technical assistance, including the development of a broad legal and regulatory framework but more work is needed. Additional donor support is necessary to solidify past achievements and move forward towards developing a more sustainable and diversified microfinance sector.

Several fundamental problems must be addressed for microfinance to fulfill its potential of helping the poor and contributing to overall economic development in Central Asia. These problems include the limited outreach and penetration of current MFIs and the relative absence of effective microfinance services in rural areas. Both are important. Additionally, there is a need to increase the outreach of microfinance services among urban traders and small businesses, as large numbers of urban poor still do not have access to financial services. There is also a compelling need to develop microfinance services that specifically serve poor rural farmers and small agribusinesses. World Bank and other donor resources need to be firmly oriented toward furthering these objectives.

This study finds that much more could and should be done to expand microfinance services to the poor. The results to date provide valuable lessons as well as the initial foundation upon which to build. The key issues and constraints identified during the study are not necessarily unique to Central Asia, but this first comprehensive review of the Central Asia microfinance sector does provide an assessment of specific constraints at each country level. Internationally successful microfinance operations provide actual experiences from which Central Asian countries can learn, and from which they can adopt selective interventions that are relevant for Central Asia, with governments, MFIs, and donors as key partners in this important but still not yet fully realized development agenda. The recommendations of this study are geared to meet the specific constraints that each country is facing today, with several operational options for further exploration by donors.
Box 14. Country specific operational options

**Kazakhstan**
- Finalize the legal framework for MFIs.
- Improve the legal framework for member-based financial organizations (credit partnerships).
- Offer wholesale lending to MFIs through commercial banks.
- Provide funds to existing MFIs to expand into new regions, sectors (including agriculture), products, and clients.
- Support microleasing initiatives.
- Facilitate the linkage between MFIs and Halyk Bank through its extensive branch network.
- Promote linkages between commercial banks and MFIs.
- Reduce subsidized credit.

**The Kyrgyz Republic**
- Finalize normative acts to implement the new Microfinance Law.
- Establish eligibility criteria for on-lending through MFIs, possibly under the World Bank Second Rural Finance Project (RFP II).
- Include better performing NGO MFIs as participating PFIIs under RPF II.
- Facilitate MFI ratings for monitoring and benchmarking.
- Support transformation of KAFC into a rural bank.
- Encourage commercial banks to go down-market.
- Coordinate the World Bank projects such as RFP II, Agribusiness, and Village Investment for consistent (or at least complementary) financial intermediation models.

**Tajikistan**
- Finalize the legal framework for microfinance.
- Establish financial norms and eligibility criteria for MFIs to borrow under World Bank projects.
- Set standard MFI performance indicators to be applied under World Bank projects.
- Strengthen the capacity of TASIF or explore more agencies for APEX function (possibly CAMFA).
- Explore possibility for introducing informal approach of ROSCA, ACTED/CARE model.
- Facilitate MFIs to provide expanded services beyond credit such as handling remittances.
- Facilitate better MFIs to transform into formal financial institutions (NABW, ACTED).
- Explore the APEX option to provide coordinated technical assistance, institution building training, and on-lending.
- Explore options to work with state banks’ extensive network.

**Uzbekistan**
- Work on a comprehensive policy framework for creating a conducive business environment.
- Finalize the legal framework for microfinance.
- Strengthen the operational capacity of MFIs.
- Directly fund the better and more promising NGO MFIs. Build on state banks’ networks for microfinance operations.
- Explore savings and postal bank as a low cost option to expand rural outreach.
- Create a local MFI network to stimulate more effective lobbying and representative functions for MFIs.
- Explore the APEX option to provide coordinated technical assistance, institution building training, and on-lending.
- Explore the possibility to work with state banks for better banking for microfinance.
- Reduce subsidized credit.

Source: Central Asia microfinance team.
Appendix 1 List of Identified NGO MFIs

<table>
<thead>
<tr>
<th>Name</th>
<th>Donor</th>
<th>Contact Information</th>
<th>Filled Questionnaire</th>
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<tr>
<td>Kazakhstan</td>
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<tr>
<td>1. Agriculture Credit Corporation</td>
<td>Ministry of Finance</td>
<td>Karazhigitov, Askabek, Astana, Ul. Almatinskaya, 49, pone/fax: 23 96 20</td>
<td></td>
<td>✔</td>
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<tr>
<td>2. Agroconsulting Center (ACC)</td>
<td>Eurasia Foundation, Soros Foundation, Canadian Embassy, British Embassy, DFID</td>
<td>Elchibekov, Amir, 473000/Astana, Pr. Republiki 16, kv.2, Ph. 28 64 90</td>
<td></td>
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<tr>
<td>3. Almaty Credit</td>
<td>Tsesna Bank</td>
<td>Kasym, Arman, Almaty, ul. Bogibay Batyra 248, Ph. 68 22 66, fax: 68 82 58</td>
<td></td>
<td>✔</td>
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<tr>
<td>4. Asian Credit Fund</td>
<td>Mercy Corps International</td>
<td>Zhanina Zhakupova, Almaty, 410 Seifullin Str., 3rd floor 480004b <a href="mailto:acfe1ecutive@nursat.kz">acfe1ecutive@nursat.kz</a> (7 3272) 506 190</td>
<td></td>
<td>✔</td>
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<tr>
<td>5. Assistance to Farmers in East Kazakhstan</td>
<td>none</td>
<td>Kenchenbayev, Rais, Ust-Kamenogorsk, ul. Uritskogo 121-210</td>
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<td>6. Association of Business Women</td>
<td>na</td>
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<td>7. Astana Finance</td>
<td>na</td>
<td>Islamov, Kintal, 54 Bigeldinova St., 473000 Astana, Ph.7 3172/ 230 770, fax: 230 773</td>
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<tr>
<td>8. Atyrau Pilot Microcredit Center</td>
<td>UNDP</td>
<td><a href="mailto:raushan.mussina@undp.org">raushan.mussina@undp.org</a></td>
<td></td>
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<tr>
<td>9. Baspana</td>
<td>Cordaid, DanChurchAid, Christain Aid</td>
<td>Malokov, Ernar, Almaty, 480012, ul. Maulenova, 93, phone: (3272) 63 98 74, fax: 50 18 04</td>
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<tr>
<td>10. Business Association (AB)</td>
<td>GTZ</td>
<td>Kakimzhanova Zharkin <a href="mailto:kakimzhanovagtz@nursat.kz">kakimzhanovagtz@nursat.kz</a></td>
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<td>11. Credit Partnership (AJI)</td>
<td>none</td>
<td>Vorobiova, Raisa, Taraz, ul. Ayteke bi 10, phone/fax: 45 44 32</td>
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<tr>
<td>14. Fund for Assistance to Farmers 2</td>
<td>Regional Government Budget</td>
<td>Abdullin, Murzatay, <a href="mailto:aktobe-fsf@host.kz">aktobe-fsf@host.kz</a></td>
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<td>15. Fund for Assistance to Farmers and Entrepreneurs in South KZ</td>
<td>Winrock International, GTZ</td>
<td>Karaibragimov, Rais, Shymkent, ul. Tukestanskaya 2/5 office 64, Ph./fax: 53 57 30</td>
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<tr>
<td>16. Fund for Development of Small Business</td>
<td>EBRD, Local Budgets</td>
<td>Ibadullayev, Azamat, Almaty, ul. Gogolea 111, Ph. 50 79 79, fax: 32 17 71</td>
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<td>17. Gold Cash Credit-Deposit Partnership</td>
<td>na</td>
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<tr>
<td>18. Kazakhstan Community Loan Fund (KCLF)</td>
<td>USAID, Soros, Eurasia, USDA Food Program, HIVOS/TRIDOS Fund, New Hampshire Episcopal Diocese</td>
<td>Shalkar Zhusupov, 30 Kaldayakov Street, 480100 Almaty, Ph. (7 3272) 506 877 <a href="mailto:office@kclf.kz">office@kclf.kz</a></td>
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<td>20. Kazakhstan Small Business Program</td>
<td>EBRD, TACIS, FSBS</td>
<td>Hertzfeldt, Bertolt, Almaty, ul. Kabanbay batyra 76, Ph. 91 18 91; fax: 91 43 84</td>
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<td>21. Microcredit (Branch)</td>
<td>Ministry of Labor and Social Protection</td>
<td>Isanov, Mukhtar</td>
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<td>22. Microcredit (NGO)</td>
<td>Government of Kazakhstan</td>
<td>Isakakova, Saida <a href="mailto:microcredit@nursat.kz">microcredit@nursat.kz</a></td>
<td>✓</td>
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<td>24. ORDA-Credit</td>
<td>none</td>
<td>Sorochenko D.F., 486050 Shymkent, Tynbayeva, 7, Ph. 8 3252 21 15 56</td>
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<td>25. Ok-Zhetpes</td>
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<td>26. Public Fund for Business Support and Development</td>
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<td>Karaganda, ul. A. Alukanova 37, Ph. 48 38 72, fax: 48 08 57</td>
<td>✓</td>
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<td>27. Semipalatinsk Micro-Credit Project</td>
<td>UNDP</td>
<td>Khairlybayeva, Zhumagul, 40-400, Kozbarov, St., Semipalatinsk, 490050, Ph 7 3222 662 783, fax: 623 366</td>
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<td>28. Shygys Fund for Assisting the Poor</td>
<td>Cordaid, Counterpart Consortium</td>
<td>Ermukhan, Serik, Ust-Kamenogorsk, ul. Myzy, 1a, Ph./ fax: 8 3232 260340</td>
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<td>29. South Kazakhstan Fund for Social Programs</td>
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<td>30. TAT Credit Deposit Partnership</td>
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<td>32. Village Credit Partnership “Ajutas Credit”</td>
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<td>33. West Kazakhstan Public Fund for Business Support 1</td>
<td>Shareholders</td>
<td>Chesnokov, Oleg, Uralsk, pr. Dostyk 194, kom. 207, phone: 8 3112 50 55 61</td>
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<td>34. Women Federation STATUS</td>
<td>none</td>
<td>Unzhakova, Irina, 492020 Ust-Kamenogorsk, ul. Gorkogo 50ª, phone: 3232 26 72 26, e-mail: <a href="mailto:status@mail.kz">status@mail.kz</a></td>
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**Kyrgyz Republic**

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<td>36. Agriculture Credit</td>
<td>USDA, UNICEF, Mercy Corps</td>
<td>Uraimova Rahat, Program Manager, SME Credit Program, 51-23-32, 28A, 4th Floor, 8 Microdistrict, Business Center, Bishkek</td>
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<td>37. Bai Tushum Financial Foundation</td>
<td>USDA, ACDI/VOCA, CARITAS (Swiss Gov.)</td>
<td>Gulnara Shamshieva, Chairperson <a href="http://www.baitushum.com">www.baitushum.com</a></td>
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<td>38. Center for Microcredit for Unemployed</td>
<td>Ministry of Labor and Social Protection</td>
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<td>39. Civil Fund for Microcredit (CFM)</td>
<td>Meerim Foundation, Asia Development Bureau</td>
<td>Musabekova Mairam 66-51-93, <a href="mailto:gfm@transfer.kg">gfm@transfer.kg</a> 114 Chui Avenue, Bishkek</td>
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<td>40. Counterpart Consortium</td>
<td>na</td>
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<td>41. KAFC: Farm Development Fund, Small Farmers Credit Outreach Program</td>
<td>World Bank, UNDP, IFAD, TACIS</td>
<td>Liliya Androsova, Interim Head of Credit Department, 66-22-58, 50 Pushkin Street, Bishkek, Kyrgyzstan</td>
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<td>42. Financial Credit Company “Kyrgyzaltrust”</td>
<td>na</td>
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<td>43. FINCA Kyrgyzstan</td>
<td>FINCA International</td>
<td>Jason S. Meikle Country Director 127 A Gogol Str. Biskek 720011 <a href="mailto:jmeikle@finca.org.kg">jmeikle@finca.org.kg</a></td>
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<tr>
<td>44. Helvetas Agro Project (HAP)</td>
<td>Swiss Government</td>
<td>Peter Schmidt, KASP Manager, 21-05-03, <a href="mailto:Rufi@helvet.elcat.kg">Rufi@helvet.elcat.kg</a> 503 Frunze St., Bishkek</td>
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<tr>
<td>45. KAIS</td>
<td>TACIS, Helvetas</td>
<td>Ruslan Mamyrov, Rural Finance Specialist, 21-05-05, <a href="mailto:Rufi@helvet.elcat.kg">Rufi@helvet.elcat.kg</a> 503 Frunze St., Bishkek</td>
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<td>46. Small and Medium Sized Enterprise Credit (SMEC)</td>
<td>CAAEF, Mercy Corps</td>
<td>Uraimova Rahat, Program Manager, SME Credit Program, 51-23-33, 28A, 4th Floor, 8 Microdistrict, Business Center, Bishkek</td>
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<td>47. Small Business Development Program</td>
<td>Swiss Government</td>
<td>Eugene Ryazanov, Team Leader, 21-05-04, <a href="mailto:wpp@helvet.bishkek.su">wpp@helvet.bishkek.su</a> 503 Frunze St., Bishkek</td>
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<td>48. Small Farmers Credit Outreach Program (SFCOP)</td>
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<td>Liliya Androsova, Interim Head of Credit Department, 66-22-58, 50 Pushkin Street, Bishkek</td>
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<td>49. State Commission of Enterprise Development</td>
<td>State Commission of Enterprise Development</td>
<td>Kamilia Kenenbaeva, Chairman <a href="mailto:gkprp@bishkek.gov.kg">gkprp@bishkek.gov.kg</a> 120 Tinstanova St., Bishkek</td>
</tr>
<tr>
<td>50. Talas Farmers Union</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>51. Women’s Micro Credit (WMC)</td>
<td>USDA, Mercy Corps, UNHCR, ISW, ECT, Eurasia Foundation, Community Fund</td>
<td>Uraimova Rahat, Program Manager, SME Credit Program, 51-23-33, 28A, 4th Floor, 8 Microdistrict, Business Center, Bishkek</td>
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</table>

