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Sida Review

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Review of Impact of Sida's Microfinance Support in Bosnia and Herzegovina

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The views and interpretations expressed in this report are the authors' and do not necessarily reflect those of the Swedish International Development Cooperation Agency, Sida.

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Abbreviation and Glossary

AMFI	Association of Microfinance Institutions in Bosnia and Herzegovina, the Bosnian microfinance sector's business association
BiH	Bosnia and Herzegovina
CHF	Cooperative Housing Foundation International
CGAP	Consultative Group to Assist the Poor, an institution within the World Bank Group dedicated to research on and policy work in microfinance. Sida is a member of CGAP.
DFID	Department for International Development, the UK's international development agency
EBRD	European Bank for Reconstruction and Development
EFSE	European Fund for Southeast Europe
EKI	Microcredit Foundation EKI
Euribor	Euro Interbank Offered Rate
FBiH	Federation of Bosnia and Herzegovina, the Bosniak – and Croat-dominated entity of Bosnia and Herzegovina
IFI	International Financial Organization
IMF	International Monetary Fund
KfW	Kreditanstalt für Wiederaufbau
KM	The convertible mark, Bosnia's currency, designated as BAM in the foreign exchanges. One KM is worth about 50 Euro, or 5,5 SEK.
LID	Local Initiative Department, the agency administering and supervising the LIP I and II
LIDER	Loan Initiative for the Development of Economic Regions
LIP	Local Initiative Project, the World Bank's funding vehicle for MCOs
LRC	Long-Range Company Kreditni Biro, a private Bosnian credit bureau
MCO	Microcredit organization. For the purpose of this report, those organizations that make loans for income generation or micro-businesses
MFC	Microfinance Centre
MSME	Micro- and Small and Medium-sized Enterprise
PARE	Partnership for Advancing Reforms in the Economy
PLI	Partner Lending Institution
RS	Republica Srpska, the Serb-dominated political entity of Bosnia and Herzegovina
Sida	Swedish International Development Cooperation Agency
SME	Small- and Medium-sized Enterprise
TA	Technical Assistance
UNCDF	United Nations Capital Development Fund
WWB	Women's World Banking

Executive Summary

The purpose of this report is to review the impact of the Swedish International Development Cooperation Agency's (Sida's) support to the microfinance sector in Bosnia and Herzegovina (BiH) during the past five years and to provide independent input to Sida for possible use in the upcoming period of writing a new Country Assistance Strategy in 2010. Support to the microfinance sector has consisted of:

- Direct support to Microcredit Foundation EKI (EKI), one of the largest microcredit organisations (MCOs) in the country, for a project that piloted housing loans and also provided business loans to support sustainable livelihoods in rural areas
- Direct support for loan funds of about EUR 1,5 million to the Loan Initiative for the Development of Economic Regions (LIDER), a MCO established by the Cooperative Housing Foundation International (CHF), to generate incomes and to build the sustainability of the organization
- Microcredit refinance, through Kreditanstalt für Wiederaufbau (KfW) in Bosnia, to enhance the commercial relationship between banks and MCOs. Active until 2012, the refinance line was placed through Raiffeisen Bank in BiH and has to date been used by five MCOs.

A secondary objective of the report has been to review the existing information of the development impact of the microcredit sector as a whole, including a discussion of the impact of the global financial crisis on the sector and how it has affected microcredit clients. This information was gathered in discussions with MCOs and through visits to major international financial institutions (IFIs) in the country, discussing the impact of the global crisis and possible ideas for supporting the financial sector.

The BiH microfinance sector was regarded as an important resource for creating jobs and incomes after the war destroyed much of the productive infrastructure in the country, and had the benefit of two World Bank (WB) projects, Local Initiative Projects (LIP) I and II, which ran between 1996 and 2005, offering loan funds and technical assistance and training. At the end of the projects, eight sustainable and very competent organizations had been created, and had raised the standards for the industry as a whole; twelve MCOs dominated the market. In 2006, both social and commercial investors began to offer funding to these MCOs, which took the opportunity to expand their portfolios. Between 2005 and 2008 the industry tripled in number of clients, reaching nearly 400,000 active clients, or one of every six to seven people in the workforce. During the same period banks also began to lend down market, decreasing their requirements for accessing credit and more microfinance clients were also able to access bank loans.

In 2007 a new microfinance law offered MCOs the possibilities of re-registering as foundations or as for-profit companies, and while a few decided to remain as foundations, most chose the for-profit legal form. In the Republica Srpska (RS) for-profit MCOs now operate, while in the Federation of Bosnia and Herzegovina (FBiH) this transformation has been blocked by the Banking Agency's interpretation of the new law and their concerns about protecting the MCO's donations from international organizations. Consequently the FBiH MCOs remain foundations today, making the playing field uneven, as the for-profits in the RS can lend larger sums and finance their activities in more diverse ways, such as through equity funding and bond issues.

In 2008, the financial crisis hit BiH and led to much tighter and more expensive credit as well as many lost jobs, primarily in construction and the export industries in the metal and wood sectors. The country has also undergone a fiscal crisis, resulting in budget cuts and late and reduced state salaries, pensions and benefits. This situation has affected clients substantially, as many carry quite high debt burdens from multiple sources and have now suffered reduced incomes from their businesses, while other

family member receive lower salaries and/or benefits, or may have lost jobs. Guarantors have had to step in and take over repayment in numerous cases. A distinction should be made, however, between good clients who were managing their debt before the downturn but cannot do so now, and those who have taken advantage of the easier credit of 2006 and 2007 and taken on more debt than they could reasonably manage even in better times.

The MCOs began to notice rising delinquency rates in mid-2008, and could note, through the newly-established credit registry at the Central Bank, that numerous clients – between 20 to 40% – had multiple loans and thus risked problems in repayment. Since then MCOs have focused on collecting repayments and limited their disbursements in an effort to return their portfolios to sustainable levels. As a result they now have very high liquidity and are repaying more costly lines of credit.

The refinance line supported by Sida through KfW was placed with Raiffeissen Bank in June of 2007. It was lent to five MCOs, four of whom have repaid it or plan to do so before the end of 2009. Because credit flowed into the MCOs from many different sources in 2007 the refinance line had limited impact, and when Raiffeissen raised its interest rates in early 2009, MCOs were eager to prepay. Although there are somewhat different beliefs regarding the situation in coming years, most MCO leaders and IFIs do not think that access to funding will be a problem, the question is rather what it will cost and how long terms will be available. Thus removal of the refinance line appears unlikely to have a big impact on the organizations or their clients.

The impact of Sida's direct support to EKI and to LIDER has been satisfactory. EKI clients in the interview sample were mostly involved in agriculture and had loans for income generation, while the sample of LIDER clients included more businesses and were located mainly in urban or semi-urban areas. The structured interviews conducted with 60 EKI clients and 50 from LIDER show that loans are highly appreciated and that they are used to generate income or to finance fixed assets. Thirty-six of 60 EKI clients and nineteen of 50 LIDER clients had increased their incomes, although only a portion of these were able to quantify the increases; the finances of household businesses are generally not separated from those of the house, and the income generated goes into supplying daily needs on the first hand, and is reinvested in maintaining or expanding the business in the second hand. Surplus income is often invested in home construction or improvement. Almost half of the LIDER clients and 38 of 60 EKI clients invested partly or wholly in fixed assets, which do not generally generate income; if family housing were to be counted as a fixed asset, even more would be in this category, as a percentage of the clients interviewed had housing loans. Business loans are also sometimes diverted into improving housing.

Surprisingly, one quarter of the EKI clients and three quarters of the LIDER clients had access to bank loans, which were sometimes combined with loans from one or more MCOs to finance larger undertakings such as house construction or setting up a business. On the other hand, few clients saved in banks, preferring to reinvest earnings or to buy properties, believing that this generates better profits.

Interviews indicate that many MCO clients are now dependent on loans to finance their businesses and count on them: 'without loans you can't do anything' was a common refrain. Thus a ruined credit history or gaps in disbursement from the MCOs would be very prejudicial for them.

Lessons Learned

- While the loans in EKI reached vulnerable groups and were directed towards housing or income generation in rural areas, the LIDER sample included several large loans (over KM 30,000)¹ and three quarters of the clients had access to bank loans. Thus it appears that direct support to microfi-

¹ See Annex D for information on average loan size and its development over time.

nance organizations that is focused on specific poverty-alleviation programs such as the one implemented by World Vision/EKI is likely to have a greater impact on the poor than general funding to MCOs as in the case of LIDER. Although client targeting is controversial (Helms 2006:35), the major MCOs currently operating in BiH are all sustainable, do not lack other unrestricted funds, have a broad client base and focus on similar segments of the market. Therefore, client targeting by focusing on new product development and/or vulnerable regions or groups is neither a burden to the MCO nor superfluous considering persistent poverty levels in the country.²

- The rapid expansion of MCO lending and use of multiple loans by clients has led to over indebtedness in a sizeable portion of the population to the detriment of both MCOs and clients: rising write-offs and losses, and blemished credit histories and humiliation. Thus the sound growth of MCOs requires that competent and efficient meso-level institutions such as credit bureaus, supervisory agencies, and consumer information and protection organisations and groups be in place.
- The rise in client delinquency and need to collect late loan instalments, limit disbursement and shrink portfolios has changed the work situation of loan officers dramatically, and some institutions also need to fire staff. While much is known about how microfinance institutions can and should grow, less competence exists regarding how to successfully downsize; knowledge which is much needed in this difficult time.
- During the period of rapid growth between 2006 and 2008, MCOs added staff quickly and incentives were in place which rewarded disbursement. Although delinquent clients affected the loan officers' bonuses, delinquency was low in the expanding organizations. The difficulties of making sure that all staff shared microfinance ideals and understandings as well as bonus policies likely contributed to overlending which later led to high delinquency levels. Rapid growth in organizations requires close control of staff and mission.

Recommendations

1. In coming months, many of the organizations are going to be taking decisive steps regarding their futures. Some will remain foundations and seek their niche in the market. Others are likely to join forces, creating new constellations and groups of competencies. What they need is technical assistance (TA) and training that will help them increase their institutional capacity for long-term development. Focus should be on issues such as transparency and disclosure, risk taking, dealing with international investors and with shareholders as well as other challenges of consolidation. To provide such technical support, Sida might partner with other institutions – for example European Bank for Reconstruction and Development (EBRD), European Fund for Southeast Europe (EFSE), or KfW – that are now taking an active role in supporting a consolidation process; or with an industry organization such as Association of Microfinance Institutions in Bosnia and Herzegovina (AMFI).
2. There is a need for a policy dialogue at the level of the Finance Ministry and the Banking Agencies. At present the law on microfinance is being applied differently in the RS and the FBiH, creating unfair competition. Discussion and greater consensus is needed, but the communication between stakeholders is not functioning well, so it is necessary to find channels of communication that can resolve the current deadlock. While amending the legal framework will take time, by-laws can be changed more rapidly by the Banking Agencies. The EBRD is involved in policy discussions, and could be a partner for Sida in this area.

