

# BULLETIN CASE STUDY

## Bosnian MFIs: Performance, and Productivity

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Bosnia-Herzegovina<sup>33</sup> is a former republic of Yugoslavia, which was a middle-income country before its breakup and the war. It is now in process of both post-conflict reconstruction and economic recovery, and in transition to a market economy. This has proven difficult, and high unemployment and limited opportunities in the formal sector have increased the demand for microcredit<sup>34</sup>. Due to these factors, many of the poor targeted by MFIs are “new poor” (i.e. people who lost their jobs and assets during the war), who were previously employed in state-owned enterprises with a fairly stable income and a high level of social security.

Given the increased demand for microcredit, the government of Bosnia-Herzegovina has been supporting the microfinance industry through a number of measures: investing government funds in the sector, including microfinance as a key part of their development strategy, and adopting legislation to legalize the provision of microcredit by NGOs<sup>35</sup>.

Microfinance in the country is evolving quickly. As of March 2000, there were 18 main MFIs in Bosnia-Herzegovina, down from 34 in 1999. This article focuses on eight MFIs that represent a range in terms of both target clientele and performance: AMK, Bospo, LOK, MEB, Mercy Corps/Partner<sup>36</sup>, Mikrofin, Sunrise, and World Vision.

These are relatively new MFIs (average of 2 years in 1999), averaging just over US\$3.3 million in outstanding portfolio with about 2,500 borrowers. They use a mix of individual and solidarity group methodologies, and are all serving broad or high-end clients, with an average loan balance relative to GNP per capita of 163 percent (or US\$1,731). The latter hides important variations between

institutions. Indeed, Bospo offers loans that are on average 39 percent relative to GNP per capita while MEB targets small business clients, with an average loan balance of 336 percent relative to GNP per capita.

All are NGOs except MEB, a full service bank that offers a wide variety of products, including loans, savings and payment services. Due to a complex political environment, only MEB, Mercy Corps/Partner, and LOK have branch networks that span the whole country.

### Issues Facing Bosnian MFIs

**Business Environment:** *MFIs face a challenging business environment.*

Bosnian MFIs and their clients, as all organizations in the country, face the lack of a supportive business environment. For example, since many clients are not registered to avoid prohibitive tax rates on their small businesses, Bosnian MFIs need to track their dual reporting systems (one for the financial police<sup>37</sup>, one to track the real financial strength of the businesses). This additional task taken on by the MFIs to accommodate clients increases the loan processing time.

**Competition:** *Although still low, competition is on the rise, and MFIs are already trying to adjust to it.*

According to LID, a specialized, semi-governmental microfinance funding and capacity-building body, competition for microfinance services is low, due to excess demand and a culture gap between commercial banking and microfinance. Indeed, the microfinance target market in Bosnia-Herzegovina includes a growing number of high-risk displaced persons or returnees<sup>38</sup>, whom commercial banks are reluctant to serve because of the risks involved and their unwillingness to expand into the poorest regions of the country to reach this dispersed population.

Nevertheless, as young MFIs mature and the formal banking sector stabilizes, competition is expected to

<sup>33</sup> Bosnia-Herzegovina (BiH) is comprised of: the Federation of BiH and the Republika Srpska, governed by different sets of banking rules.

<sup>34</sup> Demand for savings product is considered to be low due to the loss of confidence in banks resulting from the war.

<sup>35</sup> A new law for microcredit organizations was passed in the Federation of BiH in July 2000 and in April 2001 in Republika Srpska. MFIs are now legally able to provide credit to their clients.

<sup>36</sup> Mercy Corps's name changed upon registration as a local microcredit organization under the Federation law. Partner's registration became effective January 1, 2001.

<sup>37</sup> A governmental body in charge of conducting financial audits of institutions and private entities.

<sup>38</sup> This refers to persons who were displaced during the war and persons who were able to return to their homes when it ended.

increase. Some MFIs are already beginning to feel competitive pressure. For example, MEB lost 3 percent of its clients in 6 weeks due to aggressive campaigns from two Austrian banks that reduced their minimum enterprise loan size from DM50,000 to DM25,000<sup>39</sup>, while requiring no collateral, and offering very competitive interest rates for both savings and loans.<sup>40</sup> Sunrise is also experiencing challenges in matching the demand for bigger loans (over DM20,000) with reasonable terms (5 years). Competition between MFIs and commercial banks is likely to continue for high-end loans above DM20,000, and will have the most impact on MEB, which is serving a higher-end clients compared to the NGO MFIs.