**Tajikistan**

<table>
<thead>
<tr>
<th>Name</th>
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<th>Contact Information</th>
<th>Filled Questionnaire</th>
<th>Interviewed</th>
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</thead>
<tbody>
<tr>
<td>52. ACTED</td>
<td>EU Humanitarian Office, UNHCR, Swiss Development Cooperation</td>
<td>Stephane Nicolas <a href="mailto:stephane.nicolas@acted.org">stephane.nicolas@acted.org</a> Zulfia Davlatbekova</td>
<td>✓</td>
<td>✓</td>
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<tr>
<td>53. Association “Social Partnership and Development”</td>
<td>UN, Ministry of Labor and Social Protection</td>
<td>Davlyatbekova, Zieda, <a href="mailto:ziyoda@tajnet.com">ziyoda@tajnet.com</a></td>
<td>✓</td>
<td></td>
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<tr>
<td>54. Association of Scientific and Technical Intelligentsia (ASTI)</td>
<td></td>
<td>Farrukh Tyuryaev, Dir. Gen. <a href="mailto:farrukh@asti.khi.tajik.net">farrukh@asti.khi.tajik.net</a></td>
<td>✓</td>
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<tr>
<td>55. Bonuvon NGO</td>
<td>na</td>
<td>na</td>
<td></td>
<td></td>
</tr>
<tr>
<td>56. Enterprise Support Facility (ESF)</td>
<td>Aga Khan Foundation</td>
<td>Zurbekov Khudoberdi, <a href="mailto:esfkhorog@aol.com">esfkhorog@aol.com</a></td>
<td>✓</td>
<td>✓</td>
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<tr>
<td>57. Gender and Development</td>
<td>UNDP, IFAD, Government of Japan</td>
<td>Mirzoeva, Viloyat, Dushanbe, ul. Husseinzaide 35, phone: 21 06 45, 23 03 51, 23 03 53, fax: 21 06 45, 21 04 04 <a href="mailto:wid@tajnet.com">wid@tajnet.com</a></td>
<td>✓</td>
<td></td>
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<tr>
<td>58. Global Operations and Development (GO&amp;D)</td>
<td>Stiftung Salz</td>
<td>Joachim Jaeckle, Aini St 27, 734051 Kurganteppa, Tajikistan, phone: 992 3222 28146, 27304, 25135</td>
<td>✓</td>
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<tr>
<td>59. Mehrangez NGO</td>
<td>Christian Aid (ACT Central Asia), Norway Refugee Council</td>
<td>Umarova, Sharofat, Khatlon Oblast, Bekhtorskii Raypn, I Somoni, ul. Ibn Sino 4, phone: (9923245)21 7 37</td>
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<td>60. Millennium Development Partners</td>
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<tr>
<td>62. Murghab Rural Development Fund (MDF)</td>
<td>ACTED</td>
<td>na</td>
<td></td>
<td></td>
</tr>
<tr>
<td>63. NASMB</td>
<td>UNOPS</td>
<td>na</td>
<td></td>
<td></td>
</tr>
<tr>
<td>64. National Association of Business Women (NABW)</td>
<td>USAID – USDA (Mercy Corps)</td>
<td>Sharipova, Sanovbar, Khujand, 185 Kamoli Khujand St. floor 3, phone: 992 3422 67378</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>65. National Association of SMEs (NASME)</td>
<td>U.S. State Department, Shelter Now International</td>
<td>na</td>
<td></td>
<td></td>
</tr>
<tr>
<td>66. Oryon NGO</td>
<td>Mercy Corps</td>
<td>Rizvonov, Muhammadab, Jirgitul Rayon, I Somoni St 55/5, phone : 9992 3132 22622</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>68. Sitorai Najot (SN)</td>
<td>World Bank (PPAP), UNHCR, TASIF</td>
<td>Ibragimova, Lola, ul. Leningradskaya, dom 9, Kurgan Tyubebel, <a href="mailto:main@tajmfi.vakhsh.td.silk.org">main@tajmfi.vakhsh.td.silk.org</a></td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>69. Small Business Development Project</td>
<td>Central Asia Development Agency (CADA)</td>
<td>Joseph Longen, Acting Country Manager, CADA, <a href="mailto:Jwlongen@Pactec.Net">Jwlongen@Pactec.Net</a></td>
<td></td>
<td></td>
</tr>
<tr>
<td>70. Tajik Micro-Entrepreneurs Development Support Center (MDTM)</td>
<td>USAID (ACDI/VOCA)</td>
<td>Jillann W. Richardson-Rohrscheib <a href="mailto:Jwrr@Aol.Com">Jwrr@Aol.Com</a></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>71. Women’s Economic Opportunity Project (WEOP)</td>
<td>EU, USAID, CIDA, ADB, Private Donors, CARE International</td>
<td>Vargas, Rafael, 25 Bekhzod St., Dushnabe, phone: 992372 21 17 83, fax: 992 372 21 17 78</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

**Uzbekistan**

<p>| 72. ACTED                                                           | ACTED                                                               | Bunce, Noah, Tashkent, st. General karimov 21, phone: 152 29 71, fax: 55 54 56 | ✓                   |             |
| 73. Association of Business Women                                   | NOVIB (Netherlands), UNDP                                           | Botir Toshniyozov                                                               |                     | ✓           |
| 74. NGO Daulet                                                      | Soros Foundation, UNDP                                              | Kuzmin, Artik, <a href="mailto:daulet@intal.uz">daulet@intal.uz</a>                                                   | ✓                   | ✓           |
| 75. NUFUZ T’ALIM (MF Training Center)                               | Eurasia Foundation                                                  | Pereverzeva, Elena, 700206, Tashkent, ul. Navoi, 16a, phone/fax : 144 82 50     | ✓                   |             |</p>
<table>
<thead>
<tr>
<th>Name</th>
<th>Donor</th>
<th>Contact Information</th>
<th>Filled Questionnaire</th>
<th>Interviewed</th>
</tr>
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<tbody>
<tr>
<td>76. O’z MARD (Microentrepreneurs Development Center)</td>
<td>USAID, ACDI/VOCA</td>
<td>Jillann W. Richardson-Rohrscheib, <a href="mailto:Jwrr@Aol.Com">Jwrr@Aol.Com</a></td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>78. Sabr Trust Center</td>
<td>NOVIB (Netherlands)</td>
<td>Irmat Iskandarov, <a href="mailto:sabr@online.ru">sabr@online.ru</a> 3662-336666</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>79. Business Women’s Association (Tabdikor Ayol Karakalpakstan Branch)</td>
<td>UNDP</td>
<td>Elibayeva, Nazira, Karakalpakstan, Nukus, Doslyk Guzary No 96, phone/fax: 361 222 94 54, 222 94 55</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>80. Business Women’s Association (Kashkadarya Branch)</td>
<td>NOVIB, UNDP</td>
<td>na</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>81. BARAKOT Microfinance Program (formerly Women’s Micro Credit)</td>
<td>FCO, Flora Foundation</td>
<td>Karimov, Otabek, 36922 6 60 60, 6 60 10</td>
<td>✓</td>
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## Appendix 2. Description Of 21 NGO MFIs Interviewed

<table>
<thead>
<tr>
<th>Name</th>
<th>Year established</th>
<th>Description of MF program</th>
<th>Notable features</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Kazakhstan</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
| 1. Asian Credit Fund                      | 1997             | Launched with US Government support, the fund provides microloans to self-employed entrepreneurs and micro businesses.                                                                                                   | ▪ Diversified portfolio, including consumer lending  
▪ No lending for on-farm activities  
▪ Individual lending only                                                                                                                      |
| 2. KCLF (Kazakhstan Community Loan Fund)  | 1996             | Started with USAID support, KCLF provides microcredit to the very poor, mostly women traders, using group lending methodology.                                                                                           | ▪ Oldest and most advanced MF institution in KZ  
▪ Predominantly urban                                                                     |
| 3. Kazakhstan Fund for Support of Entrepreneurs | 1999           | Created by Winrock International, it targets small scale producers in Almaty Oblast, with no specific poverty focus.                                                                                                      | ▪ Predominantly rural  
▪ 15% of portfolio is on-farm activities                                                                                                             |
| 4. Microcredit NGO                         | 1998             | Established by the Governmental Decree to provide microcredit to the poorest segments of the rural population including families with many children.                                                                                                         | ▪ 70% of clients are women  
▪ Provides training to clients on business planning and operation                                                                                     |
| 5. Semipalatinsk Microcredit Fund          | 1998             | Initiated by UNDP and implemented by Mercy Corp, it aims to develop a credit and savings culture among its clients, 100% women.                                                                                           | ▪ Lending to women groups based on social collateral  
▪ 90% are urban clients                                                                                                                             |
| 6. National Fund for Support of Poor Citizens | 1997           | Established as a non-bank finance institution to carry out lending operations targeting poor people in rural areas. Also engaged in charity activities.                                                               | ▪ 16 branches  
▪ Focus on individual and family businesses                                                                                                           |
| **Kyrgyz Republic**                       |                  |                                                                                                                                                                                                                        |                                                                                           |
| 7. KAFC (Kyrgyz Agricultural Finance Corporation) | 1997           | Funded by the World Bank and IFAD, KAFC offers low interest rate group loans to farmers and micro-businesses in rural areas.                                                                                              | ▪ Largest MFI in CA  
▪ 100% rural lending for agricultural and rural business activities                                                                                       |
| 8. Women's Microcredit (WMC)              | 1997             | In close partnership with Mercy Corp, WMC’s works through 4 local NGOs. Loans are provided to groups of women based on social collateral.                                                                                   | ▪ 37 branches  
▪ 80% of loans are for petty trade                                                                                                                  |
| 9. FINCA Kyrgyz Republic                  | 1995             | Funded by USAID, FINCA has a large geographical coverage; provides collateralized group loans to women borrowers and individual loans.                                                                                       | ▪ Village bank model  
▪ 98% of the portfolio in petty trade                                                                                                                |
<table>
<thead>
<tr>
<th>Name</th>
<th>Year established</th>
<th>Description of MF program</th>
<th>Notable features</th>
</tr>
</thead>
</table>
| 10. Bai Tushum Financial Foundation                                 | 2000             | Started operating as a merger of ACDI/VOCA and Caritas credit programs. 40% of portfolio is SME lending, 30% crop production, and 30% livestock. Women borrowers comprise 30% of the total number of borrowers. | • Agricultural and SME lending  
• Average loan size of US$1,600                                                                         |
| 11. Small- and Medium-Size Enterprise Credit (SMEC)                  | 1998             | In close partnership with Mercy Corp, SMEC targets individuals borrowers with collateralized loans for income generating business purposes. Clients must be registered tax-payers.   | • SME lending with average loan size US$1,636  
• 94% are urban clients  
• 86% are petty traders                                                                   |
| Tajikistan                                                          |                  |                                                                                                                                                                                                                           |-------------------------------------------------------------------------------------------------------|
| 12. Mountain Societies Development Support Program (MSDSP)           | 1993             | Part of a larger scale development program, MSDSP enjoys synergies with the activities of other programs and benefits from a large team of expatriate management. Mainly agricultural loans.                                             | • Expected that consolidated portfolios of MSDSP and ESF programs would form a part of Micro-finance Bank in collaboration with IFC |
| 13. Enterprise Support Facility (ESF)                                | 1996             | Privately owned program focuses on supporting and developing of small and micro scale enterprises. Also provides business support training.                                                                                    |-------------------------------------------------------------------------------------------------------|
| 14. National Association of Business Women (NABW)                   | 1999             | In close partnership with Mercy Corp, NABW aims to promote women’s economic rights and opportunities in the labor market, to increase women’s access to resources and education, and to create more jobs.      | • Strongest MFI in Tajikistan  
• 95% women borrowers  
• Targets poor women entrepreneurs                                                                 |
| 15. ACTED                                                            | 1996             | Apex institution working with different forms of locally owned credit cooperatives; ACTED specifically targets landless farmers in cotton-growing areas.                                                                        | • Low cost high outreach institution  
• Lends through group arrangements                                                                      |
| 16. Sitorai Najot                                                    | 1997             | Formerly World Bank TASIF beneficiary, lends to women from poorest groups of population in both rural and urban areas.                                                                                                    | • 100% loans to groups of women based on social collateral  
• Mostly petty trade                                                                                   |
| 17. Women's Economic Opportunity Project (WEOP)                     | 1998             | In partnership with Care International, WEOP provides social assistance for women. Microcredit is the most important component. Focuses on women and small farmers. Portfolio divided between agriculture and petty trade | • 74% borrowers are women  
• Group lending methodology  
• Offers cash transaction services                                                                     |
| Uzbekistan                                                          |                  |                                                                                                                                                                                                                           |-------------------------------------------------------------------------------------------------------|
| 18. BARAKOT Microfinance Program                                     | 2001             | Operated by an international NGO, Mercy Corp Intl. Specialized MFI institution with good potential for expansion. Loans are for both                                                                                         | • 100% lending for groups made of women  
• 100% in urban areas                                                                                   |
<table>
<thead>
<tr>
<th>Name</th>
<th>Year established</th>
<th>Description of MF program</th>
<th>Notable features</th>
</tr>
</thead>
<tbody>
<tr>
<td>19. Karakalpakstan Branch of Business Women Association</td>
<td>1997</td>
<td>Non-specialized NGO, selected by UNDP to implement its micro-credit program. Needs substantial strengthening and further grant funding. Social collateral based group lending.</td>
<td>▪ 100% of clients are women ▪ Focus on rural areas ▪ Loans mainly for agriculture and petty trade</td>
</tr>
<tr>
<td>20. Kashkadarya Branch of Business Women Association</td>
<td>1997</td>
<td>Selected by UNDP to implement its micro-credit program. Groups lending methodology based on social collateral. Loans are for livestock, petty trade, services and small production.</td>
<td>▪ 64% of clients are women groups ▪ Lends in both rural and urban areas</td>
</tr>
<tr>
<td>21. NGO Daulet</td>
<td>2000</td>
<td>The only locally owned NGO specialized in micro-credit. Supported by UNDP and grants from Soros Foundation. Portfolio focus on livestock, agro-processing, services, handicrafts and petty trade.</td>
<td>▪ 100% of clients are women in ▪ Works in rural and peri-urban areas ▪ Group lending based on social collateral</td>
</tr>
</tbody>
</table>
Appendix 3 An Overview of Microfinance in Central Asia