² The last World Bank Poverty Assessment, published in 2003, estimates the number of poor in BiH to be 20% of the population, and the number of vulnerable at another 30%. The UNDP notes the poverty rate as of 2007 at between 14 and 24% of the population.

3. The FBiH Banking Agency is in need of more human resources, technical assistance and training to supervise the microfinance sector appropriately and effectively. With only two employees, one currently on maternity leave, the microfinance section of the agency is clearly understaffed and also appears to be squeezed between the demands of the MCO directors and their own duty to apply the letter of the law. The USAID Partnership for Advancing Reforms in the Economy (PARE) program which works on support to the banking sector might be an entry vehicle for USAID – Sida collaboration on a program with the microfinance section of the Banking Agencies. The World Bank has also expressed interest in supporting the fine tuning of the legal and regulatory framework for microfinance in BiH, and would work towards mobilizing resources if this were to be requested by the Banking Agencies.
4. The Association of Microfinance Institutions in Bosnia and Herzegovina – AMFI – is a potential resource which is underutilized today and could serve the sector much better. Part of the KfW refinance line is to be used for TA, and AMFI is expecting to undergo an evaluation supported by this funding. Based on the outcome of the evaluation there could be an excellent opportunity for Sida to support the development of an institution that can have substantial value for the continued development of the sector.

As a member of the Consultative Group to Assist the Poor (CGAP), Sida could also advocate for research on how to successfully downsize an MCO. The research could be conducted by CGAP at a global level or at a local level in partnership with AMFI.

5. Financial education is another area in which investment can be beneficial. It will be interesting to see how the current initiative for financial counselling centres works out. However, financial understanding and know-how needs to be disseminated across the population. The Bankers Association, AMFI, and consumer groups are all possible partners for support to educational initiatives, and another profitable avenue could be to work through youth groups to promote financial understanding among young people.
6. The data collected through interviews and focus groups indicated that microfinance loans are being used in a variety of ways – to augment bank loans, build homes, pay heating bills, and provide health care in emergencies, fund economic activities that provide for a child's high school or university education. This indicates that clients could make use of financial products that are not yet widely available, and MCOs should be able to provide their clients a greater diversity of products. However, product development is a risky and demanding process, which may also require changed legislation. Sida could support product development either through direct support for programs similar to the World Vision/EKI project, or through support to a research and development facility located in AMFI and for the benefit of all AMFI members.
7. Although the outlook concerning the funding of microfinance in BiH looks positive at this time, the situation may change depending on how the economic crisis evolves in BiH during the coming year, and how the MCOs manage. In planning for the long term it is therefore not out of place to consider how funding might be enhanced. As an MCO's loans from local banks must be fully collateralized, a loan guarantee scheme could play a role in enabling local banks to lend larger sums to MCOs. At least one MCO has noted the usefulness of such a facility. USAID has set up a loan guarantee scheme for SME lending, and might be a possible partner; international financial organizations may also be interested.
8. Work towards a regulated economic space and rule of law is of importance to microcredit clients, who lose investments due to late subsidies, suffer from bankruptcy when participating in agricultural schemes (such as snail farming) that turn out to be scams, are unable to use their assets as collateral for loans, and have limited access to justice when they are cheated. The inability to put up property

as collateral, for example, is a result of, among other things, the inefficient court system and the lack of a functioning pledge registry. Due to the lack of efficient government institutions, opportunities are limited, and hard work sometimes comes to nothing. Thus all support for an improved business infrastructure is support that directly or indirectly benefits micro-entrepreneurs. Microfinance clients are businessmen, and are still waiting for that 'business-friendly environment.'

1. Introduction

The purpose of this report is to review the impact of Sida's support to the microfinance sector in Bosnia and Herzegovina (BiH) during the past five years and to provide independent input to Sida for possible use in the upcoming period of writing a new Country Assistance Strategy in 2010. Support to the microfinance sector has consisted of:

- Direct support to Microcredit Foundation EKI (EKI), one of the largest microcredit organisations (MCO) in the country, which was established by World Vision and has received Sida support for five projects since 1998. Although there are presently no active projects with World Vision, approximate total support for loan funds to EKI from Swedish sources has been EUR 2,3 million during the past 5-year period. The goal of support to EKI is income generation through microcredit, and piloting new microcredits such as for home improvement.
- Direct support for loan funds of about EUR 1,5 million to the Loan Initiative for the Development of Economic Regions (LIDER), a MCO established by the Cooperative Housing Foundation CHF International. Here, too, the goal has been income generation; but also building the sustainability of the LIDER organization.
- A microcredit refinance line, through KfW in Bosnia, has been a third focus of support to the sector. In late 2005, due to concerns about the availability of commercial funding for MCOs in view of the fact that most donors were ending direct grants, Sida entered into a project with KfW to enhance the commercial relationship between banks and MCOs. The refinance line was placed through Raiffeissen Bank in BiH and has been used by five MCOs; it is intended to remain active until 2012.

Questions to be answered through the review concern the impact of EKI and LIDER loans on micro-businesses and their impact on income generation activities. Using structured interviews and a random sample of clients, beneficiaries were to be segregated by the type (business or individual clients) and the following hypotheses checked:

- loans to businesses led to an improvement in income for the business and job creation for the beneficiary
- loans to individuals lead to an increase in household wellbeing, as measured in fixed assets, expenditures and savings

The impact of the refinance line for the sector is analyzed by interviewing banks and microcredit organizations that made use of the line to determine the effect it has had on their operations, and what the effect would be on the organizations and their end clients if the line were to be withdrawn.

A secondary objective of the review has been to assess the existing information of the development impact of the microcredit sector as a whole, including a discussion of the impact of the global financial crisis on the sector and how it has affected microcredit clients. This information was gathered through visits to major international financial institutions (IFIs) in the country, discussing the impact of the

global crisis and possible ideas for supporting the financial sector. The analysis is to consider lessons to be learned from past support in the light of the current country strategy, and to comment on the overall relevance of further support to the financial sector in BiH.

Because this review does not, as customary, focus on one particular intervention but deals with three distinct topics

- The effect of the global crisis on the financial sector in BiH, particularly the microfinance sector and its clients,
- The outcome and impact of the refinance line and what would occur if it was to be withdrawn, and
- The impact on clients of Sida's direct support for two distinct organizations, EKI and LIDER,

the main body of the report has been organized in six sections to provide greater coherence and flow. The description of each topic, the findings and the evaluative conclusions are therefore included under one main heading, entitled 'The Evaluated Interventions, Findings and Evaluative Conclusions'. This core chapter of the report is followed by chapters on lessons learned and recommendations.

For a Map of BiH and Areas Visited See Annex G.

2. The Evaluated Interventions, Findings and Evaluative Conclusions

2.1 The Global Crisis and the Financial Sector

The series of wars that marked the disintegration and destruction of the federation of nations that made up Yugoslavia reached Bosnia and Herzegovina (BiH) in 1992. By the time the Dayton Peace Accords were signed in the end of 1995, 250,000 of the pre-war population of 4,4 million had been killed or were missing, and according to the estimates of the United Nations High Commission on Refugees (UNHCR), 1,3 million people were internally displaced and 1,2 million were refugees in other nations.³ Moreover, the productive infrastructure of the country, which had been heavily industrial, was almost entirely destroyed and only a fraction of the working population of 900,000 had jobs to return to after the war.⁴ Much of the population's basic asset base, such as housing, vehicles, farm equipment, livestock and household possessions had also been destroyed as a result of warfare.⁵ The banking system was weak, most bank assets state-owned with over 90% of loans non-performing, and much of the population had lost savings when foreign currency deposits were seized by the National Bank of Yugoslavia prior to the war, or in various bank failures in the end of the 1980s or late 1990s. Thus the country faced a formidable task in re-establishing the population and reconstructing the economy; a task in some ways made more difficult by the political structure of the newly formed country of Bosnia and

³ Dunn, 2005, p.7.

⁴ BiH Demobilization and Reintegration Project, World Bank.

⁵ World Bank, 2003, Bosnia and Herzegovina. Poverty Assessment.

Herzegovina.⁶ By 2003, the population of Bosnia and Herzegovina was estimated by the United Nations at about 4 million.

2.1.1 Early Establishment: Local Initiatives Projects I and II

Small loans, microcredits, to individuals for the purpose of establishing some type of economic activity were one part of the solutions found to the economic problems facing the Bosnians after the war. Even during the war some humanitarian organizations had been offering small loans, and with peace, more organizations offering credit were established and supported by NGOs and bilateral donors. Microcredit to returnees, war invalids, demobilized soldiers and internally displaced people were one way of coping with the social costs of the war and of offering people a way to begin rebuilding their lives. The World Bank piloted a test program in Tuzla with three microcredit-type organizations in 1996, the success of which proved the need for microlending and led to the bank's establishment of the first Local Initiatives Project (LIP I) which supported 17 NGO MCOs with funding and training. A loan of USD 22 million was granted to the Bosnian Government, which set up the Local Initiatives Departments (LIDs) to administer and supervise the project in both the Federation and the Republic of Srpska (RS). The goals of LIP I were to:

- Provide access to loans for business purposes to individuals and micro-entrepreneurs who did not have access bank loans or other types of credit,
- Establish self-sustainable microfinance organizations
- Support the improvement of the legal framework for non-bank microfinance organizations, a goal which was realized through the adoption of the Law on Microcredit Organizations which was passed in early 2001.

Focused on creating sustainable organizations that would eventually be able to operate without donor funding, LIP I encouraged the participating microcredit organizations to charge fully for the loans provided to their target clientele, with the goal of reaching financial self-sustainability within 3 to 5 years. Thus subsidized lending was not an option in the growth of the microfinance sector in BiH.

The 17 participating NGO MCOs were admitted to the program through a competitive and selective process. After a midterm review in 1998 that examined key institutional and financial indicators for the institutions, the number of partners was reduced to eight; a reduction which spurred a series of consolidations and resulted in seven fully financially sustainable institutions by the end of the project.

By the time the LIP I project closed in June of 2000, over 50,000 loans had been disbursed by participating MCOs, five times the original goal of KM 10,000. The average loan size was close to KM 3,000, half of the loans went to women and one fifth to people that had been displaced by the war. As the project closed, the MCOs had 19,361 active clients.⁷

A second project with a value of an estimated USD 24 million, LIP II, was initiated in March 2002 and ran through June 2005, with the aim of

⁶ The Dayton Peace Accords signed on December 14, 1995 retained BiH's international boundaries and created a joint multi-ethnic and democratic government tasked with formulating the budget and foreign policy. A second tier of government was established consisting of two entities roughly equal in size: the Bosniak/Croat Federation of Bosnia and Herzegovina (FBiH) and the Bosnian Serb-led Republika Srpska (RS). The Bosniak/Croat Federation is further divided into ten cantons, each with a representative government. The political structure established by Dayton is thus a very divided and costly one, and has increasingly come to be seen as a serious hinder to political and economic progress. A primary challenge still facing the country is the construction of one economic space, in which the governmental functions of the FBiH and the RS adopt common goals and policies.