Some programs, like Sunrise, fear that MFIs will be competing on two fronts: with the commercial banks and with their peers, and are adopting a variety of measures to address it:

**Forming Mergers:** Institutions are merging to take advantage of their complementary resources and regional coverage. For example, after merging with three other institutions, LOK now has the best infrastructure and branch network. Other examples include Sunrise, or World Vision, that merged with an organization in Mostar.

**Increasing Product Flexibility:** To meet client needs, MFIs are moving towards a demand-driven approach for the design of their services. For example, Mikrofin is increasing the flexibility of its products by introducing bigger ranges per cycle, a grace period starting with the 2<sup>nd</sup> cycle, lower interest rates, and no upper limit for loans in their last cycle. Mercy Corps/Partner, on the other hand, has implemented a program of focus groups to identify their client's needs and adapt their loan products accordingly.

**Targeting Untapped Markets:** MFIs are expanding their outreach to less competitive segments of the market. For instance, Mercy Corps/Partner targets lower-end clients and provides loan officers with incentives for the number of first time loans under DM2,500. In addition, sixty percent of their clients are in rural areas. In the future, there may be more opportunities for MFIs to operate in rural areas, as some industries are expected to fail due to the transition from the old economic system, which will

<sup>39</sup> As of December 2000, 1US\$ = 2.29DM, *IMF Statistics*.

<sup>40</sup> These banks do require guarantees but no collateral. While the market interest rate for MEB's clients was 2-3% per month, Volksbank set its interest rates at 1-5% for SME loans. For savings, MEB was offering 2-3% vs. 14% at the commercial banks. Because of these interest rate policies, MEB lost 20-30 clients (of a total of 240) during a period of 6 weeks.

increase the number of persons turning to self-employment in these regions.

**Streamlining Procedures:** All the MFIs studied were trying to improve their procedures to be more responsive to client needs. For instance, Sunrise is simplifying its complex procedures and reducing the number of days to screen clients in order to increase productivity; Mikrofin has reduced the time for processing loan renewals to two days; MEB is training loan officers to deliver multiple products to take advantage of cross-selling opportunities; and LOK is streamlining the disbursement and collection of its loans. Benefit<sup>41</sup>, following the example of ABA in Egypt, now disburses loans only three times a month and collects installments only four days a month to organize the workload for the head office and branch staff and improve productivity.

**Reducing the "Loan Gap":** This gap refers to clients who require loans from DM10,000 to 30,000 not offered by MFIs or commercial banks.<sup>42</sup> Because these clients are hardly serviced by anyone, they respond to this challenge by securing multiple (lower) loans from different MFIs. This "loan gap" represents an opportunity for MFIs seeking to increase their market share. For example, Mercy Corps/Partner has introduced a new loan product in 2000 in response to client demand: loans from DM10,000 to 20,000 for repeat clients in good standing. While some MFIs, such as MEB<sup>43</sup>, view this segment as a potential target market, other MFIs, such as Bospo, focus on deepening their outreach downwards, not upwards.

**Staff:** *There is a high level of competition for qualified staff.*

Bosnia-Herzegovina is experiencing a shortage of good loan officers, in part due to the presence of a large international community (bilateral and multilateral agencies) focusing on post-war relief efforts. It is attracting new university graduates with very high salaries well above country standards.

**Arrears:** *Arrears are low, but should be carefully monitored.*

Bosnian MFIs have very low arrears rates. This is due to a combination of factors, including the MFIs' strong focus on delinquency management from the very beginning, and the credit culture and powerful sense of honor among their clients, who are "new"

<sup>41</sup> Benefit does not currently participate in the *Bulletin*, and is not included in the rest of the study.

<sup>42</sup> Estimates for this gap vary from DM5,000 to 50,000. Even the most aggressive commercial banks are starting their loans at a minimum of DM20,000.

<sup>43</sup> MEB currently has applications pending for loans that fall within this range.

poor, due to the post-war conditions. Repaying loans is an important way for people to regain their economic standing, and microfinance services are highly valued.