Central Asia is the poorest of the regions in ECA, with poverty incidence reaching up to 83 percent in Tajikistan. It also includes some of the most widely dispersed and remote communities.

The study is based on a survey of 59 NGO MFIs (21 of which were contacted for detailed analyses) and 23 banks involved in microfinance. These institutions represent over an estimated 90 percent of the microfinance industry in the region.

The microfinance sector in Central Asia is dominated by microfinance NGOs (NGO MFIs) and commercial banks with microfinance operations. Among Central Asia’s NGO MFIs, some show quite high performance, such as KAFC and FINCA in Kyrgyz Republic and KCLF in Kazakhstan. However, the majority of NGO MFIs are small, with limited levels of sustainability. Among the region’s commercial banks with microfinance operations, those in Kazakhstan are performing well. There are also a number of successful credit unions (CUs), especially in the Kyrgyz Republic. There is only one specialized microfinance bank in the region, which was recently created in Tajikistan.

As illustrated by graphs above, the combined microfinance portfolio is about US$193 million. While the microfinance industry has been growing rapidly both in terms of clients and portfolio (the sample of MFIs reviewed showed a portfolio growth rate of 73 percent from 2001 to 2002), its current outreach is still limited with about 191,315 current clients, less than 0.5 percent of the total population. Because of the smaller loan sizes of NGO MFIs, these institutions hold only 20 percent of the portfolio but serve 71 percent of the current microfinance clients. NGO MFIs also

<table>
<thead>
<tr>
<th>NGO MFIs Identified</th>
<th>Participated in Study</th>
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<tr>
<td>Kyrgyz Republic</td>
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<td>Tajikistan</td>
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<td>Uzbekistan</td>
<td>10</td>
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<tr>
<td>Total</td>
<td>81</td>
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</tbody>
</table>

* Commercial banks’ definition of microfinance in many cases is up to US$50,000.
have the lowest depth of outreach among MFIs in the region. In general, the microfinance services provided are limited mainly to microcredits.

### Commercial Banks’ Microcredit Portfolio

<table>
<thead>
<tr>
<th>Country</th>
<th>Commercial Banks Surveyed</th>
<th>% to Total Banking Assets</th>
<th>Microcredit as % of total loan portfolio (000)</th>
<th>Number of Microcredit Borrowers (000)</th>
<th>Average Microcredit Size (US$’000)</th>
<th>Average Interest Rate (%)</th>
<th>Average Maturity (months)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kazakhstan</td>
<td>7</td>
<td>68</td>
<td>3</td>
<td>8</td>
<td>13</td>
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<td>Kyrgyz Republic</td>
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<td>10</td>
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<tr>
<td>Tajikistan</td>
<td>5</td>
<td>81</td>
<td>0.2</td>
<td>0.3</td>
<td>1*</td>
<td>25</td>
<td>12</td>
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<tr>
<td>Uzbekistan</td>
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<td>93</td>
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<td>15</td>
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<tr>
<td>Total</td>
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<td>80</td>
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<td>24</td>
<td>6</td>
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<td>13</td>
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</tbody>
</table>

Source: Results from survey questionnaires; *Staff estimates.

### Kazakhstan

#### Microfinance Industry Overview

The microfinance industry in Kazakhstan has three main types of institutions: 38 commercial banks, 27 non-bank financing institutions, and 34 MFIs.

The country has one the most advanced, liquid, and vibrant financial sectors amongst NIS countries with high domestic lending rates, supported by the presence of large corporate borrowers and agricultural producers. Nevertheless, SMEs and microfinance lending is still underdeveloped as the sector has limited breadth of outreach and a narrow clientele focus. Thus, the institutions that participated in the study provide microfinance to about 28,770 people (about 0.4 percent of the population or 0.74 percent of the poor population).

As the banks’ definition of microcredit in Kazakhstan includes loans of up to US$50,000, the majority of the banks’ clients are above the poverty line, thus further decreasing the current access of the poor to...
microfinance. The banks’ average loans are US$13,241 (almost 10 times the per capita GNI). While accounting for 92 percent of the reported microfinance portfolio, banks only serve 27 percent of the current microfinance clients in the country, almost all of who are traders or service providers in towns or cities. Microfinance services provided are limited mainly to microcredits.

Creation of membership-based organization (Credit Union, Credit Partnerships) in the country is in early stage with only 27 Credit Partnerships established so far that focus mainly on larger rural producers. NGO MFIs serve the highest number of microfinance clients (70 percent) with the lowest depth of outreach at 17 percent.

Established by international institutions, NGO MFIs have substantially matured, and the country has the most developed network of local NGO MFIs. Although the microfinance industry has been growing rapidly, both commercial banks and NGO MFIs are largely focusing on urban and peri-urban clients, providing financial services to small traders and service providers. Microcredit NGO is an exception as it was created by the Government to specifically assist the rural poor.

Potential Outreach. The rural poor are virtually excluded from the financial sector. The rural population is estimated at around 4.7 million people. There are 2 million household farms in the country that support the majority of the rural population. While the largest farms and agro-producers are served by the commercial banks, this large segment of rural population living off household farms presents a huge potential for microfinance services. Based on the data from the Statistics Committee, 65 percent of people questioned in the household survey quoted lack of finance as the number one reason for not starting an economic activity. It should be noted that as rural areas have higher poverty incidence, about 3 million of rural people live below the poverty line, mainly comprising farming households.

Government Policy and Legal Framework. The Government’s financial sector strategy recognizes that there is a segment of society that can be best served by NGO MFIs, so the strategy focuses on developing an institutional framework and a general environment conducive to more competition amongst institutions and affordable financial services for the poorer population and microenterprises.

Financial intermediation and credit activities in Kazakhstan fall under the regulatory jurisdiction of the National Bank which licenses, supervises, and regulates all financial institutions including MFIs. Recognizing that institutions that provide only limited financial services on a smaller scale do not require supervision by the National Bank, the National Bank has initiated a new Law on Microfinance to promote the development of MFIs and expand access of smaller entrepreneurs to financial resources.

Under the new law, an MFI is defined as a non-depository financial institution that provides microloans. As with the prohibition on taking deposits, the systemic risk is minimal, the legal requirements for MFIs are substantially lower than those for commercial banks:

- an MFI extending loans less than US$5,000 equivalent only needs to establish itself as a legal entity, without the need to obtain NBRK license;
- minimum start-up capital is US$5,000 equivalent; and
- the limit of a loan provided to one borrower is 25 percent of MFI capital.

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17 This number can actually be higher if it is calculated only for microloans lent from the banks’ own resources. The average loan size is lower because of the effect of the EBRD Small Business Credit Line.
However, the prohibition limits funding sources for smaller MFIs and access to savings services by small depositors. The law was made effective in the summer of 2003.

Commercial Banks

Kazakhstan has a two-tier banking system consisting of the National Bank of the Republic of Kazakhstan (NBRK), serving as the regulatory and supervisory agency, and 38 commercial (second-tier) banks (17 with participation of foreign investors). As of late 2002, total consolidated assets amounted to KZT 1,146 billion (US$7.6 billion) and total lending to KZT 672 billion (US$4.5 billion), whereas total capital reached KZT 162.8 billion (US$1.1 billion), and deposit-to-GDP ratio was about 16 percent.

Kazakhstan’s banking system is somewhat ahead of those in other CIS countries and has been experiencing significant growth since 2000. As confidence rose, domestic deposits grew rapidly and liquidity increased, while banks expanded their lending portfolios. It is worth noting that some of the leading Kazakh banks are investing in other commercial banks in the neighboring countries, including Kyrgyz Republic. Overall, the banking sector is relatively stable and well regulated, steadily moving towards international standards, and foreign investments were substantial.

SME financing. While credits to SMEs have been growing at almost 55 percent a year on average, and reached KZT 146.5 billion in 2002, they are still very low at less than 3 percent of the total lending portfolio, mainly consisting of EBRD Credit Lines for SMEs in the amount of US$78.5 million:

- Low general confidence in the legal environment is prompting banks to lend out more shorter-term loans;
- Banks generally tend to rely more on full collateralization, rather than sound business concepts and cash flows, have not developed capacity to appraise and supervise smaller loans, and consequently lending mainly to large-scale borrowers;
- Most of the surveyed banks have different size definitions for microcredit ranging from US$500 to as high as US$50,000, with average loan size of about US$13,241. The average depth of outreach is the highest in the region at around 981 percent. Banks hold 92 percent of the MICROFINANCE portfolio in the country, but serve 27 percent of microfinance clients, indicating larger loan averages.
- Microcredit is still limited to the urban population, mainly traders;
- In general, the commercial banks’ perception of the rural sector is somewhat biased since rural lending is seen as high cost and high risk, and, despite the rural credit lines (World Bank, ADB) operating in the country through commercial banks, banks are not yet comfortable with and not willing to lend their own resources to the rural sector. Exceptions are large collateralized loans to large corporate agro-producers and uncollateralized credits of up to US$3,000 mainly to tobacco growers in which case the repayment is secured by payments from cigarette producers (Philip Morris).
Banks do not issue loans below US$5,000 from own resources. Smaller loans are typically provided from the EBRD credit line wherein the average loan size has been US$4,000;

The average interest rate on microcredit is at 22 percent with average maturity below one year, which makes these credits available only to the current target population.

The National Bank is urging commercial banks to improve their operational efficiency, expand their scope, and most importantly, decrease the interest rates further to allow poorer citizens an opportunity for economic growth.