⁷ Dunn, 2005, p.12. Final Report. Impact of Microcredit on Clients in Bosnia and Herzegovina. Local Initiatives (Microfinance) Project II.

- Financing the growth and institutional development of high-performing institutions with the capacity to serve significant numbers of low-income people without, or with limited, access to commercial services
- Supporting the microfinance sector towards sustainable sources of financing.

After assessment, nine MCOs qualified for the project: BENEFIT, BOSVITA, EKI, LOK, MI-BOSPO, MIKROFIN, PARTNER, SINERGIA, and SUNRISE. Because BOSVITA merged with PARTNER soon thereafter, eight MCOs participated in the second project.⁸

As of 2003 those eight MCOs comprised 70% of the sector based on earning assets. By June 2002, the project had resulted in 130,000 loans that created or sustained 180,000 jobs and there were 30,000 active clients and loan sizes averaged KM 3,500.⁹ The final assessment of the LIP projects indicates that the ten major MCOs (MIKRO ALDI and PRIZMA MIKRO were also included in the assessment) in the country were, as of December 2004, providing loans to 100,000 active clients, with a total amount of outstanding loans of KM 209,128,400 (about USD 145,5 million) with average loan sizes in the organizations ranging from KM 1,000 (PRIZMA in particular lends small amounts) to KM 3,200.¹⁰

The success of the LIP projects by far exceeded the original goals and expectations, and proved the great demand for loans for investment in small-scale economic undertakings, particularly in rural areas and among low-income people. The final report from the projects, which was an extensive undertaking involving two rounds of interviews with over 3,300 respondents from ten MCOs and also used a control group, demonstrated that microlending had a positive effect on income, employment, investment, and business registration.

But the success of LIP I and LIP II can also be noted in the successes of the institutions that they helped to build. The projects supported eight MCOs that received extensive training and technical assistance (TA), the leaders of which travelled widely to observe and learn techniques from state-of-the-art institutions in other countries and participated in international conferences. Thereby the projects helped to create a strong, highly competent and competitive group of institutions, and also contributed to raising the standards for microfinance in the other, non-participating organizations in the country. As a result, most of the Bosnian MCOs have for several years been ranked and rated by international agencies (see Annex D for rating information), and are well-known internationally for their success, frequently receiving awards within the industry.

Table 1 Growth of MCOs in BiH

Year	Number of active loans	Average loan size in KM	Amount outstanding loans in KM	Assets of microfinance industry in KM	Assets of banking industry in KM	Percentage of credit market (MCOs)
2000	19,361	3,000	n/a	n/a	n/a	n/a
2002	30,000	3,500	n/a	n/a	n/a	n/a
2004	100,000	1,000–3,500	209,128,400	150,000,000	5 billion	3% ¹¹
2008	398,691	2,683	1,084 million	1,191 million	20,8 billion	5%

Source: Dunn 2005, Lindh de Montoya and McNeil 2003. Data for 2008, see Cumulative Performance Indicators of 12 Microcredit Organizations (2005–2009), and Banks Association of Bosnia and Herzegovina, www.ubbih.ba, 10th Interbalkan Forum Banks, Sarajevo, 16th October 2009.

⁸ BENEFIT has since merged with MIKROFIN.

⁹ Lindh de Montoya and McNeil, 2003, p.17.

¹⁰ Dunn, 2005, p.15.

¹¹ Calculated in the end of 2003, See Lindh de Montoya and McNeil, 2003, p. 69.

As can be seen from the table and as will be explained below, the microfinance sector expanded enormously between 2004 and 2008. According to the numbers, as of 2008, almost 15% of the working population had a microloan, or one of every six to seven people in the workforce.¹²

There was less success in establishing an institutional framework conducive to the growth of the industry. The Law on Microcredit that was passed in early 2001 was late in coming, and restricted microfinance activities to credit alone, making it difficult if not impossible for the organizations to undertake other activities such as micro-insurance or micro-leasing, which were possible in some other countries. Deposit taking, which might have financed lending, was out of the question. As the World Bank exited its activities in the microfinance sector in 2005 with the end of the project and the closure of the LID offices in the Federation of Bosnia and Herzegovina (FBiH) and in the RS, there were still numerous loose ends which had not been resolved. A new microfinance law which would allow the industry to develop was still not in place. Supervision of the MCOs was eventually turned over to the Banking Agencies of the FBiH and the RS, but without adequate capacity in these institutions or the Ministry of Finance, which writes the laws, regarding the characteristics and needs of microfinance institutions and how they might most suitably be monitored and supervised. Reasons for this unclear situation for the industry were, among others, the time needed and difficulties of enacting laws in the complex political world of BiH, the general reluctance of banking officials to take on the responsibility for a new group of financial institutions, suspicion on the part of social authorities regarding organizations that charged high interest rates on loans to the poor, and the lack of funding for a proposed project in which CGAP, part of the World Bank Group, would support work for a new law and training of regulators and supervisors. Also, the Association of Microfinance Institutions in Bosnia and Herzegovina (AMFI), the business association established to represent and advocate for the microfinance sector, had not grown strong, with a partner with as much clout as the World Bank already working for the advancement of the industry.

There was also concern regarding how institutions would be able to continue growing, and how they would finance increased lending awaiting the establishment of the European Fund for Southeast Europe (EFSE), which consists of European funds to the Balkan countries and is focused on supporting microlending. Thus Sida supported a refinance line through KfW, with the goal of fostering the relationship between the microfinance sector and the commercial banks that might finance them.¹³ Access to commercial funding such as that which could be provided by local banks was seen as the primary way to continue microfinance growth with the withdrawal of the World Bank from the sector as well as decreasing donor funding for the country.

2.1.2 Microfinance and Bank Lending Boom – 2006–2008

However, between 2006 and 2008 there was an influx of both social and commercial investors into the Bosnian microfinance sector, and somewhat to the surprise of the MCOs, who had been accustomed to competing for funds, they were offered substantial funds to increase their lending. There are several plausible reasons for this sudden bonanza of funding. One could be that Muhammad Yunus won the Nobel Prize in the end of 2006 for his work with Grameen Bank, focusing media attention on the benefits of microfinance and bringing more social investment into the sector. The highly-rated Bosnian microcredit sector benefited from this renewed attention, and its MCOs were attractive clients for investment. Another reason could be that this period also coincided with the financial boom internationally in the banking sector, and there was more money looking for lucrative investments. The sub-prime markets were growing, and new, if risky groups were being incorporated into the formal financial system through housing loans and credit cards. Investment in microfinance was a way of participating

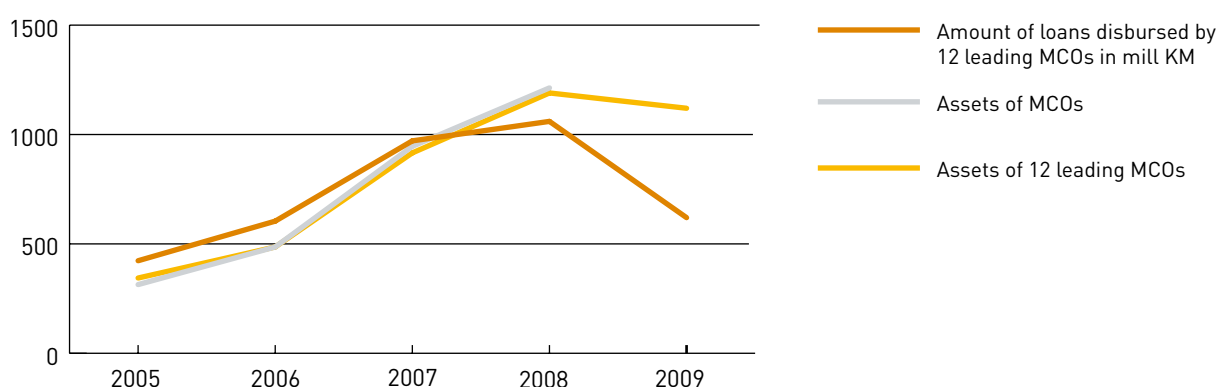
¹² Information from the Bureau of Statistics indicates that the potential workforce in the country is 2.7 million people. See *Statistički informator – III kvartal 2006*.

¹³ USAID's agricultural project, Linking Agricultural Markets and Producers (LAMP) also provided conditional grant money to several MCOs based on their abilities to meet targets in agricultural lending starting in 2004.

in new, different markets – and happened to be fashionable. Also important in this context is that the reigning theory within the multilateral institutions and NGOs that advise on microfinance, such as CGAP, the Microfinance Centre (MFC), the United Nations Capital Development Fund (UNCDF) and Women’s World Banking (WWB), promoted access to commercial finance as the highway into the future for microfinance, and also the idea that the potential for growth in the industry is huge.

The Bosnian MCOs seized this opportunity to grow, and while some organizations were more cautious than others, the numbers show how rapidly lending expanded after 2005. In retrospect one might ask why nearly all institutions chose to grow so rapidly. The unclear legal situation and questions about the future contributed to this decision, as well as the reigning international ideas that rapid growth fuelled by commercial loans is positive. After all, growth, serving more clients, is part of the microfinance mission, and there was a demand; MCOs had long easily placed any funds at their disposal, had always had very low delinquency rates, and the economy was expanding at the time. As they waited for a new law on microcredit, which was expected to allow transformation into for-profit institutions to be enacted, it was also important for the MCOs to keep or increase their market share. For the smaller institutions, quick growth was necessary just to not be left in the dust by rapidly expanding larger competitors. Here, the organizations’ high competence, past successes, and competitive natures combined with an unresolved legal situation regarding future institutional forms to spur increasing lending.

Diagram 1 Growth in lending by Bosnian MCOs, 2005-2009.¹⁴

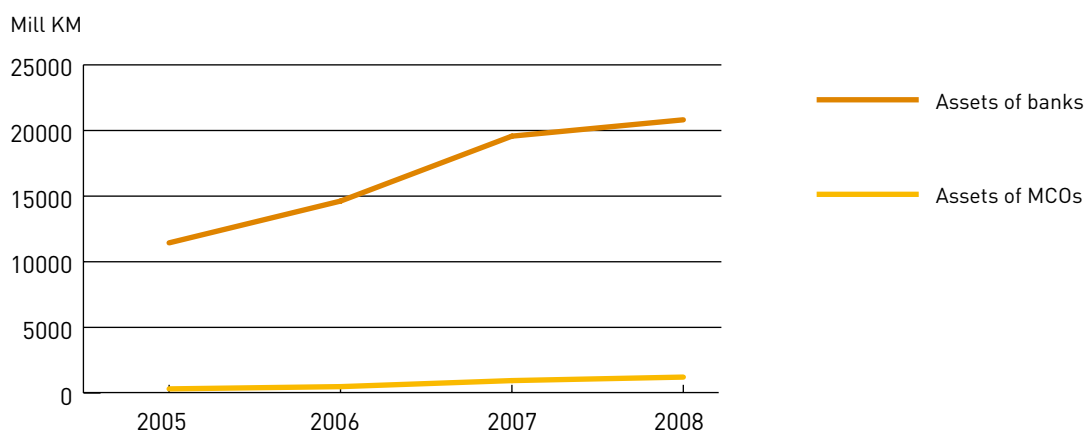


Source: AMFI, *Cumulative Performance Indicators of 12 Microcredit Organizations (2005–2009)*.