Nevertheless, arrears should be carefully monitored, especially as the lack of regulation and increasing competition motivate clients to take concurrent loans from different MFIs. MFIs currently call each other to share client information because of the difficulty in tracking the whereabouts of some of their borrowers (i.e. displaced persons). As competition increases, MFIs may become less willing to share client information. In addition, with the closure of ZPP, the government's payment bureau, arrears are expected to increase; all customers of financial institutions (including MFIs) were previously required to maintain accounts at ZPP that were used as collateral for loans.

### Performance of Selected Bosnian MFIs

As of 1999, the Bosnian programs were profitable only because of subsidies. After adjusting for subsidies, the financial self-sufficiency (FSS) ratio averaged 92 percent for the eight MFIs in this study (see Figure 1).

Figure 1: Overall Performance

	Bosnian MFIs	New MFIs	All MFIs
Portfolio Yield (%)	33	37	39
Real Yield (%)	18	24	30
Adjusted Return on Assets (%)	-3.9	-9.8	-3.5
Adjusted Return on Equity (%)	-39.6	-21.5	-5.7
Operational Self-sufficiency (%)	113	93	104
Financial Self-sufficiency (%)	92	76	90

Source: *MicroBanking Bulletin* database. Data are for Dec. 1999 except for Mercy Corps/Partner (Dec. 2000).

This implies that the MFIs were generating income to cover only 92 percent of their total expenses. Nonetheless, their overall performance surpassed that of all the MFIs in the *Bulletin* that fall within their age group (operating for less than 3 years). On average, they showed an adjusted return on assets of -3.9 percent (compared with -9.8 percent for all the New MFIs in the *Bulletin*), even with lower yields. These results are explained by their high level of efficiency.

### Efficiency

As shown in Figure 2, the Bosnian MFIs have better efficiency ratios on average than other MFIs analyzed by the *Bulletin*. This is due mostly to a lower ratio of administrative expenses to average loan

portfolio. The average loan balance as a percentage of GNP per capita (the depth ratio) in Bosnia-Herzegovina is more than twice that of all New MFIs in the *Bulletin*, which compensates for a higher wage structure and lower staff productivity (with an average of 75 clients per staff vs. 96 for all New MFIs). These findings hold even after excluding MEB (the only MFI in the sample targeted at small businesses) from the Bosnian programs. Because MEB offers a wide range of financial products to its clients and targets a higher-end market, excluding it from the sample increases the average staff productivity and lowers the average depth ratio for Bosnian MFIs.

Even so, the depth ratio is still twice that of all New MFIs in the *Bulletin*, and three times more in comparison to all participants. The Bosnian MFIs would experience much lower efficiency ratios (relative to loan portfolio) were they not targeting a higher-end market.

Figure 2: Efficiency Indicators

	Bosnian MFIs	Bosnian MFIs*	New MFIs	All MFIs
Total Admin Expense / LP (%)	25	26	42	31
Salary Expense / LP (%)	15	16	24	17
Average Salary (multiple of GNP per capita)	9.3	9.6	7.0	5.8
Staff Productivity	75	81	96	122
Cost per Borrower (\$)	333	240	184	137
Depth Ratio (average loan size/GNP per capita) (%)	163	138	70	45

Source: *MicroBanking Bulletin* database. Data are for Dec. 1999 except for Mercy Corps/Partner (Dec. 2000).

\* Excluding MEB.

The high cost per borrower results from the fact that Bosnian MFIs have fewer borrowers on which to spread the costs (2,486 clients on average compared to 5,081 for the New MFIs in the *Bulletin*).

### Productivity

Figure 3 summarizes the main productivity indicators. Although on average staff productivity of Bosnian MFIs is almost half of that of all MFIs, it is nearly equivalent when we compare them to programs that serve similar target markets. Broad programs (MFIs with average loan balances between 20 and 150 of GNP per capita) show productivity levels double that of High-end programs, which is explained in part by the solidarity group loan methodology used by most programs serving the "Broad" target market.