Credit Partnerships

In Kazakhstan, there are no traditional Credit Unions yet. Nevertheless, the Government is supporting the creation of Credit Partnerships (CPs) which are also membership-based financial institutions, but CPs significantly differ from CU s in regards to membership and management, sources of funds, and nature of organization. The Ministry of Agriculture takes 35-50 percent equity positions in such partnerships established by larger agro-producers. After establishment of such a CP, the Agricultural Credit Corporation, owned by the Government, makes concessionary loans to leverage CPs equity at 4:1 ratio with loans at three percent to five percent annual interest rates. ACC has been established by Ministry of Agriculture to support CP development, with more than US$5 million in assets, mainly in the form of interest free credits. CPs are licensed institutions supervised by Ministry of Finance. To date, 27 CPs have been established.

CPs provide individual loans to ultimate borrowers, CP members, collateralized at 75 percent of CP charter capital, at around 10 percent interest rate, for one to five years. About 20 percent of its portfolio is for investment credits, 80 percent for working capital. Size of individual credits varies from US$5,000 to US$300,000.

Some shortcomings of the system are mainly due to the process of selection of members, focusing on larger producers, and to the commercial status of CPs. The new draft law on CPs will allow individuals and physical entities to create CPs. CPs would still not be allowed to take deposits, and would continue to be governed by the National Bank, except for cases when CPs are created to make loans of less than US$5,000 only, in which case these CPs would fall under the new microfinance law.

NGO MFIs

Creation of MFIs in the country started mainly in 1997/1998 under the TACIS / Winrock program, and led to the establishment of local NGOs. While NGOs hold only 4 percent of the outstanding MICROFINANCE portfolio, they serve more than 70 percent of active MICROFINANCE clients (20,000 in total). There are two distinct types that are included in the NGO MFI group: (i) Government-created programs and (ii) independent NGOs.

Government Programs. The Government MICROFINANCE programs run through NGOs account for 36 percent of the total portfolio of NGO MFIs. These MFIs do provide assistance to the segment of population excluded from the formal financial sector, namely the rural poor with household farms. However, theses institutions generally show weaker financial performance. State funds are channeled to ultimate recipients through a variety of intermediaries (Government entity, MFI, regional budget) with under the market rate annual interest rates of 5 to 12 percent. While Government-supported programs in general show low interest rates, some have hidden charges, which make the effective interest rate comparable to independent MFIs. Thus, in some cases, the upfront fees and charges to process and review
a loan application reach up to one-third of the requested loan amount. In cases when the programs were established more for social assistance purposes, they usually lack strong financial discipline and have week indicators.

Independent NGOs. The rest of the NGO MFI portfolio belongs to independent MFIs (with a significant share of a single MFI, KCLF), all created with assistance and/or funding of international donors such as Winrock, ACDI/VOCA, Eurasia, TACIS, UNDP, Mercy Corp, Soros Foundation, DFID, to name a few. These MFIs vary in size (from portfolios of 30 clients to 7,000 clients) and portfolio quality, and are located in various oblasts. While the NGO MFIs do offer similar products and target similar populations, the success of individual programs (especially evident in the case of KCLF) was possible when a dynamic management team with a strategic vision was identified, and, most importantly, donors provided long-term TA and grant funding for operational costs, expansion, and lending capital.

Portfolio. The other important characteristics of NGO MFIs are as follows:

- The MICROFINANCE industry, in general, is very chaotic and in its infant stages of development. While offering similar products, the interest rates charged by NGO MFIs range from five to 72 percent and the operational cost ratio ranges from four to 53 percent.

- While NGO MFIs vary in size and portfolio quality, they offer similar products (group loans) to the same client base (urban traders) starting to compete with commercial banks.

- As competition with commercial banks over this clientele is sharpening, some NGOs are already forced to develop new products like mortgages, to meet the diversifying demand of their main clientele or for a new client base like rural investment capital.

- There is a significant gap in the financial sector for providing financial services (i) to the rural population in general; and (ii) for investing in productive assets in rural areas.

<table>
<thead>
<tr>
<th>Institution</th>
<th>Portfolio Outstanding (US$ million)</th>
<th>Number of active borrowers (000)</th>
<th>Typical Loan Purpose</th>
<th>Average Loan Size (US$)</th>
<th>Depth of Outreach (%)</th>
<th>Annualized Average Interest Rates (%)</th>
<th>Average Loan Term (months)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asia Credit Fund</td>
<td>1</td>
<td>0.3</td>
<td>trade</td>
<td>3,167</td>
<td>235</td>
<td>23</td>
<td>9</td>
</tr>
<tr>
<td>KCLF</td>
<td>1</td>
<td>5</td>
<td>trade smallscale</td>
<td>318</td>
<td>24</td>
<td>55</td>
<td>4</td>
</tr>
<tr>
<td>Kazakhstan Fund for Support of Entrepreneurs</td>
<td>0.3</td>
<td>0.2</td>
<td>producers</td>
<td>1,603</td>
<td>119</td>
<td>26</td>
<td>14</td>
</tr>
<tr>
<td>Semipalatinsk Microcredit Fund</td>
<td>0.3</td>
<td>1</td>
<td>livestock</td>
<td>213</td>
<td>16</td>
<td>46</td>
<td>3</td>
</tr>
<tr>
<td>Sub-Total for Indep NGOs</td>
<td>3</td>
<td>6</td>
<td></td>
<td>466</td>
<td>34</td>
<td>41</td>
<td>6</td>
</tr>
<tr>
<td>Microcredit NGO</td>
<td>0.6</td>
<td>2</td>
<td>livestock</td>
<td>250</td>
<td>19</td>
<td>10</td>
<td>9</td>
</tr>
<tr>
<td>National Fund for Support of Poor Citizens</td>
<td>1</td>
<td>12</td>
<td>n.a.</td>
<td>93</td>
<td>7</td>
<td>5</td>
<td>16</td>
</tr>
<tr>
<td>Sub-Total for Gov Programs</td>
<td>2</td>
<td>14</td>
<td></td>
<td>118</td>
<td>9</td>
<td>7</td>
<td>14</td>
</tr>
<tr>
<td>Total for KZ</td>
<td>5</td>
<td>200</td>
<td></td>
<td>226</td>
<td>17</td>
<td>30</td>
<td>9</td>
</tr>
</tbody>
</table>

- No saving services are offered by NGO MFIs due to legal restrictions. Kazakh Post is the only agency in the rural areas that does not have active bank branches but that does offer savings services. It currently has about 2,240 branches that collect savings across the country. The collected funds are invested exclusively into Government securities.
A review of MFIs reveals that unless a specific institution is created with a mandate to support rural entrepreneurs and agro investments, this population segment is left outside of the financial industry. Thus, despite the strong banking sector and growing microfinance industry, only the programs created by the Government focus on rural population outside of towns.

Where subsidized programs exist, they develop an unfavorable environment for competing MFIs. The Discrepancy in interest rates between Government programs and independent NGO MFIs is large. While the average effective interest rate for the country is 30 percent, it is 41 percent for independent NGO MFIs and seven percent for Government programs.

Lack of sources of funds is cited as the most important factor impeding the growth of MFIs in the country, although two MFIs have been able to attract credits from outside sources, one on commercial terms and another one at concessional rates.

In addition, the majority of MFIs offer social collateral based group loans, while the tendency in the world is towards individual loans, as group base lending in general is more expensive at a certain point, with a lower number of potential clients per credit officer. Social collateral based lending has a risk of an “avalanche effect” when default of one borrower causes default of all group members or even all groups in the village.

**Kyrgyz Republic**

*Microfinance Industry Overview*

The country’s financial sector consists of 20 commercial banks with total assets of US$39 million, 350 non-bank financial institutions (credit unions), and 17 MFIs, all of which provide microfinance services to varying degrees. Combined, these institutions provide microfinancing to about 99,260 people, about two percent of the population or three percent of the poor population. As such, MFIs in Kyrgyz Republic have the largest breadth of outreach among Central Asian countries.

<table>
<thead>
<tr>
<th></th>
<th>Banks</th>
<th>NGO MFIs</th>
<th>CUs</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Outstanding Portfolio</td>
<td>4%</td>
<td>20%</td>
<td>4%</td>
<td>60%</td>
</tr>
<tr>
<td>Current Clients ('000)</td>
<td>0.7</td>
<td>70%</td>
<td>70%</td>
<td>100%</td>
</tr>
<tr>
<td>Average Loan Size (US$)</td>
<td>2,338</td>
<td>431%</td>
<td>269</td>
<td>397%</td>
</tr>
<tr>
<td>Depth of Outreach (%)</td>
<td>835%</td>
<td>154%</td>
<td>96%</td>
<td>142%</td>
</tr>
</tbody>
</table>
Due to a relatively underdeveloped banking sector, most of the on-lending funds available in the country from various international sources were channeled through institutions established by donors for specific purposes. In order to facilitate this process, and understanding the importance of MFIs for inclusion of the poor in the economic activities, the Government has made a significant effort in building a favorable environment for the microfinance industry. Currently, Kyrgyz Republic has the most comprehensive legal and regulatory framework in Central Asia for microfinance activities with the Laws on Microfinance Institutions and Credit Unions and several relatively mature MFIs, one of which is considering transformation into a specialized bank.

NGO MFIs have both the largest microfinance portfolio (76 percent) and the largest number of clients (68 percent of total), almost three-quarters of which comes from one institution, KAFC. The country also has the most advanced credit union network in the region developed with the assistance of the on-going ADB program. CUs currently serve about 29,000 people and have much lower depth of outreach, about 96 percent, compared to the country average of 142 percent. This illustrates that the majority of microfinance clients are an economically active poor population. Most MFIs that serve this segment of poor have very good financial performance indicators. Combined, KAFC and credit unions provide more microfinance services to the rural sector than any other institutions in the region.

Potential Outreach. While the microfinance sector has been growing rapidly, the demand for microfinance remains extremely high. The number of SME’s is growing at 11 percent per year and employ about 60 percent of the country’s population. The SME sector accounts for 43 percent of the total GDP and employs about 1 million people. While the commercial banks and most of the NGO MFIs mainly focus on urban and peri-urban SMEs and microentrepreneurs, the credit unions and KAFC are providing microfinance services to the rural population where they are most needed as a majority live in rural areas (2.4 million) with a higher concentration of poverty (75 percent of the total poor).

Government Policy and Legal Framework. MFIs are regulated and supervised by the National Bank of the Kyrgyz Republic (NBKR), and comprise three categories: (i) Microfinance Companies (MFCs), established as joint stock companies; (ii) Microcredit Companies (MCCs), established as dividend-paying commercial legal entities; and (iii) Microcredit Agencies (MCAs), established as non-dividend paying, non-commercial agencies. Only the MFCs are allowed to take deposits after two years of operation, although the MCCs and MCAs may apply to become MFCs after two years and thus take deposits as well. The minimum paid-in capital amounts are as follow: US$550,000 for deposit-taking MFCs; US$200,000 for non deposit-taking MFCs; and US$2,000 for MCCs/MCAs.

The Kyrgyz Republic law on credit unions was issued in October 1999, under which a CU is defined as non-commercial, financial-credit institution established with the purpose of providing savings and loan services to its members. A credit union must be an established legal entity and licensed by the NBKR, with a minimum of 10 members and 30,000 KGS capital. While the NBKR regulates CUs, its supervisory roles are delegated to the CU Apex, the Financial Company for Support of Credit Unions (FCCU).
There are still some contradictions between the existing MFI law and regulations and other existing legislation. First, the requirements for establishing a legal MCA are unclear. The MFI law requires MCAs to submit proof of legal entity when applying for a NBKR certificate, which contradicts the non-profit organizations law, which stipulates that non-commercial organizations may be established with or without the formation of a legal entity. The NBKR’s authority to reorganize and liquidate MFIs is seen as excessive and contradicts the civil code, which stipulates that these decisions should be made by the entity’s founders and by court order. Finally, under the tax code, loan loss provisions are tax deductible for banks, not MFIs. Moreover, donor grants are treated as taxable income.

ADB is providing assistance to the NBKR and the FCCU to strengthen their supervisory capabilities and to draft amendments to the credit union law.

**Commercial Banks**

The banking sector in Kyrgyz Republic is relatively small and underdeveloped. As of late 2002, the total banking assets for all the 20 banks were US$39 million (approximately nine percent of GDP), with total lending of US$68 million, while deposit-to-GDP ratio was about four percent, which is the lowest among transition economies.18

**Credit Unions**

The banking sector needs to be consolidated since it is over-banked in terms of the overall number of banks and yet under-banked in terms of capital, product range, and penetration. There are 20 banks in operation currently, of which the top five control more than 49 percent of the sector’s assets and 55 percent of the deposit base, while the remaining 15 banks have extremely small business volume.