At the same time, the foreign-owned banks were beginning to move into a part of the market previously served by the MCOs, trying to place money from their European ‘mother institutions’. Loans and credit cards began to become more widely available as banks eased their requirements for lending to the general public. During this period Raiffeissen Bank advertised an ‘XXL’ loan, in which up to EUR 10,000 could be borrowed with the only documentation required being an ID card, proof of employment and a salary slip proving an income sufficient to make the monthly loan repayments. Unicredit Bank advertised loans up to KM 10,000 without guarantors - the usual security for individual loans being guarantors – although a salary, possibly in a state institution, was also a likely requirement. Although some point out that these advertisements were more ways of getting people into banks, and raised hopes, rather than produced loans for the majority, they did signal that more money was available to the public and that the onerous requirements for getting access to credit were easing somewhat. However, the real costs of loans and the interest rates and various fees associated with credit cards came as a surprise to some, and banks have been criticized for their less than transparent information in this regard. While banks almost doubled their assets between 2005 and 2008, those of the microcredit organizations almost tripled.

¹⁴ Projection for 2009 made based on performance as of June 2009.

Diagram 2 Growth in the assets of banks and MCOs, 2005–2008.



Source: Banks Association of Bosnia and Herzegovina, www.ubbih.ba, 10th Interbalkan Forum Banks, Sarajevo, 16th October 2009.

2.1.3 The New Law on Microfinance

Meanwhile, the much-expected new law on microcredit was approved in 2006. The law turned over the responsibility for regulating and supervising MCOs to the Banking Agencies of the FBiH and the RS, and required MCOs to re-register either as foundations or as for-profit companies. Foundations were allowed to accept grants, and to make loans up to KM 10,000, while the for-profits would not be allowed to accept grants but could make loans up to KM 50,000.

Thus, in 2007 and 2008, the MCOs made strategic decisions and re-registered. Most organizations wished to transform into for-profit institutions. However, the law was interpreted differently in the respective Banking Agencies. While in the RS the MCOs were allowed to transform directly into for-profit organizations, in the Federation all were instructed to transform into foundations first, and thereafter seek permission to become for-profit. A few MCOs sent in both sets of papers at once, hoping to transform into foundations one day and into for-profit organizations the following day, other MCOs applied to become for-profits soon thereafter. However, to date no for-profit licenses have been granted in the Federation; the FBiH Banking Agency has used its discretionary powers to slow the transformation process while waiting for consolidation in the sector.

Three for-profit MCOs are currently based in the RS. MIKROFIN and SINERGIA are the largest, and lend throughout the country, up to the KM 50,000 limit, although most loans remain far smaller. All the MCOs based in the Federation remain foundations, however, and may only lend up to KM 10,000 – less than the KM 30,000 limit they were permitted under the previous law. This has led to an unfair competition where strong organizations that all lend throughout the entire country work with very different parameters depending on the entity in which they are based. As a result, MCOs based in the RS are taking over some clients of the MCOs based in the Federation who need to borrow larger sums, primarily business clients; a situation which is experienced as frustrating and unfair. These for-profit companies also have other advantages: they are able to attract equity investment, which is impossible for foundations, where the ownership of the capital is still unclear; and they have other ways of financing lending. SINERGIA recently successfully issued a bond, and MIKROFIN has an insurance branch and is investigating getting involved in pension funds.

The FBiH Banking Agency is supervising according to the letter of the law. They point out that they are not policymakers, leaving that role to the Ministry of Finance. Their concern is that the existing laws be followed, and they are anxious to protect the donations that the MCOs have received during their activities over the years, and want to prevent leakages of these funds. They are also worried about potential money-laundering taking place in the few tiny microfinance organizations that exist along

with those that dominate the market. At the moment the agency's energy – two employees are dedicated to the microfinance sector - appears to be spent more on the small, problematic organizations than on the large and competent ones. The agency has had supervisory responsibility for over 18 months and is just now beginning to conduct on-site visits to the MCOs.

Viewing the aggressive growth of the recent past as negative, the agency believes that there are currently too many MCOs operating in the relatively small market of the country, and is critical of the bonus schemes for MCO employees which they feel contributed to over-lending. They would like to see consolidation in the sector at the level of the foundations to create a few, strong and efficient organizations which will be able to negotiate better terms from lenders and will concentrate on lending to the poor. They criticize the sector for acting like, or wanting to "be banks."

The latest decision from the FBiH Banking Agency on transformation to for-profits is that the MCOs will be allowed to do this only if they maintain their foundations as well, and continue to lend through them. This means that each organization would have to maintain a dual structure, one foundation and one for-profit, each with a complete and separate organizational setup of board, directorate, and staff, which would multiply costs. The organizations would in effect be competing against themselves, creating an impossible situation.

During the past year of financial crisis, there has been considerable criticism of the financial sector in the press, and some citizens have even taken the banks to court over increased interest rates (banks raised their rates due to their increased costs of lending, although the Euro Interbank Offered Rate, Euribor, rate fell) and won. Some IFIs thus suggested that the Banking Agency is sensitive to public opinion, and is unwilling to make decisions regarding microfinance that might have unintended, and controversial results.

The future of the MCOs in the Federation thus remains an open question. Remaining a foundation is not an attractive option for the larger MCOs, and there is little incentive for them to merge into larger foundations as these would provide no new opportunities. In a one-day workshop in the middle of October, 2009, which brought MCO leaders and social investors together with representatives of the Banking Agency, a dialogue was attempted but the outcome remains to be seen. KfW has indicated that they, together with EFSE, have started negotiations with the FBiH Banking Agency, the Central Bank and the Ministry of Finance to initiate a revision of the current regulations.

The EBRD, which has financed four MCOs during 2006 and 2007, plans to provide them with the technical assistance necessary in their commercialization and future transformation to deposit-taking (i.e., banking) institutions.¹⁵ It is also active in the policy dialogue concerning the future of the industry, and has noted the challenges posed by enactment of by-laws and the implementation of the new law, and the need for monitoring of the capacity of the Banking Agencies to supervise the sector effectively.¹⁶

2.1.4 The Central Bank Credit Registry

An entirely positive recent development is the credit registry established by the Central Bank. The need for a centralized form of financial information about potential borrowers had long been recognized. A private company called the Long-Range Company Kreditni Biro (LRC Credit Bureau) was established in 2002 but has not been able to oblige banks or MCOs to report to them; some institutions report while others do not. However, the LRC does collect information about bill payment, such as water, electricity and telephone bills, and thereby provides important information about the comportment of potential clients. Recognizing the need for a registry of loans, the Central Bank went about establishing a credit registry, initially with the assistance of a USAID project. It was placed in the payments systems

¹⁵ The EBRD has financed the following MCOs: in 2006, MIKROFIN (EUR 8 million) and EKI (EUR 6 million); in 2007, PARTNER and SUNRISE, with EUR 4 million each. See EBRD 2007, p.8

¹⁶ EBRD, 2007, p.9

division of the bank because they had the technical expertise necessary. Being part of a state organization, the credit registry is able to demand that all banks, MCOs and leasing businesses report to it. The Central Registry of Credits of Legal Entities began operating in 2006 and the Central Registry of Credits of Physical Persons in early 2007. Some MCOs began to send data to the registry in June of 2007, but did not receive access to it until early 2008. As of September 2009 all MCOs must by law report data to the registry. There are still some problems with delays in reporting (data for each month is reported 15 days after the close of the month) but improvements are underway.

2.1.5 The Onset of the Global Financial Crisis in BiH

Because the financial institutions in BiH are conservative in nature and did not have any exposure to mortgage-backed securities, it was first thought that the global financial crisis would not affect the country. While some of the parent banks of international banks operating in BiH did suffer losses, none has gone bankrupt. Yet their losses had an effect on confidence in the BiH banking system because Bosnians have a strong memory of lost deposits in the last war, and began to withdraw deposits as news of losses in European banks spread. In October of 2008 alone, EUR 420 million of deposits (6,4% of the stock of deposits) were withdrawn. The Central Bank decreased reserve requirements to increase liquidity, and foreign parent banks also injected liquidity into local subsidiaries to stabilize the situation. In early 2009 the deposit guarantees were raised to nearly EUR 10,000.¹⁷ Deposits have since been returning.

As the financial situation in the world worsened it became apparent that the crisis would far transcend the financial sector, becoming a more general economic crisis with worldwide economic recession and contractions in GDP and would affect Bosnia as well. After the run on banks in October an economic slowdown began that did not begin to improve until spring. World Bank analysts reconsidered and concluded that the crisis is likely to affect BiH in three primary ways:

- Difficulties in the financial sector, especially the large foreign-owned banks
- A drop in remittances from workers in the US and Europe
- A drop in exports

The main result in the financial sector has been a tightening of credit as banks are now more cautious and are lending less, primarily adapting a 'standby' position, waiting to see how things evolve. They are less able to borrow abroad to finance credits in BiH (necessary because of terms mismatch; deposits are primarily short-term in BiH and there is a need for long-term loans) which makes credit more expensive. Banks are overly liquid, but are experiencing more problems with clients' repayments than previously, due in part to over indebtedness but also to lost jobs and decreasing earnings in businesses. As they are now more risk-adverse, it has become more difficult and more expensive for individuals and micro- and small and medium-sized enterprises (MSMEs) to obtain credit.

Remittances have fallen somewhat, but so far not as much as projected, which may be due to the effectiveness of the stimulus packages put in place by the US and European governments, or perhaps to the fact that people are tapping into reserves that they accumulated in better times.

Finally, exports are suffering. Metal prices have dropped along with demand, and consequently the BiH plants are working at low capacity (many workers have been laid off). Exports of basic metals make up 27% of BiH's exports. Demand for other key exports such as car components, wood products and chemicals have also declined. After three years of growth at about 6%, the GNP is projected to be a negative 3% in 2009.¹⁸ The World Bank has worked out a strategy which will address these issues by

¹⁷ European Union, 2009, p. 28.

¹⁸ IMF, 2009, p. 9.

providing budget support for social transfers if measures are taken to improve targeting, a scheme to provide credit lines for lending to SMEs through local commercial banks, and increased support for infrastructure projects that can quickly provide jobs. The Bank also points out that it is vital for BiH to prepare its economy for the post crisis resurgence, or be left further behind the rest of Europe due to a lack of much needed economic reform.¹⁹

Due to the economic crisis and poor fiscal policies, in May of 2009 the BiH government's National Fiscal Council entered into negotiations with the International Monetary Fund (IMF) on a Stand-By Agreement which included commitments to some structural reforms and fiscal adjustment measures. An important, and sensitive, part of the reforms is to better target social spending, much of which currently goes to war veterans regardless of their economic need, and to curb salaries in state institutions. In July this loan, for EUR 1,15 billion over a three-year period, was signed. The requirements have led to pension cuts for some beneficiaries, and some reductions in state salaries.²⁰ Also, the budget crisis during the summer months led to late pensions, late salaries, and late or cancelled agricultural subsidies for some products.