Figure 3: Efficiency and Productivity Indicators for 8 Individual MFIs

	Method- ology	Clients/ Staff	Clients/ Loan Officer	Loan Officer/ Staff (%)	Staff Turnover	Loan Portfolio/ Staff (\$)	LP/ Loan Officer (\$)	Number of Borrowers	Total loan portfolio (\$)	Portfolio at Risk (%)	Depth Ratio*
<b>AMK</b>	Individual	36	76	47	26	62,827	132,636	680	1,193,720	0.0	162
<b>MEB</b>	Individual	30	96	31	na	110,348	351,108	2,118	7,724,382	na	336
<b>Sunrise</b>	Individual	70	121	58	0	112,173	193,754	1,331	2,131,293	0.0	258
<b>World Vision</b>	SG / Ind.**	63	106	60	13	138,761	231,268	1,902	4,162,820	1.2	202
<b>Bosnian (High - end)</b>		<b>50</b>	<b>100</b>	<b>49</b>	<b>13</b>	<b>106,027</b>	<b>227,192</b>	<b>1,508</b>	<b>3,803,054</b>	<b>0.4</b>	<b>239</b>
<b>Bospo</b>	Solidarity	156	423	37	11	66,081	179,363	2,961	1,255,540	0.0	39
<b>LOK</b>	Ind. / SG	64	121	53	0	87,233	165,283	2,302	3,140,378	0.0	126
<b>Mercy Corps</b>	Individual	90	133	67	3	66,797	99,380	5,461	4,074,599	0.1	99
<b>Mikrofin</b>	SG. / Ind.	89	156	57	6	80,958	141,677	3,129	2,833,535	0.0	83
<b>Bosnian(Broad)</b>		<b>100</b>	<b>208</b>	<b>54</b>	<b>5</b>	<b>75,267</b>	<b>146,426</b>	<b>3,463</b>	<b>2,826,013</b>	<b>0.0</b>	<b>87</b>
<b>All MFIs (High - end)</b>		48	120	43	7	127,017	300,539	4,373	9,778,077	0.7	310
<b>All MFIs (Broad)</b>		113	252	47	11	70,093	154,481	60,480	24,414,911	2.6	65
<b>All MFIs</b>		122	257	50	11	45,929	101,967	11,398	3,764,997	1.9	45

\* GNP per capita = US\$1,086 for 1999 and US\$760 for 2000, *World Bank Statistics*.

\*\* SG = Solidarity Groups; Ind. = Individual Loans.

Source: *MicroBanking Bulletin* database. Data are for December 1999 except for Mercy Corps (December 2000).

Despite lower overall productivity for Bosnian MFIs compared to all MFIs in the *Bulletin*, they have a higher average loan portfolio per staff, due to higher average loan sizes. Results also show that Bosnian MFIs have excellent quality portfolio, with an average portfolio at risk over 90 days of only 0.2 percent.

The data in Figure 3 also highlight considerable differences between Bosnian MFIs. Indeed, Bospo, which uses the solidarity group methodology exclusively, has the highest level of staff productivity, with an average of 423 clients per loan officer. Mikrofin, with 70 percent solidarity group loans, is second on the list. The MFIs showing the lowest staff productivity offer only individual loans.

Although the lending methodology clearly influences staff productivity, other factors are also at play. For example, MFIs that offer a multiple range of products (i.e., MEB) have lower productivity levels given the burden on field staff who manage products other than loans.

Many programs use financial incentives to boost staff productivity. Given the evidence that differences in staff productivity can arise from factors that are outside the loan officer's control (i.e. loan methodology), MFIs should consider a mix of criteria on which to base incentives. No conclusive results can yet be drawn from the implementation of incentive plans, but their effects are worth monitoring.<sup>44</sup>

<sup>44</sup> The incentive systems are either new (LOK) or were recently reviewed (MEB and Mercy Corps/Partner). No information was

## Conclusion

This article analyzed the performance of eight Bosnian MFIs and the environment where they operate. They are playing a key role in post-war Bosnia by providing credit to low income entrepreneurs.

Analysis of the financial performance of the selected MFIs shows that they are, on average, still not financially sustainable, and their staff productivity is slightly lower than that of all MFIs in the *Bulletin* targeting similar markets. Nonetheless, their overall performance surpassed that of all MFIs in the *Bulletin* that fall within their age group (operating for less than 3 years).

Microfinance in Bosnia-Herzegovina benefits from a strong credit culture, cooperation between MFIs, and potential for growth. In the future, increased competition is expected to stimulate efficiency. To improve outreach while answering the challenges of increased competition and unfavorable business environment, the regulatory framework will need to be updated.

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available for AMK, Bospo, and World Vision.