**SME Lending.** Most banks lack specific sector specialization and skills. They are not actively lending and the level of intermediation is low. Aside from existing donors’ SME credit lines (mainly the EBRD US$15 million credit line), almost no banks provide loans with maturities greater than one year because of funding constraints and limited experience.19 Needless to say, smallscale lending by commercial banks is even lower. The surveyed banks reported 10 percent of their lending portfolio was microcredit ranging from US$1,500 to US$10,000, with an average size of about US$2,300 (see table above). Interest rates were at 25 percent, which is somewhat comparable to market interest rates on scarcely provided new loans, while average maturity is relatively short at eight months. Given the structural weaknesses in the banking sector, it is envisaged that the gap of rural microlending will continue to be filled largely by non-bank institutions such as KAFC, which is currently the largest agricultural lender in the country.

The banking sector in Kyrgyz Republic is also undermined by the NBKR’s weak supervisory and regulatory enforcement functions, partly due to the political sensitivity of the sector. This was largely demonstrated in mid-2001, when 10 banks failed to meet NBKR minimum capital requirements and were only minimally sanctioned. The commercial banks’ operational licenses with respect to securities and precious metals operations were limited.

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18 According to the WB/IMF financial sector study, the deposit to GDP ratio was 17 percent in Russia, 20 percent in Ukraine, 35 percent in Estonia, 16 percent in Kazakhstan and 31 percent in Albania.

19 The existing IFI credit lines (EBRD, KfW and World Bank) have been mainly directed at the SME sector with typical loan sizes of US$100,000 to US$500,000.
ADB provided US$12 million (only US$3.9 million disbursed) for funding equity of up to US$35,000 per CU, matched with equal member contributions. The Financial Company for Support of Credit Unions (FCCU) is an APEX company mandated to manage the matching grant program, channel the ADB funds, and supervise the CUs. GTZ is providing technical assistance to the credit union system, with advisors from DGRV, the German credit union development agency. Currently, 350 credit unions have been formed with 29,000 members with 313 fairly strong credit unions, for an average of about 80 members per CU. The remaining CUs are expected to be closed or merged. CUs serve about 31 percent of the total microfinance clients in the country.

It is important to note that FCCU is a government-owned entity that reports to a Supervisory Council in the National Bank. At this time, credit unions are not empowered to capture savings, though the National Bank and the advisors are working on this issue.

**NGO MFIs**

Kyrgyz Republic has the most mature NGO MFIs and most developed MFI law in the region. There are two types of NGO MFIs in the country: (i) comparatively large NGOs involved in micro-finance operations, backed by international donor organizations; and (ii) several much smaller organizations, usually funded from domestic sources, often by national or local authorities.

**Portfolio.** Donor-supported NGOs serve 68 percent of about 100,000 microfinance clients in the country. Predominantly supported by IFIs both in terms of lending capital and technical assistance, NGO MFIs hold a large portfolio of US$30 million. All lenders provide loans for productive purposes, with very little lending of consumer or other non-productive loans. About 55 percent of the total lending is provided to rural clients, which is the highest rural outreach in the region. No MFIs accept deposits other than for loan guarantee funds. NGO MFIs started diversifying their portfolios from social collateral-based short-term group lending activities to providing individual, longer-term loans for productive purposes. One MFI is considering transforming into a rural bank. All MFIs have developed a fairly comprehensive network of branches and representative offices, covering the whole country, the combined number of customer contact points has reached 110.

Local NGO MFIs are also emerging but have a limited impact so far, serving less than 1,000 borrowers.

Although the target client groups of some of the donor-funded NGO MFIs overlap, the microcredit market is far from saturation, especially in rural areas, and there is no crowding-out effect yet. The only market, which is considered almost saturated, is lending for petit trading activities, especially in urban areas.

The other important characteristics of this industry segment are as follows:

- Total number of active borrowers is about 70,000, with the average loan size of US$ 431.
- The average depth of outreach ratio (loan size/per capita GNI) is 154 percent, including the individual loans; however, social collateral-based group loan depth of outreach ratio drops to about 45 percent.
- Nominal on-lending rates to the ultimate beneficiaries range between 20-54 percent annually.
- In majority of cases, the NGO MFIs have received an injection of grant funds from the international donors and during the initial period, the operational expenditures were often covered with donor funds.
In addition, extensive technical assistance support financed by the international donors, and in some cases direct management assistance, is being provided to the NGO MFIs.

As a result, the operational self-sufficiency ratio is very high (215 percent in average), and all MFIs are able to fully cover their operational expenditures.

All MFIs have been or are in the process of registering as legal entities under the new law on microfinance.

<table>
<thead>
<tr>
<th>MFI</th>
<th>Portfolio Outstanding (US$ million)</th>
<th>Number of active borrowers (000)</th>
<th>Typical Loan Purpose</th>
<th>Average Loan Size (US$)</th>
<th>Depth of Outreach (%)</th>
<th>Annualized Average Interest Rates (%)</th>
<th>Average Loan Term (months)</th>
</tr>
</thead>
<tbody>
<tr>
<td>KAFC individual lending</td>
<td>20</td>
<td>17</td>
<td>livestock</td>
<td>1,196</td>
<td>427</td>
<td>21</td>
<td>24</td>
</tr>
<tr>
<td>KAFC group lending</td>
<td>2</td>
<td>18</td>
<td>livestock</td>
<td>86</td>
<td>31</td>
<td>20</td>
<td>18</td>
</tr>
<tr>
<td>Women's Microcredit (WMC)</td>
<td>1</td>
<td>13</td>
<td>petit rade</td>
<td>109</td>
<td>39</td>
<td>51</td>
<td>6</td>
</tr>
<tr>
<td>FINCA</td>
<td>4</td>
<td>20</td>
<td>petit trade</td>
<td>213</td>
<td>76</td>
<td>54</td>
<td>4</td>
</tr>
<tr>
<td>Bai Tushum Financial Foundation</td>
<td>2</td>
<td>1</td>
<td>SME, crop production, livestock</td>
<td>1,600</td>
<td>571</td>
<td>41</td>
<td>12</td>
</tr>
<tr>
<td>Small- and Medium-Sized Enterprise Credit (SMEC)</td>
<td>0.7</td>
<td>0.4</td>
<td>petit trade</td>
<td>1,636</td>
<td>584</td>
<td>35</td>
<td>10</td>
</tr>
<tr>
<td>Total for KG</td>
<td>30</td>
<td>70</td>
<td></td>
<td>431</td>
<td>154</td>
<td>31</td>
<td>12</td>
</tr>
</tbody>
</table>

**Tajikistan**

**Microfinance Industry Overview**

The financial sector of the country is still weak as represented by 14 under-capitalized and under-performing commercial banks (the largest four control 85 percent of total banking assets), about 20 microfinance institutions stemming from early humanitarian efforts of donor organizations, and one newly opened microfinance bank. Lending to SMEs from commercial banks is limited and is estimated to be under US$300,000. In the absence of strong banking sector, most of the financial assistance to the poor is channeled through specialized NGO MFIs serving 99 percent of microfinance clients in the country. There are no credit unions currently operating in the country.

**Potential Outreach.** Tajikistan’s population of 6.2 million people is the poorest in the region. About five million people live below poverty line, four million of who live in rural areas. MFIs currently serve less than 45,000 people, so the demand for finance is extremely high, especially in rural areas. Immediate target clients for MFIs are small businesses and small family farms, around 12,000 of which were operating in 2001.

**Government’s Policy and Legal Framework.** In 2002, the Government of the Republic of Tajikistan declared micro-finance as an important policy feature of poverty reduction and financial sector...
development. The Government has committed to ratifying enabling legislation, which is currently being discussed in close collaboration with the international donor community and microfinance practitioners. The *Law on Microfinance Organizations* developed in February 2003 is a starting point for the implementation of the Government strategy based on facilitating sustainability and competition among all types of microfinance providers as well as promoting commercialization of microcredit institutions that are willing to evolve from humanitarian and social development programs into formal financial institutions.

The draft regulations contain provisions for creation of two non-deposit taking lending institutions, not subject to National Bank supervision, and one deposit-taking “credit institution” subject to National Bank regulations and supervision. All three forms allow for the variety of existing operational models of microfinance from non-commercial, humanitarian assistance focused foundations to more advanced “microcredit deposit-taking companies”. The proposed legislation does not yet cover the activity of the credit unions and has to be complemented by a number of detailed regulations on the supervision and qualifications for tax exemption status of donor funded humanitarian and social development programs.

**Commercial Banks**

The largest conflict in the existing legislation is the disparity between the Civil Code and the Tax Code and the Law on Banks and Banking Activities. The disparity stems from the differences in how the codes and the law define “loans” and “credits”. While any entity, including NGOs and make “loans”, only organizations that are licensed and supervised by the National Bank can extend “credits”. This has an important implication on taxes, favoring institutions that extend credits by exempting their income from VAT and allowing deductions from the taxable profits.

Tajikistan’s banking sector is also very small and fragile with US$195 million in total assets, US$70 million in total lending, and only about 4 percent deposit to GDP ratio. There are 14 commercial banks, of which four control 85 percent of banking assets and 70 percent of household deposits. The banks may be classified into two groups: first, large and old-style banks that have undergone varying degrees of restructuring and second, smaller banks that operate more effectively. The largest four banks have poor loan portfolio quality, with non-performing loans reported to be at 94 percent, as of mid-2002. Overall, the banking system is undercapitalized, its supervision is inadequate as many prudential requirements are not enforced, and banking skills are lacking.

The majority of commercial bank lending, particularly from the four largest banks, went into the cotton sector. The smaller banks are playing an increasingly important role in enlarging the share of non-cotton lending. However, the overall lending is still constrained by the National Bank’s prudential regulations on liquidity.\(^{20}\) The smaller banks

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\(^{20}\) Banks are required to hold 75 percent of deposits in liquid assets, 20 percent reserve requirements, and 25 percent liquidity on total assets.
have also significantly improved their loan portfolio quality and increased their share of deposits, but they still find it difficult to comply with the minimum capital requirements.

*SME Lending.* The commercial banks’ share of microloans to total loans is about 0.2 percent, which is the lowest among the countries in CA. The low ratio is due to the challenges of the financial sector discussed above. Microloans are short-term (up to 12 months) and range from US$200 to US$2,000 with an average size of US$1,050 usually provided for trade and working capital. The annual interest rates range between 22-25 percent on foreign currency loans and 26-30 percent on national currency loans. Given the problems of capitalization, as well as public and donor mistrust, it is reasonable not to expect a substantial increase in commercial banks’ microlending activities.

*Credit Unions*

There are no credit unions active in the country.

*NGO MFIs*

The emergence of MFIs in the country has been led, in large, by international, donor-funded, humanitarian efforts. The existing microcredit programs are rapidly expanding their portfolios. Currently, they have relatively good repayment rates and possess the potential to gain more importance in the financial system of Tajikistan. As of January 2003, the identified microcredit programs, collectively, had about 42,000 active borrowers with the cumulative outstanding loan portfolio of US$3 million. Because of the country’s geography, the microcredit providers usually have a regional focus with the concentration of their activities around major cities and rural towns. They do not face much competition.

*Types of NGO MFIs.* The NGO MFIs can be divided in three groups: (i) the National Association of Business Women of Tajikistan (NABWT), a dominant MFI accounting for 50 percent of disbursements, 46 percent of loan portfolio, and 23 percent of clients; (ii) six larger MFIs with the total of their portfolios equal to NABWT, with smaller disbursement parameters but with a much larger number of clients; and (iii) a continuum of smaller localized micro-credit programs with the average size of portfolio of about US$15,000 and with their cumulative share of 7 percent in the total outstanding loan portfolio.

*Portfolio.* The other important characteristics of this industry segment are as follows:

- Most NGOs have similar loan products.
- The volume of microcredit through NGO MFIs is increasing rapidly (47 percent annual growth in portfolios since 2001) with the second group providing for the most of such growth. However, the substantially smaller growth in the number of active clients reflects the tendency towards larger group loans and the introduction of individual credit programs.
- Another reason for slow client growth is the difficulty in attracting new clients. Very high interest rates (almost uniform at around 4 percent per month) and the short nature of offered credits (generally up to 4 months with bi-weekly repayment) can be afforded by only a limited number of clients, making them unsuitable for traditional activities, like agriculture.
- All existing MFIs operate under international NGOs, given the absence of a legal basis for microcredit as a development activity.
- A “micro-finance coalition” has been established as a voluntary alliance of all microfinance practitioners in the country with the aim to represent the MFIs, to strengthen the capacity of existing NGO MFIs, and to participate in the development of the new MICROFINANCE law.
All NGO MFIs would require substantial donor assistance (both funding and TA) to become fully sustainable instruments for credit provision to the poor.