2.1.6 The Effects of the Crisis on the Microfinance Sector

Naturally, the clients of the microfinance organizations are feeling the crisis. However, the impact of the crisis varies between different areas of the country and sectors of the economy, and it varies between different kinds of businesses. Those that are well-established and efficient are better able to weather the downturn than those that are newer, established during the economic boom, and thus have higher costs.

Clients are affected by the economic downturn. Those associated with the construction industry, such as shops for construction materials and carpenters who supply window, doors, and furniture are affected if they supplied the construction industry; but less, as yet, if they are local suppliers to people who are renovating homes. Agricultural producers have been hit hard by decreasing milk prices, late subsidies, and lower meat prices. Services such as hairdressers have fewer customers, and have to keep prices low; not being able to increase prices to compensate for increasing costs. While fast food outlets are selling less, small groceries and butchers do not seem to be hit as hard. Bakeries and pastry producers are also managing well. Tailors are managing partly due to demand for reparation and mending of clothes that might otherwise be replaced, as are mechanics whom are sought for repairs to keep old cars running. This would indicate that people are budgeting more frugally, avoiding expenses where possible. Those who continue to work, as well as the jobless are trying to spend less, unsure of what the coming months or years hold; and the anxiety regarding the economic crisis is exacerbated by the deadlocked political situation in the country which also makes many feel angry and hopeless.

Many MCO clients depend on a pension or a second income in the family to pay a part of their monthly loan fees. They have been hurt by the fiscal crisis in the country, which has reduced some pensions and salaries, and also by the delays in these, which make it difficult for them to pay their instalments on time and make them risk ruining their credit. It is also worthy of note that numerous companies in the private sector that have been affected by the fiscal and general economic crisis have had to (or have taken the opportunity to) reduce employees' salaries, and in many cases these salaries are also late. Added to clients who have difficulties meeting payments on time due to late or reduced salaries and benefits, are those who have lost jobs and therewith income that they were counting on for repayment. In a few cases clients have lost jobs abroad (usually in construction in Croatia or Slovenia) that contributed to loan payments for another economic venture, or house construction in BiH. And in other cases, clients have recently migrated abroad in search of a job that will enable them to provide for their families and pay back their loans. Thus, due to the crisis, clients that were once 'good clients' now

¹⁹ World Bank, 2009.

²⁰ See IMF, 2009.

find themselves delinquent, late with payments or unable to pay, and struggling to ‘put enough money together’ to pay the monthly instalment.

The performance of MCOs declined in 2008, but in general the sector was not affected by the economic crisis. The main consequence of the crisis was a period in the end of the year during which organizations found access to commercial credit more limited as institutions that were providing credit for this market decided to limit investments, increase interest rates and decrease repayment periods. At this point the IFC, with the support of KfW, founded a Microfinance Enhancement Facility to prevent MCOs from suffering from a lack of liquidity due to the crisis impact.

In the summer of 2008 MCOs first began to notice increasing delinquency (some MCOs say it was slightly earlier, while some say as late as January 2009). By then they had received access to the credit registry at the Central Bank, and examination showed that a number of delinquent clients had loans in more than one organization. As delinquency continued to rise, MCOs began to realize that a large portion – between 20 to 30%, or even between 20 to 40% – of their portfolios were ‘affected’, in the sense that clients had multiple loans, and thus might be delinquent in upcoming months in view of the economic crisis. The calculated number of nearly 400,000 MCO clients might actually be closer 250,000, if one considers how many have loans in more than one institution simultaneously, one MCO director suggested.

There has been a decrease in disbursement in the sector, both as a consequence of the onset of the economic crisis and of more careful lending now based on the information in the credit registry – not only the potential client’s commitments, but those of his/her immediate family are checked. MCOs are more cautious in approving loans, and clients are also less inclined to borrow due to increasing interest rates and uncertainty about the future. As disbursement slows and portfolios remain at the same level or decrease, delinquency takes a growing toll on the balance sheet, growing in proportion. Loan loss provisions in BiH are high, which is a further burden to the MCOs.

Delinquency is a result of the financial crisis, but also of the period of rapid growth between 2006 and 2008; the sector almost tripled in only four years (See Diagram 1 Growth in lending by Bosnian MCOs, 2005–2009). It is difficult to manage such high rates of growth; not only may due diligence suffer, but it is hard to manage the sheer volume of loans. As staff increases fast, it is also difficult to assure that newcomers all share the ideals and goals as the mission of the organization, and to manage internal controls. Considering the small market and the volumes, there must have been a lot of pressure to disburse. The remuneration schemes for loan officers are notable here, too; in most organizations officers received higher bonuses, the more loans they placed. While they were also penalized for delinquent clients, delinquency was not a problem at the time – and clients in difficulties could sometimes be refinanced with a larger loan; something far less likely today.

MCOs have had to reorganize the work of staff; there is much more emphasis on collection and less on disbursement; in fact some loan officers do not disburse at all any longer. In some cases staff has been added solely to work on collection. Today the loan officers who were the disbursement heroes of yesterday sit with larger numbers of delinquent loans than their more conservative peers, and the threat of being fired hanging over their heads as staffs are being reduced. Ironically, officers are being penalized today for behaviour that was exemplary a year or two ago; the ‘victims of the crisis’ are not only at the client level. Staff is being cut at some organizations, and anecdotal accounts indicate that this is not always done in the most professional way – which ideally should recognize the past contributions of the employee, maintain his/her dignity, and assist as possible in the job search. MCOs are well-versed in adding staff, but less able in reducing their numbers of employees. Also of note in this regard is the fact that many MCO employees feel that it is a public shame to be fired from a financial institution, and that the firing will leave a stain on their work record (as it might be deduced by future potential employers that they were fired for dishonesty). Therefore some say that they would rather quit than be fired,

even if they then have to forego the unemployment benefits for which they would be eligible.

The increased focus of organizations on collection has an impact on clients. While we heard from many that if they knew they were going to be a few days late with the monthly payment, they could call their loan officer, who, according to the clients, would allow them a few day's grace (although loan officers do not have the authority to allow late repayments and should follow procedure). However, this leniency is decreasing, and organizations are now quicker to call guarantors. One of the worst things that can happen to a client is for an MCO to call their guarantor, as this involves an embarrassing loss of face and reputation, and also, most likely, of the guarantor's future cooperation. Finding guarantors has always been a difficulty for those MCO clients who do not have social networks that include many fully and formally employed people, nor state employees; state jobs are a requirement for guarantors of larger loan sums. Thus relationships with guarantors are highly valued – they are an economic asset, of sorts, for those with irregular employment, and are sabotaged when MCOs call guarantors to inform them that they will need to step in and pay. One MCO client, a pensioned woman, described her relationship with her guarantor this way: “My guarantor is not a rich person, she has an income, but she is really as poor as I am. If she should be called by the MCO she would worry terribly about having to pay for me – and I would never want to put her through such torment!”

The fear of having one's guarantors called up, and the effort required to collect enough funds from different sources to make repayments on time thus haunts some clients today, either because their businesses have been affected by the crisis or because they have taken too many loans in times of easier credit. One strategy which can be used is to reschedule or reprogram the loan, and MCOs are using this tool to reduce instalments, spreading them out over a longer period of time. However, it tends to be the larger loans that are reprogrammed because these, if late, affect the MCOs more than the smaller ones.²¹ There is also the possibility that continued difficulties will make the new loan just as hard to repay, so the MCOs have to choose which clients to assist in this manner. In the Tuzla area, three strong MCOs (EKI, PARTNER and MI-BOSPO) usually get together and sit down with clients who have multiple loans at their institutions to develop a feasible repayment plan with the debtors. MIKROFIN, now able to lend up to KM 50,000 as a for-profit, is offering larger sums for loan consolidation to struggling clients of other MCOs, exacting a promise that they will not continue to borrow elsewhere. In our interviews in the field we also met clients who had been able to obtain bank loans for this purpose, thereby reducing both monthly payments by spreading them out over longer periods and receiving the lower interest rates that banks offer. Thus, some organizations are working to help clients overcome their problems; but as noted, it tends to be debtors with large loans that are able to renegotiate.

It appears that when credit was easier to disburse, MCOs were amenable to increasing loan sums (to add money for working capital, for example) to clients after they had repaid half of their loans. At the time, this made repayment easier for clients with temporary repayment difficulties; but in retrospect it appears to have intensified problems for some clients. At the time, the loan officer was able to increase disbursement, and the client to gain respite; but today, such clients are deeper in debt due to past leniencies. The good judgement of loan officers in their work is really paramount – without it, there is no success for the MCO or for clients. Thus the remuneration schemes for loan officers need to be established with prudence, and institutional growth must focus as much on the practice of responsible finance as on increasing disbursements.

Since the onset of the crisis the issue of financial education has becoming increasingly interesting to the microfinance and the banking sectors, and some new initiatives in this direction have recently emerged. ProCredit bank is distributing at least two compact discs, one on household budgeting and the other on ‘how to talk to the bank’, which explains, for example, what to look for when seeking a loan, how to

²¹ Clients are also often upset because in order to reprogram a loan, guarantors are required for the new, restructured loan, and guarantors are increasingly difficult to find.

best negotiate with a lender and what the costs of loans are and why. MI-BOSPO is spearheading the establishment of counselling centres, first envisioned as resources for the over-indebted, but now likely to offer a broader range of advice. Supported by EFSE, IFC and DFID (Department for International Development), a pilot centre is soon to be rolled out in Tuzla, with the future aim of establishing centres in other parts of the country as well.

Some other initiatives undertaken by IFIs regarding the dangers of rapidly expanding credit should be mentioned. EFSE, KfW and ProCredit Bank have been concerned about the significant growth rates of the MCO-loans since 2008. Since the Central Bank is not in a position to share the data of the Central Registry for an analysis of the indebtedness situation of clients, EFSE has initiated a study based on data provided by a sample of clients provided by several MCOs.²² The study is currently in a final assessment by the various partners involved. Additionally, a conference on Responsible Finance initiated by EFSE and KfW together with the Central Bank was held in December 2009 to contribute to the ongoing discussion and to stress the importance of banks and MCOs not overburdening their clients.

To date, write-offs in the microfinance sector as a whole is less than 5%, which is not high in a global perspective and measures up well when compared with other countries in the region. However, it is a shock and setback for the BiH organizations, which have prided themselves on their professionalism and low delinquency rates. Directors and staff alike are reflecting on what has happened. While they work to clean up portfolios and get them to a reasonable level, microfinance practitioners are now talking about 'getting back to basics' – that is, returning to the basic tenants of microfinance. Lending carefully and responsibly to 'the working poor' to alleviate poverty – certainly no MCOs in BiH have forgotten their missions, but there have been some missteps along the way. Now, the MCOs are considering their paths into the future.