<table>
<thead>
<tr>
<th>MFI</th>
<th>Portfolio Outstanding (US$ million)</th>
<th>Number of active borrowers (000)</th>
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<th>Average Loan Size (US$)</th>
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<th>Annualized Average Interest Rates (%)</th>
<th>Average Loan Term (months)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mountain Societies Dev Support Program</td>
<td>0.9</td>
<td>20</td>
<td>agriculture</td>
<td>44</td>
<td>25</td>
<td>24</td>
<td>12</td>
</tr>
<tr>
<td>Enterprise Support Facility</td>
<td>0.4</td>
<td>0.9</td>
<td>start-ups, SMEs</td>
<td>442</td>
<td>246</td>
<td>16</td>
<td>8</td>
</tr>
<tr>
<td>Nat Assn of Business Women (NABW)</td>
<td>1</td>
<td>6</td>
<td>various</td>
<td>197</td>
<td>109</td>
<td>36</td>
<td>6</td>
</tr>
<tr>
<td>ACTED</td>
<td>0.2</td>
<td>9</td>
<td>various</td>
<td>19</td>
<td>10</td>
<td>48</td>
<td>2</td>
</tr>
<tr>
<td>Sitorai Najot</td>
<td>0.2</td>
<td>3</td>
<td>various</td>
<td>70</td>
<td>39</td>
<td>45</td>
<td>5</td>
</tr>
<tr>
<td>Women's Economic Opportunity Project</td>
<td>0.2</td>
<td>3</td>
<td>agriculture</td>
<td>70</td>
<td>39</td>
<td>33</td>
<td>11</td>
</tr>
<tr>
<td>Total for TJ</td>
<td>3</td>
<td>42</td>
<td></td>
<td>73</td>
<td>41</td>
<td>31</td>
<td>7</td>
</tr>
</tbody>
</table>

Uzbekistan

Microfinance Industry Overview

The overall financial industry in the country is extremely segmented and underdeveloped with the Government controlling 96 percent of the banking sector’s assets. A number of subsidized programs are channeled through the banks. The NGO MFIs are undercapitalized being the smallest in the region. Both the NGO MFIs and the emerging credit unions are operating under insufficient legal and institutional framework. There are about 36 banks, 10 NGO MFIs, and seven newly-established credit unions providing microfinance services in the country. The banks and the NGO MFIs have around 21,000 clients, which only constitutes about 0.1 percent of the population. The average microloan from the banks is more than four times the GNI per capita. While the NGO MFIs do have a low depth of outreach, their combined portfolio is around US$542,000. Although a few credit unions have recently emerged (7 with 50 members each on average), no data was available on their activity at the time of the study.

Potential Outreach. Based on the Tax Committee’s statistics, in 2002, there were registered: 300,000 entrepreneurs (mainly traders), 170,000 microfirms (mostly in trade and services), and 3.3 million family farms. Given the severely underdeveloped finance system in the country, the potential demand for microfinance can be very high, especially provided the high density of the population in the country, which is the highest in region. There are 25.1 million people in the country and about 7 million live below the poverty line. Poverty has a higher rural incidence, as the rural population amounts to about 70 percent of the total population as well as about 70 percent of the total poor. Out of the rural population of 16 million, almost a third, or about 4.9 million, are poor. Thus, while the urban MFIs have unlimited
potential for growth, the development of rural MICROFINANCE programs focusing on the 3.3 million family farms, would have a higher impact on poverty alleviation.

**Government Policy and Legal Framework.** As its macroeconomic policy had focused mainly on industrialization, import-substitution and centralized control over the economy, the Government has yet to fully acknowledge the importance of microentrepreneurship. Thus, the development of microfinance has not been a priority. There is no specific law on microfinance and/or any type of MFIs. The current regulatory framework consists only few separate regulations, which make microfinance activities complicated. The segmentation of the regulatory framework for small private entrepreneurship further complicates the overall microfinance regulatory framework. A coherent regulatory framework for MFIs needs to be developed to promote further development of this sector.

The existing legislation that affects MFIs in Uzbekistan includes:

- A Presidential decree allowing the creation of non-profit MFIs providing small loans up to US$3,000;
- CBU regulations concerning banks’ microcredit to non-legal and legal small business entities, allowing banks to lend 50 percent of microcredit in cash and restricting microcredit interest rates to not exceed the CBU re-finance rate;
- A resolution by the Cabinet of Ministers concerning donors’ microfinance/SME credit lines, legalization of NGO microfinance activities and tax exemption of banks’ income from microfinance activities;
- A law on credit unions that allows CUs to accept deposits and make loans to their members, with at least 50 members and minimum share capital of US$10,000 equivalent, under CBU regulation and supervision;
- Cabinet of Ministers, Ministry of Labor and Social Protection, and CBU regulations on the use of non-budgetary funds as the source of microcredit for small businesses.

**Commercial Banks**

The Uzbekistan banking system consists of 13 banks with both direct and indirect state ownership, 16 private banks, and 5 joint venture banks. In real terms, the sector is stagnant, with shrinking total assets (currently at US$4,649 million), loans (currently at US$2,864 million), and capital. It is also highly dominated by the state which holds about 96 percent of banking assets and which guarantees over 70 percent of the total loan portfolio.

Banks are generally risk averse and hesitant to lend in the absence of Government guarantees, most of which are provided for loans to state enterprises. Lending to SMEs and individuals is low, representing only 1.3 percent (US$39 million) of total bank loans.

On the funding side, depositors’ confidence in banks is low with household deposits at only 1.2 percent of GDP which is growing very slowly, largely due to the savings
disincentives built into the banking system. Overly intrusive tax reporting requirements make banks into state’s agents, thereby undermining depositors’ trust and encouraging the use of cash for transactions.

There is also a cash quota/liquidity system administered by the National Bank determining how much cash is to be made available to each bank based on their deposit size. As the result, depositors cannot be certain of access to their deposits on demand. Meanwhile, internationally based supervisory norms have been introduced by the National Bank, but the enforcement is far from effective. For instance, the banks’ lending portfolios are highly concentrated and there continues to be cross-shareholdings between banks.

**Credit Unions**

**SME Lending.** Banks generally consider microcredit as anything less than US$10,000, with the average microcredit at about US$2,493. Banks offer the longest maturity (an average of 21 months) and an average interest rate of less than 24 percent. In addition, the banks also channel various Government funds directed for SMEs. In 2002, the Employment Fund issued US$1.4 million in microcredits to 1,700 poor families, with an average loan size of US$848 (at 5 percent a year).

**Sources of banks’ microcredits**

- Fund for Preferential Crediting
- Business Fund
- Dekhqtan and Private Farmers Support Fund
- Employment Fund
- Micro-credits for start-up capital

<table>
<thead>
<tr>
<th>Sources of banks’ microcredits</th>
<th>(US$ million)</th>
<th>NBU</th>
<th>Pakhta Bank</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>MICROFINANCE</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Portfolio</td>
<td>12</td>
<td>16</td>
<td>28</td>
<td></td>
</tr>
<tr>
<td>For Agriculture</td>
<td>7</td>
<td>5</td>
<td>13</td>
<td></td>
</tr>
<tr>
<td>Rural Clients (000)</td>
<td>4</td>
<td>5</td>
<td>9</td>
<td></td>
</tr>
</tbody>
</table>

As lending to traders is promoted through the EBRD program, many banks have a sizable rural portfolio. In fact, the two largest banks in the country, NBU and Pakhta Bank with a combined microcredit portfolio of US$28 million, have lent about US$13 million to agriculture, which is the highest microlending to agriculture among all banks in the CA region.

CUs are new to Uzbekistan financial markets, with only 7 registered CUs by February 2003. An ADB loan is supporting the development of CUs. A recent law allows CUs to accept deposits and make loans to its members. According to the law, a credit union must have at least 50 members with US$10,000 share capital and be supervised by the Central Bank. It is premature to evaluate efficiency of CUs at this stage.

**NGO MFIs**

As the Government has not fully recognized the importance of MICROFINANCE in general, the industry is the most underdeveloped among Central Asian countries. There are no locally owned and specialized NGO MFIs in Uzbekistan. The existing successful NGO MFIs are financed and protected by the donors (e.g. Association of Business Women [ABW] in Karakalpakstan and Kashkadarya) or established as an international NGO (e.g. Barakot in the Namangan area). The total amount of microcredits issued by donor-financed NGO MFIs was about US$0.6 million in 2002 to about 8,000 borrowers.

There are two types of NGO MFIs in the country: (i) non-specialized NGOs offering microcredits to their clients in Uzbekistan. The three most active MFIs in this group are Karakalpakstan branch of ABW, Kashkadarya branch of ABW (financed through a UNDP project), and Association of Farmers of Bulungur rayon of Samarkand (Mercy Corps). The regional branches of ABW offer cash loans only to
women, while microcredits from the Bulungur Farmers’ Associations are bank transfers into the accounts of borrowers; and (ii) specialized MFIs operating as NGO MFIs since 2000, under a group lending methodology which is most appropriate in the given regulatory framework.

**Portfolio.** It is premature to examine the sustainability of MFIs at this stage due to lack of a track record. However, the following could be summarized as strengths and weaknesses of NGO MFIs:

- The scope and breadth of outreach is extremely limited with the NGO MFI presence only in 5 out of 13 regions of the country.
- The NGO MFIs fully depend on donor financing and their operations are based on bilateral agreements of donors with the Government.
- The availability of financing was cited as a major impediment to NGO MFIs' growth; administrative expenditures of existing NGO MFIs are mainly financed out of donors’ grant resources.
- The high repayment ratio of 99 percent and the high interest rates around 55 percent for microcredits, indicate enormous potential for MICROFINANCE development.
- Women are the main clients and group lending is the dominant methodology, for microlending.
- Overall, the NGO MFIs are not sufficiently developed both in terms of number and scale. This leads to high interest rates which are 2-3 times higher than the refinance rate of CBU. The high cost of microcredits is making MICROFINANCE unavailable to the most vulnerable part of the population.

<table>
<thead>
<tr>
<th>MFI</th>
<th>Barakot Microfinance Program</th>
<th>Karakalpakstan Branch of Business Women Association</th>
<th>Kashkadarya Branch of Business Women Association</th>
<th>NGO Daulet</th>
<th>Total for Uzbekistan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Portfolio Outstanding (US$ 000)</td>
<td>312</td>
<td>38</td>
<td>105</td>
<td>88</td>
<td>542</td>
</tr>
<tr>
<td>Number of active borrowers (000)</td>
<td>3</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>6</td>
</tr>
<tr>
<td>Purpose of a Typical Loan</td>
<td>small trade, services, production</td>
<td>small trade, livestock, poultry</td>
<td>small trade, agriculture</td>
<td>small trade, services, livestock</td>
<td></td>
</tr>
<tr>
<td>Average Loan Size (US$)</td>
<td>121</td>
<td>35</td>
<td>103</td>
<td>87</td>
<td>95</td>
</tr>
<tr>
<td>Depth of Outreach (percent)</td>
<td>22</td>
<td>6</td>
<td>19</td>
<td>16</td>
<td>17</td>
</tr>
<tr>
<td>Annualized Average Interest Rates (percent)</td>
<td>47</td>
<td>35</td>
<td>72</td>
<td>72</td>
<td>55</td>
</tr>
<tr>
<td>Average Loan Term (months)</td>
<td>5</td>
<td>6</td>
<td>4</td>
<td>5</td>
<td>5</td>
</tr>
</tbody>
</table>


Appendix 4. Innovations in Microfinance from Around the World

Downscaling

_Banco del Desarrollo (Bandesarrollo Microempresas), Chile_

Information from Women’s World Nanking Web site Summer 2003.

Banco del Desarrollo (BDD), a private commercial bank, downscaled through an innovative approach by creating a separate microfinance subsidiary operating microenterprise centers that provided over 20 financial and non-financial services. The highlights of this bank’s strategy and main success factors are presented below:

- **Downscaling strategy.** BDD started its microfinance program to cater specifically to the poorest entrepreneurs. It organized microenterprise centers within a system completely parallel to its bank branches. Recognizing the growth of the microfinance program, BDD created Bandesarrollo Microempresas (BM), a separate microfinance subsidiary.

- **A variety of services have been designed by BM to serve the needs of microentrepreneurs.** Checking accounts, savings accounts, certificates of deposit, different loan instruments, credit and debit cards, consumption loans, housing and education loans, education savings, and health and life insurance allow clients to choose the product which best fits their needs. Online banking and access to a nationwide network of automatic teller machines make using BM services easy for all customers.

- **There is a clear distinction between the responsibilities of the Banco del Desarrollo and Bandesarrollo Microempresas.** BM has complete autonomy over all matters including hiring and training staff, and designing new credit products and processes. The subsidiary is responsible for attracting clients, developing and using microcredit technologies, evaluating risk, tracking credit, and undertaking recovery management. The subsidiary acts as a type of financial consultant for microfinance. BDD extends all microloans to borrowers and is responsible for ensuring that loans are processed with the greatest efficiency in order to provide maximum profitability.

- **BM and BDD are linked through their information systems.** BM has a Management Control System that manages its portfolio and clientele and analyzes whether or not an office is profitable. This system is connected directly with the central system of BDD to allow information to be easily shared. Credit officers are also connected with the central system to assure that current information is always available to all who need it.

- **Other financial products, such as the sale of demand accounts (electronic checkbooks) and savings accounts, permit the clients to have a greater added-value relationship with BDD.** In 2002, BDD added credit cards, life insurance and general insurance for the microentrepreneurs. Future products being designed include leasing, mortgage loans, higher education loans, and agricultural sector loans (fisherman and agriculture credit).
Transformation from an NGO MFI into a Microfinance Bank

Association of Cambodian Local Economic Development Agencies, Cambodia

Association of Cambodian Local Economic Development Agencies (called ACLEDA) has transformed from an NGO MFI into a bank with the extensive support of donors.\(^{21}\) As an NGO MFI, it was able to quickly expand its network while making a profit. The original NGO MFI transferred its assets and on-lent its liabilities (long-term loans from donors) to the new ACLEDA bank. At the time of transformation, ACLEDA Bank received 45 percent of the equity and foreign investors purchased 49 percent of the shares issued by the new bank. Transformation has allowed ACLEDA to significantly expand its outreach and it now serves more than 85,000 clients. Below are the main highlights of ACLEDA strategy:

- **Outreach structure.** Geographical expansion into the largest financial network (75 branches and offices in 14 of 24 provinces, mainly in rural areas) in Cambodia benefits savings mobilization and transfer payments. District offices and service posts are established close to the customers. At present, ACLEDA Bank has loans outstanding in the amount of US$28 million (averaging nearly US$330 per loan) and its market share is more than 62 percent among all Cambodian MFIs.

- **Analysis of financial statements** is performed monthly and includes comparisons of the business plan versus actual implementation, a cost analysis report, an MFI absorption cost report, and an analysis of service transfer.

- **Staff inclusion** from the very beginning of transformation was fundamental to capturing the staff’s enthusiasm and was enhanced through the creation of the Employee Share Ownership Program.

- **Staff development and training.** Transformation into a commercial institution required a new attitude throughout the entire organization. While borrowers willingly come to the bank, depositors have to be enticed to trust their money with the bank.

- **Central Bank and Government’s role** was key as there were many regulatory and licensing issues involved for which there was no precedent in Cambodia. The involvement of the prospective shareholders in the negotiating process was important to ACLEDA success as well.

- **Technology.** Once the new capital was injected, it was very tempting to lend more money to the customers. A substantial part of the new funds was reserved to provide for the longer-term development of the institution, including better IT and MIS, and this has put ACLEDA on a very solid base for future expansion.

Center for Agriculture and Rural Development Bank, Philippines

After operating successfully for six years as an NGO MFI, Center for Agriculture and Rural Development (CARD) was the first in the Philippines to transform into a rural bank (Campion and White 1999). This became possible due to long-term support by donors, and the persistent efforts of CARD to educate the Government eventually facilitated such transformation.

After only one year of operation as a transformed institution, active members increased by 90 percent, the total number of active loans increased by 70 percent, and the gross loan portfolio grew significantly, by

\(^{21}\) Information for this case was taken from the ACLEDA Web site (http://www.acledabank.com.kh/)
134 percent. In spite of this rapid growth, repayment rates remained high, averaging 98-99 percent. Main lessons from CARD experiences are presented below:

- **Strong devotion to objectives.** From the creation of CARD NGO MFI to the transformed CARD Bank, the objectives remained constant; (a) to provide banking services specifically designed for landless rural workers by bringing the services to community sites and minimizing transaction costs; (b) to provide loans to non-bankable projects with no collateral; and (c) to create a non-stock, non-profit landless people’s bank owned and controlled by the landless members.

- **Educating the Government about the importance of microfinance.** There was a relatively short time delay of six months between the submission of the application for a banking license and its approval. However, CARD dedicated many years to regulatory dialogue and education prior to submitting the application. Also, Central Bank regulators visited Bolivia at key points during the application process of CARD Bank to see firsthand the success of BancoSol in serving microentrepreneurs as a commercial bank.

- **Population density** facilitated the extension of a significant rural network.

- **Branch transformation.** The transformation from NGO MFI into a bank was gradual with NGO MFI branches being transferred to the bank operations on a branch by branch basis. This process continued for five years.

- **The financial transformation** of CARD resulted in the creation of a structure that more closely resembled a credit union than a traditional bank. The majority of the bank’s equity was assigned to its client members.

- **Staff.** Instead of hiring individuals with banking and accounting expertise, CARD provides the necessary bank training to its original staff and its new staff. The new employees are recruited based on their level of commitment to community development.

- **MIS transformation** was the most challenging aspect, but it significantly improved efficiency. The previously manual system was computerized with the introduction of loan tracking, savings, and accounting systems. Appropriate training was provided to the staff. The new MIS produces reports on weekly liquidity reserve, monthly portfolio quality, quarterly income and expense. It discloses loans to officers and employees, applications for write-offs and declared dividends among much additional information.

- **Client transactions** at CARD occur outside the bank premises, in small center meetings, conducted in villages throughout the provinces. These center meetings are crucial to CARD methodology and are the primary reason for high repayment rates at CARD.

**A State Bank in Microfinance**

*Ag Bank, Mongolia*

Ag Bank was successful in transforming from a small state-owned bank into the strongest bank in the country (Dressen, Dyer, and Northrip 2002). Being unwilling to close the Ag Bank down, the Government of Mongolia engaged international consultants to manage it under an outside management contract, protected from political interference. USAID provided the funding for technical assistance. World Bank was instrumental in bringing all parties to consensus, including the Government. In less than three years of operation under the new management, it had over 60,000 active borrowers and 82,000
active savers out of the total population of 2.4 million. Below are the main lessons from the Ag Bank experience:

- **Existence of a considerable underserved market and an untapped demand** for microfinance services are important pre-conditions for introducing microfinance into state bank operations. If other financial institutions currently serve prospective clients, then entering this market will not justify the costs.

- The Ag Bank’s network of over 350 branches was found to be a strength, not a weakness. The decision was to invest in strengthening and expanding branch staff and the facilities. New products were designed, piloted, and rolled out through the branch network. Achieving economies of scale through its multiple and dispersed branches contributed to reducing the risk of over-lending in only a few locations.

- **Staff.** Senior managers were hired locally to serve as vice-presidents of various departments and to be part of top-level decision making. The practical knowledge of the existing bank staff is an important advantage as they are usually aware of clients’ banking practices.

- **Customers** are allowed to borrow differing amounts and can pay over varying terms based on the need and cash flow.

- **No fees for savings deposits.** In an effort to increase savings deposits, the bank dropped withdrawal and maintenance fees. The result was more people leaving their money in their accounts as they felt more confident that they could withdraw the money easily at any time. The savings deposits are a low-cost source of funds, and thus, more and varied loan products can be introduced.

- Ag Bank created products to encourage pensioners to save more and to be able to access their money easily. The amounts may be small but with economies of scale, the Ag Bank found this a profitable and easy-to-serve segment. This operation generated additional income for Ag Bank.

- The bank created for itself a new brand name with strong appeal locally and started an intensive marketing campaign. The new fresh logo and slogan went up on the front of every branch and were advertised on television, radio, billboards, and print. The Ag Bank brand watches, pens, mugs, and baseball caps appear all over Mongolia.

**Banco do Nordeste (CrediAmigo), Brazil**

With support from the World Bank and significant efforts and cooperation from the Government, Banco do Nordeste (BN) launched its pilot microfinance program, CrediAmigo, which immediately benefited from the large pre-existing BN branch network by subcontracting local loan officers for microfinance activities (CGAP 2003a). Only after 3 years of operation, CrediAmigo was already among the top MFIs in Latin America in terms of geographical penetration (358 municipalities in the Northeast region of Brazil), number of clients (55,000) and depth of outreach (6 percent). Below are the main success factors in this transformation:

- **The Government appointed a private businessman** as President of BN, in an attempt to transform BN into a modern, efficient institution, responsive to the development needs of the Northeast region. Substantial reorganization was undertaken to improve efficiency through better staff incentives, enhanced information systems, clearer client focus, and greater flexibility. The reform, coupled with the highly business-oriented management and low external political interference, resulted in a substantial increase in the market share of loans in the Northeast region from 35 percent to 78 percent.
With donor support, BN initiated CrediAmigo in five branches, testing a single loan product first. Following the BRI Unit Desa model in Indonesia, CrediAmigo was established as an autonomous unit within BN. With assistance from ACCION International, a survey on microenterprises was conducted and pilot loan products were developed.

Commercial goals. Contrary to most other global experiences, Banco do Nordeste, a state-owned bank with a social mission, believed that microfinance programs can succeed provided that the design and management of the program were commercially driven with the emphasis on profitability and sustainability. Interest rates to microfinance clients were kept higher than those of larger BN loans, yet substantially lower than those charged by informal moneylenders.

CrediAmigo has benefited from the large pre-existing BN branch network in the distribution of its microfinance products: 164 branches across 702 municipalities within the Northeast region. Growth in the number of branches and loan officers were carefully controlled, and loan recoveries were emphasized. Branches were evaluated as individual profit centers.

The outsourcing of loan officers from local communities helped mitigate the traditional institutional culture inherent in state banks, which may inhibit growth. Training materials and selection criteria for outsourced microfinance lending officers were prepared. The incentives of staff were aligned with the CrediAmigo strategy of growth with quality, which contributed to the sound portfolio quality.

**NEW MICROFINANCE BANKS**

*Micro Enterprise Bank, Bosnia and Herzegovina*

The Micro Enterprise Bank (MEB) was set up with extensive donor support specifically to alleviate the financial constraints faced by micro and small enterprises by providing diversified financial services specifically tailored to their demand (World Bank 2000). Due to the complex political environment, MEB is among the few MFIs that managed to create an extensive branch network that spans the country.

Based on a network of five branches, MEB total assets have grown to US$12 million in less than 3 years (as of August 2000). The outstanding loan portfolio is US$8.5 million with the average loan size of US$4,000 and ranging from US$1,000 to US$10,000. Portfolio quality is high with only 0.7 percent of the outstanding balance in arrears by more than 30 days. Highlights of MBE strategy are presented below:

- **Reduce donor dependence.** MEB was started with the concerted support of several donors among them EBRD; IFC; IMI and KfW (Germany); and FMO (Netherlands). A medium-term goal is sustainability without the use of additional technical assistance. The bank is designed to be a permanent institution that will out-live the period of donor funding.

- MBE focuses on offering quality, diversified products such as loans, deposits, current accounts, and domestic and international money transfers. MFI loans also had a diverse use such as trade, service, production, and housing reconstruction. The loan use diversification allows MBE to considerably spread the risk as well, leaving the institution less vulnerable to economic fluctuations.

- **Expanding the branch network** allowed MBE to provide countrywide money transfer services and to create the capability to handle several hundred new loans each month. The existing micro-bank in Bosnia disburses 350 loans per month with arrears of less than 1 percent.

- **Genuine commitment and solid financial expertise** of the shareholders, executives, and staff play key roles in the success of MEB.
MEB is training its loan officers to deliver multiple products to take advantage of cross-selling opportunities.

Introducing Savings and Savings Products

Bank Rakyat Indonesia

Bank Rakyat Indonesia (BRI) is Indonesia’s largest bank with the widest network, and the Unit Desas, (BRI village branches) is the leading provider of sustainable microfinance in the world. BRI converted the existing Unit Desas (UDs) from subsidy channeling agents into a full-service rural banking network offering a wide range of financial services in a flexible and financially viable way. After 1984, massive restructuring was undertaken involving the introduction of non-targeted and non-subsidized loans, as well as savings products designed specifically to meet the rural needs. At the end of 2001, The Unit Desa system of BRI had more than 2.8 active borrowers and 27.3 million active savings accounts. These clients are served by over 4,500 offices throughout the country. These are the main lessons from BRI experience:

- A sound risk management strategy was adopted, involving collateral requirements, sound credit appraisal, monitoring and enforcement, adequate provisioning, and risk diversification. Overhead costs were also kept low with a simple operational structure and small-sized branches.