The impasse with the FBiH Banking Agency regarding transformation to for-profit companies comes at an unfortunate time. Presently the foundations have no possible sources of income other than lending; with other ways of producing income, they would be more flexible and better adapted to deal with the current crisis. Also, they have no way to grow with their clients or to provide them the additional services that they need. Small savings accounts that could guarantee tardy repayments and micro-insurance would have been useful for numerous clients today.

2.2 Microcredit Refinance Through KfW in BiH

In the end of 2005, Sida signed an agreement with KfW to enter into a project to provide a refinance line to foment the commercial relationship between banks and microcredit organizations. Sida provided funds of EUR 5 million to this end. The purpose of the project was to make sure MCOs had access to funds for lending at a time when direct grants had in most cases been phased out, while the existing donor refinance lines were in the process of being transferred to a new organization, EFSE, which was not yet fully operational.

KfW signed an agreement with Raiffeisen Bank in mid-2007, and to date Raiffeisen has been the only Partner Lending Institution (PLI). Another bank was involved in negotiations with KfW, but unfortunately no agreement could be concluded.²³ Raiffeisen, in turn, made loans to five MCOs through the fund; almost the entire sum was lent out between June 2007 and January 2008, usually for a term of three years. However, most of the MCOs have already prepaid, repaid on time, or plan to repay the loans after two years; that is during 2009.

Table 2 MCO beneficiaries of the KfW/Sida refinance line²⁴

²² See *Pilot Study: Access of Low-Income Households to Financial Services in Bosnia and Herzegovina*. EFSE.

²³ KfW has indicated that the structure and covenants of the current mandate agreement limit the possibilities of fund management significantly.

²⁴ All tables and diagrams where sources are not specifically indicated are by the authors.

MCO	Sum borrowed in EUR	Repaid
EKI	1,7 million	Yes, one year early
MI-BOSPO	1 million	Yes, one year early
MIKRO ALDI	0,3 million	No, will keep for term
PARTNER	1,5 million	Yes, repaid on time but decided against a second tranche originally planned
SUNRISE	0,5 million	Plan to repay by the end of 2009

2.2.1 Impact of the Refinance Line

Raiffeissen has been one of the primary local commercial lenders to the microfinance sector, beginning in 2005. Although negotiations with KfW got underway soon after the KfW/Sida refinance line was signed in the end of 2005, both KfW and Raiffeissen indicated that due to various constraints and the parallel negotiation responsibilities of Raiffeissen Sarajevo and Raiffeissen Vienna, it took time to thrash out an agreement. Consequently, the agreement with KfW was not signed until eighteen months later, in mid-2007.

Raiffeissen noted that they receive credit lines from supranational organizations, such as KfW, EBRD and EFSE, which also lend directly to the MCOs. Being a commercial bank, Raiffeissen has to add on interest and service charges, and their products are therefore somewhat more expensive than that which goes directly to the MCOs. While they were able to place the refinance line in mid-2007 when demand was still high, by a year later the situation had changed dramatically. While Raiffeissen feels that the credit lines were competitive with other funds on the market until October of 2008, they then had to raise interest rates because their own refinancing costs rose. The MCOs began to repay their more expensive credit lines first, and they are still highly liquid.

Because most of the credit line has been repaid and they expect the outstanding amounts to be paid by the end of the year, Raiffeissen also plans to repay the line early to KfW. The bank is also highly liquid currently, and they have to reduce their liabilities just as everyone else. Also, in the light of the financial crisis they have re-assessed their priorities and do not plan to lend to the microfinance sector in the foreseeable future; rather they will concentrate on their own core business which is their corporate and SME clients.

Raiffeissen feels that they have had a good relationship with the microfinance sector, and has helped them to develop. In addition to borrowing, some MCOs also use the bank's network for their disbursements, a service which the bank first offered them for free but that they now charge them for at the market price. The MCOs are regarded as excellent clients; they do a good job and repay correctly and on time, and reach a part of the market that the banking sector doesn't serve; although with loan limits now at KM 50,000 for the for-profit organizations, there is beginning to be more overlap. While this is a difficult period for everyone, Raiffeissen considers that the MCOs have good loss margins and should be able to weather losses, and that the sector is still of interest to them. They would like to work with them again in the future and will be interested in refinance lines in the years to come, but have had to change their policies at this time due to the crisis. KfW is still interested in placing the line with one or more banks in the country, and have indicated that so far, one other bank, Unicredit, has expressed interest in working with the refinance line and may do so once Raiffeissen prepays.

Interviews were held with the five MCOs that worked with the refinance line with the exception of PARTNER, which answered questions via telephone. The funding goes into general lending in all of these institutions, that is to say the refinance line is not used for any designated purpose or social category and consequently no particular program or groups of clients would be particularly affected if the line were to be withdrawn. Impact would be in the form of a general decreased availability of loans if

disbursement increases and the funds could not be replaced from another source.

Regarding the future availability of funds for lending, EKI was the most concerned about the future. The CEO believes that international investors, while they will stay in the country, will reduce their exposure and lend less, concentrating their lending to certain organizations; this perhaps as a way to speed the consolidation process that so many see as necessary in the sector. She believes that although institutions are over-liquid now, funding is likely to be a problem in the future. As the Bosnian MCOs' performances are worsening and lender criteria will become more risk-oriented, due diligence will take longer and some institutions may lose lenders. While she does not have specific fears for EKI, she believes that smaller MCOs will have more difficulties accessing funding in the future; the situation will resemble that in 2005 (before the funding boom) more than that of recent times.

A possible impact on clients of decreasing access to funds may be that some institutions stop lending for a few months while they collect repayments, something that would be negative for agriculture if it happened at a time when agricultural clients need money to plant, or for clients in trade, if it came at a time when inventories were being built before holiday seasons. Our research with EKI and LIDER clients also showed that some businesses rely on a steady flow of loans, and that the agricultural cycle is sensitive to lack of funding.

EKI views Sida's decision to cease direct support to MCOs with regret, as this kind of support permits cheaper loans and also the testing of new products, as was the case of housing loans that were rolled out through the Sida/World Vision project in which EKI participated. The need for direct funding was echoed by all the MCOs interviewed; direct funding eliminates intermediaries and is thus less expensive and allows for greater flexibility. EKI also indicated the great value of loan guarantees. In order to borrow from local banks the MCOs need to put up collateral, and the loan guarantee funds allow banks to increase the size of their loans to the MCOs; otherwise loans must be collateralized fully. For EKI, repaying their commercial loans was a business decision, a strategy designed to give them more alternatives for finding future funding. They wanted to free their collateral. Price is not the only thing that determines where one borrows; it is only one of many parameters. EKI recognize that they need a diversified funding strategy in order to be able to provide affordable and timely loans to their clients.

SUNRISE and MI-BOSPO shared many opinions regarding future funding availability. Both institutions are very liquid at the moment, and repaid the KfW/Sida loan because it was one of the costliest for them. MI-BOSPO cited the rise in interest rates as a decisive reason for prepaying, although with certain concern, fearing refinance lines might be pulled out if several institutions repay too soon. Neither organization expressed any fears that funding may dry up in the future; both believe that international investors will stay. MI-BOSPO noted that with future EU accession, the need for microfinance is likely to eventually decrease.

MICRO ALDI is a small organization operating primarily in the south-eastern part of the country, but also in Pale, Sarajevo and Trebinje. For them, the KfW/Sida credit line, which they signed in March of 2009, is one of the best deals they can get, cheaper than what is offered by domestic banks, and also less expensive than that offered them by EFSE. Therefore they do not have any plans to repay the line early. They are not concerned about finding funding in the future, but believe that it will be available; the question is what it will cost. Depending on the costs to the organization the loans will be more or less expensive for clients, and therefore the main impact of the withdrawal of the KfW/Sida credit line would be in the cost of loans to clients, rather than a shortage of funds for lending.

2.2.2 Future Funding for MCOs

At the time of the interviews for this review, most of the international financial organizations interviewed (EBRD, EFSE, IFC, KfW and World Bank) were not particularly concerned about a potential lack of funding for microfinance in the upcoming years. They pointed out that the institutions themselves are liquid, that they are decreasing their disbursements and aim to reduce their portfolios to more realistic levels. It is also possible that there will be consolidation in the sector, and that new configurations will have more diverse means of funding operations. The banking sector is also over-liquid, and several international banks have agreed not to transfer excess funds to their mother banks abroad. As they have to place their money somewhere, the microfinance sector should attract some of these commercial funds. Also, there is no evidence so far that international investors, particularly social investors, are going to be leaving the scene; they may lend less and in a more focused way, but this is not regarded as something that is likely to be prejudicial for the sector. Funds may be shorter-term and more expensive, but they should be available. However, KfW noted that one might question whether local banks will be available for funding MCOs when their liquidity decreases, and indicated that the current discussions regarding whether financial institutions are too conservative in lending and if private business is suffering due to a lack of funding also has some relevance for the microfinance sector. It may also be more difficult for MCOs to access funds to match maturity requirements in upcoming days.

There is a consensus among the IFIs and the FBiH Banking Agency that the microfinance sector must consolidate, although they have different opinions as to how it should be achieved. MCOs leaders themselves have long discussed mergers – with few results – but the pressures of the current situation should lead to more productive discussions. Nonetheless, outcomes are unsure. One scenario is that the future will see two or possibly three larger organizations, working either as for-profits or as microfinance banks, and a handful of smaller organizations – foundation or for-profits – that specialize in certain types of lending (agricultural, to women, solidarity group) and/or in certain regions.

To sum up, although the funds of the refinance line were quickly lent out by Raiffeisen, most of the money has since been repaid due to the effects of the financial crisis. The MCOs are over liquid because they are collecting loans and are much more cautious in disbursing, due partly to concerns about over indebtedness and partly to clients' inability to absorb increased credit in the economic downturn. They are taking advantage of their liquidity to repay some of their obligations, and repay the more costly funds first.

The refinance line appeared in the BiH refinance market at a time when international investors were 'discovering' the MCOs and there was a surplus of funding available. Thus it did not have a large effect on the market, and as the cost of the line has risen with the financial crisis, the MCOs have for the most part repaid it. At present it does not appear that a withdrawal of the refinance line would prejudice the MCOs or their clients. The organizations are over-liquid, not disbursing at previous levels, and have already repaid the loans. They do not foresee problems in financing lending in the future, other than EKI, which is more concerned about the smaller MCOs' access to funds than its own situation. The IFIs do not think there will be a problem, either; funds are likely to be available; the question will be how much they will cost. These opinions are qualified by nearly everyone, however: if delinquency should rise substantially and losses grow, the situation could change in a few months. Much depends on the developments in the coming half year, and while several institutions note that delinquency seems to have levelled out, they also fear that the first months of 2010 will be tough ones for clients. Consequently it is difficult to predict how things will look in a year's time.

2.3 Direct Support to EKI

EKI is currently a microfinance foundation, and is headquartered in the Federation, although it has offices and lends throughout the country. Thus it is supervised by the FBiH Banking Agency, and as a foundation, can only make loans of up to KM 10,000. EKI would like to transform into a for-profit, and has applied to do so.

Between June 2004 and September 2008, World Vision and EKI used direct funding from Sida to develop a new housing loan product and a new methodology that merged community participation with a business approach. A Housing Credit Branch was established and fully equipped in Gradačac, Northern Bosnia, and six staff were hired and trained to apply the new methodology. Nine municipalities with more than 70 local communities were included in the project activities. By September 30, 2008, a total of 1,820 housing loans were disbursed in the amount of nearly KM 10 million, with the portfolio at risk over 30 days less than 0,8%. Under the new methodology the input of a significant number of local representatives on a committee board was included in making assessments of loan clients' eligibility, and in providing advice and assistance to loan officers. This methodology proved to be successful and was introduced to all EKI branches together with the new product. Housing loans are now disbursed to EKI clients throughout Bosnia and Herzegovina, currently making up about 6,6% of the total portfolio.

Besides housing, the project supported the disbursement of business loans and contributed to building the capacities of businesses. A total of about KM 2 million was disbursed in loans to 333 loan clients for business activities and income generation. Of this, 70% were disbursed to clients from marginalized groups (returnees, displaced, female-headed households etc). The cooperation between World Vision and EKI in terms of the assessment of potential clients and businesses and the distribution of loans to rural areas and marginalized groups was excellent. As part of the project, loan clients who paid on time received part of their interest payment back as a grant when the entire loan had been repaid. The money was a happy surprise for most of them, and was intended for the further development of their businesses.

2.3.1 Impact on Beneficiaries

In this evaluation, structured interviews were conducted with a random sample of EKI clients who had participated in the program in five locations where the program, which as indicated focused primarily on housing and in rural areas, operated. Gradačac, in the north-eastern part of the country, is a primarily agricultural area, well-known for fruit production but also with a dairy, Imner Ltd, acquired in June 2007 by the Croatian Dukat dairy industry, which itself had joined Lactalis Group, the leading European and global dairy industry, in May of the same year. Modrica is a town near Gradačac where there is a substantial Bosniak returnee community. Bosanski Brod is an agricultural area near the Croatian border, the site of a large oil refinery that after being closed for many years, began to operate under Russian ownership in early 2009. Han Pijesak and Vlasenica are two towns located in the eastern part of the country. The area is basically agricultural but also contains forests, and a state-run and several privately owned sawmills operate in the area.

The sample breakdown regarding location, gender, family status and type of loan is as follows:

Table 3 Sample at EKI

Location	Men	Women	Married-couples	Families ²⁵	Income generation ²⁶	Business	Housing	Total clients
Gradačac	7	4	7	8	4	4	3	11
Modrica	4	1	5	5	2		3	5
Bosanski Brod	14	9	16	17	16	2	5	23
Han Pijesak	12	3	13	13	12	3	0	15
Vlasenica	4	2	5	4	4	2	0	6
Totals	41	19	46	47	38	11	11	60

²⁵ That is families with children living at home.

²⁶ Consumption loans were not supported by the World Vision/EKI project and were therefore not a part of the EKI sample.

In Bosnia it is customary for the man to be regarded as the head of the household and to be the signatory for family loans, particularly housing loans. But not all families necessarily follow traditions. Thus the gender of the client is not a sure indication of who the beneficiary is, or who is carrying out the work involved in an enterprise. While most often we made appointments with males, who were the signatories, not unusually - especially in the case of agricultural income-generation loans – we would hold the interview with his wife, who was involved in the business and had time for an interview, while her husband was occupied elsewhere.

As the Terms of Reference (ToR) indicated that the focus of the assessment should be on the impact on business and income generation activities, the sample is weighted in favour of these types of loans, even though the provision of housing loans was the main focus of the project that Sida supported. However, we considered that it would be interesting to see the impact of housing loans and how they were used, so we did include some such beneficiaries in the sample. EKI was one of the first MCOs to start housing loans in BiH, and these loans are of interest because it is difficult for low-income people with irregular incomes to obtain a housing loan from a bank. While donations from bilateral and multilateral donors have helped Bosnians reconstruct after the war, they have only reached a fraction of the population, and only cover a part of the costs of reconstruction in the majority of cases. And today, thirteen years after the end of the war, young families face great difficulties in establishing their own home.

Housing loans

The housing loans in the sample were for sums between KM 1,000 (used to pay a fee to bring municipal water to a farm) and KM 20,000 (used to buy an apartment). But most loans were for between KM 3,000 and KM 6,000, and were used for improvements in the home, replacing leaking pipes, tiling bathrooms, improving kitchens, and for buying doors and windows. In three cases a home was being enlarged to make space for a married son and his family, in four cases a house that was badly damaged in the war was being repaired. Usually the repair and reconstruction process has been ongoing for several years, and the loan provides access to a lump sum that enables substantial improvement, sometimes making the house inhabitable, sometimes finishing a long rebuilding process. Interestingly, these housing loans tend to provide jobs, as few of the clients are able to undertake the work entirely themselves – although families do work together, and sometimes friends and neighbours contribute work free of charge. The clients in the sample hired workers from between two and 110 days, but usually the days of work contracted were difficult to calculate. Workers may come to work on a project for a few hours a day after their regular jobs, construction may be held up by bad weather, family responsibilities, and so on. Most are paid in cash; some may work for return favours or other types of in-kind payment. The important thing to note is that housing loans generate not only improved living conditions for the beneficiaries, but also increased economic activity: that of labour contracted and purchases of construction materials, including wood products such as doors and windows from local suppliers. Thus the benefits are quite varied; a private space for a young couple, better-insulated windows that reduce heating bills, the possibility of returning to live in a home damaged by war.

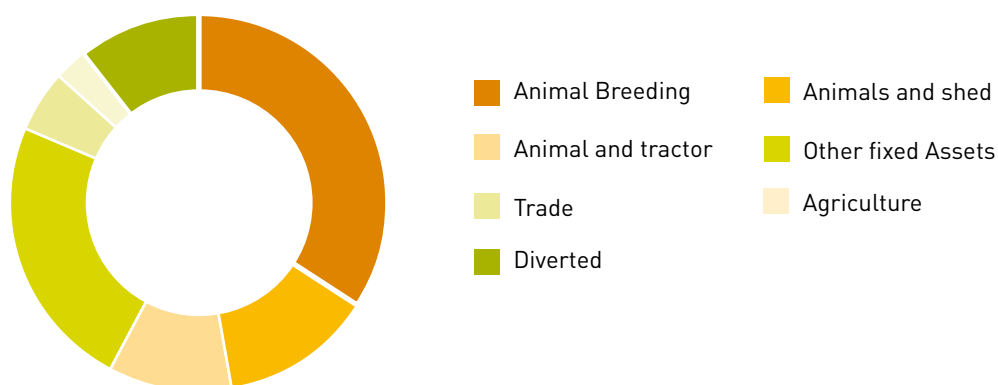
The housing loans are among the most-appreciated, especially by women who sometimes are the signers for the loans (although, again, traditionally the man of the house will be the signer for housing loans in Bosnia). Problems arose in three of the cases in the sample, however. In one, the husband lost his job and the couple were not able to continue paying the steep monthly instalment (KM 2,000) for the housing loan; in another the family had no regular income, which made every payment was a struggle. In a third case, the entire pension of the father of the family (which is the only regular income) goes to pay microloans for the various family members that share the home, and when the pension is late they are all hard pressed to pay on time – all of the adults work, but irregularly.

Business and individual loans

According to the evaluation of the World Vision/EKI project,²⁷ 127 new full-time and 102 part-time jobs were created through the business and income generation loans. Training workshops on livestock breeding, fruit and vegetable cultivation, marketing, networking and information technologies were organized for these loan clients/beneficiaries and other community inhabitants, involving over 700 participants. Project funds also contributed to an increase of market linkages via visits to and exhibitions at agricultural fairs to help participants establish contacts with potential suppliers and food-processing companies. Several cross-learning visits to successful agricultural producers in BiH were organized as well. As a large majority of the loan clients were engaged in livestock breeding or milk production, most of the networking activities were related to providing support and establishing contacts in this sector. Many clients were supported in the creation of business plans to facilitate their business development in the future, as well as to help them to get new loans from the other credit providers in Bosnia and Herzegovina. The delinquency rate for the business/income generation loans was very low (0,24%) and only one loan was written off.

Most of the business loans in the sample were used for animal breeding. In the environs of Gradačac many borrowed to buy cattle for milk production, while in the Bosanski Brod area pig production and bull fattening were the predominant activities. In both areas, corn was raised for animal feed, and having enough corn for silage to feed ones cattle was especially important for milk producers in order to be able to stay in production when milk prices fell. Loans were thus made for increasing herds or beginning a cycle of production, as well as for animal sheds and tractors or tractor machinery. In agriculture, mostly in the Gradačac area, flower and vegetable cultivation were other activities, and one client was in the process of establishing an orchard. Besides sheds, tractors and machinery, fixed assets financed with microloans included greenhouses, a delivery truck, repairs to a truck and a tractor motor, and improvements such as flooring, and asphalt paving for work spaces. Only two clients used loans for working capital in a shop.

Diagram 3 Purposes of EKI business and income generation loans.



The fungibility of loans is a concern within microfinance - if loans are not invested in productive activities it might be more difficult for clients to repay them. Four income generation loans for agricultural purposes were diverted for other ends. Two were used for house construction (one of these also financed an operation for the borrower, who is a war veteran), in one case the entire loan was used for working capital for a carpentry shop, and in the fourth case the agricultural loan was used to finance a niece's education. All these loans were repaid, however.

²⁷ See World Vision/EKI, 2008, for the complete evaluation of the World Vision/EKI project supported by Sida funds.

In most cases the loans granted in the World Vision/EKI project were disbursed between 2005 and 2007 for a term of three years and have been paid off; only a few are still active. The majority of the borrowers feel that the loans were beneficial and improved their income, although it was difficult for most of them to calculate how much their income had improved. This difficulty can have to do with the fact that the loans were granted about three years ago. But is more likely because few of these entrepreneurs have any recorded bookkeeping, and the business income is conflated with other income (salaried jobs within the family, odd jobs, in-kind payments, other business activities, remittances) into the family budget. Into the debit side goes the continuous daily needs of the family, and other expenses (illnesses, weddings, educational costs, travel to visit family, house maintenance and reconstruction), and the costs of the business and of occasional setbacks (a calf dies, the corn harvest is poor, a machine or vehicle suffers damage) along with the costs of servicing the loan. How much money do I earn a year? How much of that is attributable to the loan? What percentage is that of my annual income? How long did the people who helped me build my cowshed work for me? In hours? In full working days? We found such questions tricky; perhaps not impossible to answer, but requiring lengthy and detailed discussions with clients beyond the scope of a review of this sort.²⁸ It also occurred to us that loan officers are those best placed to provide information regarding the income likely generated by loans. They are at home in the world of economic measures, are in touch with their clients, and monitor repayments - yet their knowledge is underutilised in microfinance assessments. The important question is, however, what would we really know, if we could put a firm number on the amount of income, or 'economic benefit' that a microfinance loan generates in monetary terms?