- A self-sufficient network of rural financial intermediaries was created based on the belief that large demands for loans can be financed by locally mobilized savings. The Unit Desas were treated as separate financial entities and evaluated based on their profitability, which led to high accountability and responsibility. They were monitored and guided by BRI branches which were, in turn, overseen by the regional offices. A UD business unit in BRI headquarters monitors the performance of the Unit Desas.

- Through market studies and research, BRI found that there was huge demand for financial savings facilities among the rural communities. Rural savers look for safety, convenience, easy access, liquidity, and positive return. They perceived BRI as providing a high guarantee for safety because it was a state-owned bank. Thus, BRI focused on ways to meet the rural demand in liquidity and return in the design of its savings products. Specific clientele information collected from the studies was incorporated into the design of the savings products and advertising messages.

- Creative approaches to public relations and marketing. A strategic mapping of potential savers was conducted, financial instruments were heavily advertised, and potential customers were visited to inform them about the availability of the services. Social links with village and community leaders were established. The lottery turned out to be a very popular event with high rural turnout, which, aside from being a major attraction to the savings products, also provided a good public relations opportunity for new clients.

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22 Information taken from “Bank Rakyat Indonesia (BRI) - Unit Desa, Indonesia” posted on bellanet.org (http://www.bellanet.org/partners/mfn/memberBRI.html).
Achieving Financial Sustainability

Constanta, Georgia

Constanta identified and successfully implemented an innovative cost reduction strategy that included using part-time officers, known as service-points, to enter under-served secondary rural markets and then, partnering with banks that have extensive branches to rent their facilities (Pearce 2002). Constanta is a very profitable MFI with financial self-sufficiency of 124 percent and depth of outreach at 22 percent (as of May 2002) while providing very small loans of US$125. Portfolio quality is very good with reported portfolio at risk (greater than 1 day) below 2 percent. Below are the main highlights of Constanta strategy:

- Constanta is placing an important emphasis on compatible goals such as achieving financial self-sufficiency while reaching the poor in Georgia. The main gain in financial self-sufficiency for Constanta results from its innovations in cost and risk reduction.

- The Constanta expansion strategy consisted of using service points to penetrate under-served secondary rural towns that may or may not justify a permanent presence. By opening service points, MFIs can test the attractiveness of a market at minimum costs and risk. Constanta works with formal banks, such as Bank of Georgia, Post Bank and Microfinance Bank of Georgia-MBG, that have branches in rural areas. Constanta rents office space for disbursements, repayments, and meetings from these banks and uses their services, such as teller and MIS. Thus, service points are profitable, generating income well in excess of cost.

- Preconditions for successful use of service points. There needs to be an unserved microcredit market. A service point is usually created in a town that has a market location with sufficient market activity for a wider area of coverage. The towns chosen also need to be sufficiently close to an MFI branch, ideally within 30-60 km. Service points can be profitable with less than 300 clients and an average loan size of US$125.

- Reduced cost and risk. The presence of branches of partner banks is crucial not only for cost reductions but also for security of transactions. Additionally, Constanta designed joint products and joint marketing of products with MBG. This also reduced costs significantly.

Outreach and Poverty Targeting

SHARE, India

SHARE has successfully managed to provide services targeted specifically towards women living below the poverty line, in the lowest 20 percentiles, while maintaining good portfolio quality. SHARE uses a housing index, asset holding, and a household dependency burden index to assess the economic level of the household. SHARE staff is well trained on how to gather this information. As of August 2002, SHARE had nearly a 125,000 active clients and a loan portfolio of US$7 million with an average loan size of US$56. It had a positive Return on Assets for three continuous years and enjoys a portfolio-at-risk rate of zero. Below are the main highlights of the SHARE strategy:

- Strategy. SHARE explicitly targets its products to the poorest rural women and does so in a financially sustainable manner. Awareness of its clients and maintaining client focus inform all

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23 Mukherjee, Joyita, (unpublished), A Case of Best Effective Outreach (Impact and Poverty targeting): SHARE, India
SHARE decisions in developing its operations, from recruitment and training of staff, to selection of clients, to service delivery methodology, product design, and oversight and management, and this is what has made SHARE so effective in reaching the people it set out to serve. There is a very strong oversight and “audit” function for outreach that is taken just as seriously as the oversight over financial performance.

- The goals of reaching the poor women and of maintaining sustainability led the organization to transform itself into a for-profit entity called Share Microfin Limited (SML), a non-bank financial intermediary, that was able to mobilize savings and leverage funds from the mainstream financial sector (commercial banks, etc.).

- Clients. Clear and explicit criteria are set up to screen clients. To be eligible, a woman must have total asset holdings of less than US$500 and per capita family income of less than US$7.50 a month. In addition, a household dependency burden is also calculated to judge the economic level of the household.

- Staff members are well trained on how to identify potential clients. Having identified them, SHARE focuses on attracting them as clients. These efforts include the branch manager of a local office visiting the village where its potential clients live. Meetings are organized with these individuals and products and methodology are explained. The forum is used for testing interest in their product. Presently, the institution has generated so much recognition and good-will, that it rarely has to seek out clients.

- Branch staff members, including managers, are recruited from the community where they serve. As a result, they are familiar with the poverty levels of potential clients and the viability of their microenterprises.

- Products have been designed to best suit the needs of targeted clientele. Loans generally must be used within seven days of disbursement, but the limit increases to within three months for housing loans. This is verified by members of the group and staff and documented in a loan utilization certificate. The repayment culture among staff and clientele is kept at a very high level. Informal sanctions for non-payment (penalizing other members of the group to pay for a defaulting member, etc.) are strictly enforced. These kinds of stipulations prevent any “upward creep” clientele.

- Service delivery methodology includes loan repayments in small weekly installments, and collecting and disbursing loans and deposits at the client’s doorstep at a time convenient to the client instead of the client having to travel to the branch office. Training programs for clients and bank attentiveness to client needs, reflect in the quality of services - all play a major role in keeping SHARE attractive to new and repeat clients.

**Financing Small Farmers Through Producer Associations**

*GAPI, Mozambique*

GAPI Sarl is one of the leading nationwide institutions providing business and financial development assistance to rural SMEs and acting as a financial intermediary for donor funds. GAPI has developed an innovative delivery mechanism for providing MF to the rural poor through federations of the small farmer

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24 Source: CGAP, (unpublished), Selected Promising Agricultural Microfinance Providers, Brief Overview Profiles
associations (fora). Each fora on-lends to its member associations. Below are the main snapshots of GAPI operations:

- **GAPI Sarl** is a joint-stock company, which serves as a financial intermediary for international donors (KFW, AFD, DANIDA, USAID, EU, etc.) and manages their investments through a combination of financial services, business training, and consulting services.

- **Microfinance mechanisms.** About 80 percent of the profits from the sale of produce are handed back to the associations while the forum keeps the remaining 20 percent of the profits to cover interest payments and expenses.

- **Loans.** The company had loan capital of US$8 million in 2002. GAPI offers investment and working capital loans to the participating fora through a solidarity group-like guarantee among them. Loan monitoring is done through credit-management committees formed at the forum level and through GAPI representatives. The repayment schedules are flexible, interest is due monthly, and the principal can be repaid anytime. Longer loan terms are also offered.

- **GAPI offers financial and non-financial services and assistance** to SMEs in the following areas: finance of investment for business start-ups and existing enterprises in each economic sector; finance of working capital for retailers and wholesalers particularly in rural areas; business training; consulting and technical assistance for clients; and access to business information.

### Innovative Delivery Mechanisms for Rural Microfinance

#### PRODEM, Bolivia

PRODEM, a licensed non-bank financial intermediary, has identified an innovative delivery mechanism for its microfinance services through the introduction of smart cards that are linked to ATMs. Additionally, the loan repayment is based on the cash flows of the borrowers. PRODEM strategy has allowed for a large agricultural loan portfolio (21 percent of the total) with good financial standing. These are the main points of the PRODEM strategy:

- **In order to use the ATMs,** the clients use fingerprint identification instead of a numeric code. Thus, the clients have easier and more convenient access to loan disbursements and savings accounts. The ATMs literally speak to clients in their local language, providing them easy instructions to access funds. As of 2002, ATM services were available in 10 branch offices and plans are underway to install this technology in all the branch offices.

- **Repayment cycle matched to crop cycles.** PRODEM allows individual solidarity group members to tailor their repayments to their cash flows. Coffee growers can pay only interest during February and May, and then repay capital in four monthly installments once the coffee harvest begins in June.

- **Personalized repayment schedules** are also tailored for clients involved in commerce. This is in recognition of the influence of agricultural activities on the cash flow of non-farm rural businesses.

- PRODEM had an **overall portfolio** of US$44 million in 2002. The agricultural sector comprised 21 percent or US$9.4 million of the total portfolio. Portfolio at risk (greater than 30 days) for the overall

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25 Source: CGAP, (unpublished), Selected Promising Agricultural Microfinance Providers, Brief Overview Profiles.
portfolio was 5.3 percent, and slightly lower at 4.7 percent for the agricultural portfolio. PRODEM is financially sustainable (104 percent) and has an ROA of 0.88 percent.

Community and Membership-based Models for Rural Microfinance

_Caisses villageoises d’epargne et de credit autogenerees, Mali_

Caisses villageoises d’epargne et de credit autogenerees (CVECAs) are village-based savings and credit organizations, established in parts of West Africa and recognized for serving remote rural areas in a sustainable manner through community based microfinance. They have a highly decentralized structure and run at low cost. In 2001, the Mali network of CVECAs in Mali had over 9,100 active borrowers and 9,400 savers. As of 2001, the overall loan portfolio was US$2.3 million (with 70 percent in agricultural loans) and the reported portfolio at risk (greater than 90 days) was 2.8 percent. In 2001, CVECAs in the Niono region were reported to be financially self-sustainable, with an FSS of 144 percent. The main lessons from CVECA experience are:

- Villagers have a **high degree of ownership** and elect the management committee to govern the organization. Each village decides their own interest rates and loan products. The “savings-first” approach keeps cost of funds low (deposits-loan ratio of 0.63 in 2001).

- Costs are also kept low by **collaborating with the village farmers associations** (VFAs) for client appraisals, loan guarantees and repayments. VFAs also provide fertilizer to farmers as in-kind credit on behalf of the CVECAs, and provide collective marketing services to help increase profitability of the farmers.

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26 Source: CGAP, (unpublished), Selected Promising Agricultural Microfinance Providers, Brief Overview Profiles.
Glossary

- **Adjusted operating expense ratio.** Operating expense added to In-kind donations and divided by Average total assets
- **Adjusted ROA.** Adjusted net operating income after taxes divided by Average total assets
- **Adjusted ROE.** Adjusted net operating income after taxes divided by Average total equity
- **Age of MFIs.** Years of operation
- **Average portfolio/loan officer, US$.** Total loan portfolio divided by Number of loan officers
- **Average cost of funds.** Interest expenditure on borrowings (excluding mortgages) divided by Average balance of borrowings (excluding mortgages)
- **Average outstanding loan size, US$.** Total outstanding portfolio divided by Number of active borrowers
- **Average real margin.** Real portfolio yield minus Average cost of funds
- **Depth of outreach, perecent.** Average loan size divided by GNI per capita
- **Financial expense ratio.** Financial expense divided by Average total assets
- **Loan loss provision expense ratio.** Loan loss provision expense divided by Average total assets
- **Loan officer productivity.** Active borrowers divided by Number of loan officers
- **Number of active clients.** Number of clients with outstanding loans
- **Operational efficiency.** Operational expense divided by Average gross loan portfolio
- **Operational self-sufficiency.** Operating income divided by Total of financial expenses, Loans loss provision expense and Personnel and administrative expenses
- **PAR (over 30 days).** Outstanding balance of loans overdue more than 30 days divided by Gross loan portfolio
- **Personnel and administrative efficiency.** Personnel and administrative expense divided by Average gross loan portfolio
- **Personnel and administrative expense ratio.** Adjusted personnel and admin expenses divided by Average total assets
- **Portfolio size, US$.** Outstanding loan portfolio
- **Portfolio yield.** Financial revenue from gross loan portfolio divided by Average gross loan portfolio
- **Provision level.** Loan loss provisions divided by Average gross loan portfolio
- **Real portfolio yield.** (Yield on gross portfolio minus Inflation rate) divided by (one plus Inflation rate)
- **Staff allocation.** Loan officers as a percent of Total staff
- **Staff productivity.** Active borrowers divided by Total staff
References