Currently 57% of the sample have some other source of income, either very small, such as an old-age pension (sometimes a parent's), or larger – a job of some kind held by themselves, a spouse or an unmarried child. Many of the clients living in Bosanski Brod were now employed, or had a family member employed in the recently opened oil refinery (but had not been employed at the time they received the loan, as the refinery was inactive for many years); others were chauffeurs of trucks between BiH and Croatia, and some were employed in the wood industry around Han Pijesak. The loans generally provided funding for an activity that produced additional income, and occupied some member(s) of the family. Such incomes improved the material life of the family, and were sometimes used to educate children, sending older children to high school or to university (five cases), but usually just provided more money for daily needs, children's needs, and possibly for housing improvements and expansion of the business.

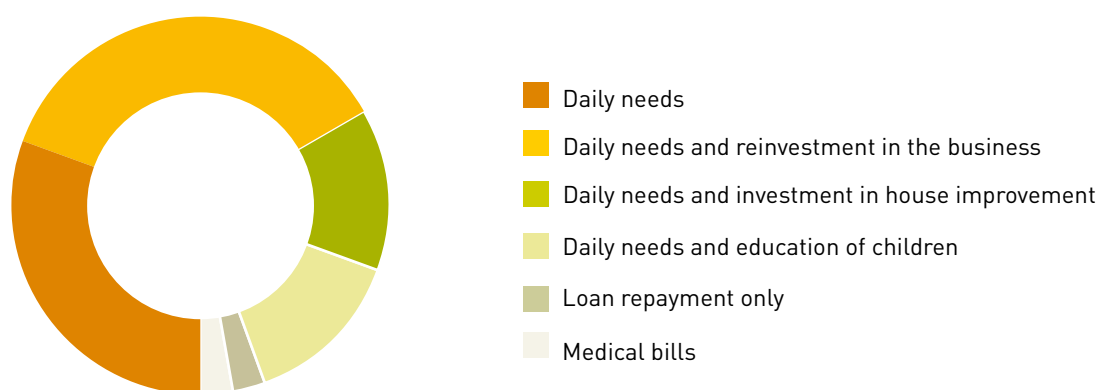
Of the 49 clients who took loans for income generation or a business, 37 said that they had increased their income due to the loan. Three were unsure whether there was an increase or not, and nine had not increased their income. Twelve (20%) of the clients were able to quantify increases, which ranged between KM 3,000 a month (for a young man whose father borrowed to set him up in milk production when prices were favourable; he had no income prior to this) and KM 1,000 monthly saved by a craftsman on transport when he was able to buy his own delivery truck, to circa KM 150 a month, earned from pig breeding. Clients earned money from the sale of milk from cows they bought, and from the sale of animals they bred – bulls, sheep, pigs and chickens, and one farm for pedigreed dogs – as well as from the rental of the services of tractors or machinery they acquired (plus the savings on renting from others). Fixed investments such as animal sheds and stables did not bring in income, nor did the investments in workplaces, but these were also experienced as necessary.

Most of the loans that EKI gives are for income generation. In some cases, clients are registered as businesses (for example, milk producers) in order to be able to access a state subsidy for milk production. However, one loan officer estimated that only 1% of their clients could be considered businesses, in the sense that they made a continuous effort at formal bookkeeping. Therefore it is not surprising that cli-

²⁸ See Gudeman (1978) and Gudeman and Rivera (1990) for discussions of the reasoning processes in rural economies.

ents have difficulties estimating increases in earnings. Business income goes into the family budget and flows into the needs of the family and the business, what remains when these costs are paid is often reinvested in the home or in business improvements, or if children are of a certain age, in higher education. Although certain micro-entrepreneurs are excellent at ‘keeping the business books in their head’, the lack of formal bookkeeping makes it difficult for some others to see when they are losing money (particularly in the case of shops and loans for working capital) before it is too late to remedy the situation.

Diagram 4 Uses of income generated by EKI loans



The loans led to an increase in household wellbeing as measured in expenditures, fixed assets, and savings. Thirty-eight clients increased their fixed assets. If housing improvements were to be added as increase in fixed assets, even more EKI clients could be said to have increased fixed assets as a result of Sida funding.

Only thirteen clients reported that they were able to save. However, savings are frequently held in the form of investment in the house or home, in cattle or raw materials, and some small funds held in the house in case of illness or other pressing obligations. Savings accounts seem to be few and far between, and quite a few clients pointed out that the interest generated on such accounts was so small that it was wiser to invest in the business or the home. Investments in property are considered to be the safest and most lucrative form of savings. Many of those who lost, or whose families lost money in the bank failures during and after the war still do not feel that it is safe to save in banks, but a handful pointed out that it was riskier to keep savings in the house, where they can be stolen, or more probably, spent to cover daily expenses.

All but three clients in the sample used the loans themselves. One woman borrowed for her husband and one man took a large loan for his son, but in each case the money was invested in income generation. In one case an older man with an animal farm borrowed money which he gave to his niece for her education.

As time has passed since the EKI clients took loans, it is also possible to say something about the success of their micro-businesses over time. Unfortunately, several of the milk producers have had to sell their cows due to falling milk prices and the pressure of loans. As prices rose milk production became attractive, but when they fell, those without enough land or other resources to produce feed for their cows found that they were losing money. When milk subsidies were late the situation became urgent for some larger producers who had taken bigger loans, and some sold part of their herds to repay loans. Those who breed animals also suffered due to fluctuating prices; sometimes imports resulted in decreased prices. It is obvious that the fragmented agricultural policy, lack of a well-regulated economic space and undependable subsidies all contribute to making life frustrating for the small producer as well as the large; and microloans well invested, constant work and high hopes can easily come to nothing when economies fluctuate, or policies are not in place and institutions do not function efficiently. Loans are

indeed a stimulus to entrepreneurial activity and did create the basic conditions necessary for people to undertake production, but they are far from enough to guarantee success for small producers regardless of how much time and energy is invested in the undertaking. Nonetheless, numerous clients expressed heartfelt thanks for their loans from EKI, indicating that it was the beginning of relative prosperity for them: ‘Without the loan I would not have anything I have today,’ and ‘Without the loan I would be a poor person working for others’ expressed the feelings of quite a few of our interviewees.

One strong argument for the benefits of microfinance is that it helps to create jobs. In the sample of EKI clients, most of the loans to businesses led to an improvement in income for the business and job creation for the beneficiary and the community, too. Loans were directly creating employment in every fourth case of the sample. Four clients had been able to provide full time employment for a total of five people, while seven clients are hiring 22 people according to seasonal need (from between 10 days to 3–4 months a year) as a result of their loans. The fulltime jobs created were mainly in wood cutting businesses, while part time jobs are in agriculture, mainly in greenhouses. And as noted above, housing loans also create employment opportunities.

2.4 Direct Support to LIDER

Through the LIDER project, Sida granted EUR 1,5 million in loan capital only (i.e. no operational budget) to support the sustainability of MKF (Microcredit Foundation) LIDER as a microcredit organization. The project was designed to build the capacity of LIDER, turning it into a viable and sustainable institution that will continue to improve the social and economic status of low and medium-income populations in BiH through microlending. LIDER is an interesting organization because of its particular methodology of focusing on lending to businesses that are members of business associations in certain areas of the country. It is possible that such a focus on registered businesses could create more jobs in the formal economy and business growth than income generation lending, the more usual focus of the MCOs in BiH.

Under the auspices of CHF and during the life of this project (2004–2008), MKF LIDER has achieved the following results:

- 14,419 new loans disbursed in the amount of KM 37,294,800; and 5,420 active clients with a portfolio outstanding of KM 11,395,203²⁹
- MKF LIDER reached a 149,57% operational sustainability ratio and a 122,82% financial sustainability ratio
- MKF LIDER has secured and used additional loan funds from commercial sources

MKF LIDER is headquartered in the Federation, and is supervised by the FBiH Banking Agency. It does not operate in the RS. Currently, it provides access to loans for SMEs and individual clients in Central Bosnia, Zenica-Doboj and Sarajevo Cantons.³⁰

2.4.1 Impact on Beneficiaries

We conducted structured interviews with a random sample of all LIDER clients from some selected municipalities: Sarajevo, Ilidža, Ilijaš, Kakanj and Zavidovići. As with many other major cities, Sarajevo’s economy is largely based on industries such as manufacturing and on tourism, and since it is the national capital and center of various levels of national and local economic and political administration, many people also work in government. Although the war had a devastating effect on the city’s economy it is recovering, and currently has industries based on food processing, electronics, and manufacturing. Ilidža is the chief suburb of Sarajevo. Ilijaš is a town and municipality located northeast of the city of Sarajevo;

²⁹ See Table 1 in Annex D for a comparison of LIDER and other MCOs in Bosnia.

³⁰ MKF LIDER, *Lider project Final Report (Sep 04–Jun 08)*

most of its inhabitants depend on the economy of the capital. Kakanj is an industrial municipality in central Bosnia where a thermal power plant, cement factory and coal mine are the main sources of employment; the coal mines employ about 2,500 people. Zavidovići, is located in Central Bosnia, about 100 kilometres from Sarajevo. Its economy is completely based on Krivaja, a big company dealing with logging and wood processing that employed 15,000 workers before the war. Due to war damage, the loss of the international market during the conflict and a complex process of privatisation the company now employs only circa 3,000 people. Krivaja's story is similar to that of most large state companies in BiH. Although substantial human resources exist, a long-term industrial culture and a concomitant limited interest in entrepreneurship contribute to the creation of the 'new poor' in BiH.

The sample breakdown regarding location, gender, family status and type of loan is as follows:

Table 4 Sample at LIDER

Location	Men	Women	Married Couples	Families ³¹	Income generation	Business	Housing and consumption ³²	Totals
Ilidža	4	4	6	6	2	5	1	8
Iljaš	5	5	9	8	3	4	3	10
Kakanj	4	2	3	5	0	1	5	6
Sarajevo	9	5	11	14	1	12	1	14
Zavidovici	11	2	13	12	2	9	2	13
Totals	33	18	42	45	8	31	12	51

Housing loans

The housing loans in the sample were for sums between KM 1,000 (used for a toilet, and the client only bought part of what was needed, lacking the money for pipes and tiles) and KM 8,000 (used to construct the roof of a new house). But most loans were around KM 3,000 and were used for reparations to roofs or other areas of the home, for bathrooms, and for buying doors and windows. In two cases families were able to leave a house in village and gain access to school and job in a new location, but in most cases loans were simply to improve living conditions and reconstruct old houses. The clients in the sample hired workers from between 15 and 180 days, but here, too, the days of work contracted were usually difficult to calculate. The important thing to note is that without housing loans, owning habitable homes would very difficult for 30% of clients, while the rest think they could have managed, but the process would be much slower; indeed, it is still slow since MCO clients are not capable of repaying larger loans in the short repayment periods (three years, at the time loans were approved). The need for housing is still high in BiH, and business clients with small businesses offering construction materials and producing doors and windows say they have not yet felt serious effects of the crises. As previously mentioned, housing loans generate not only improved living conditions for the beneficiaries, but also increased economic activity.

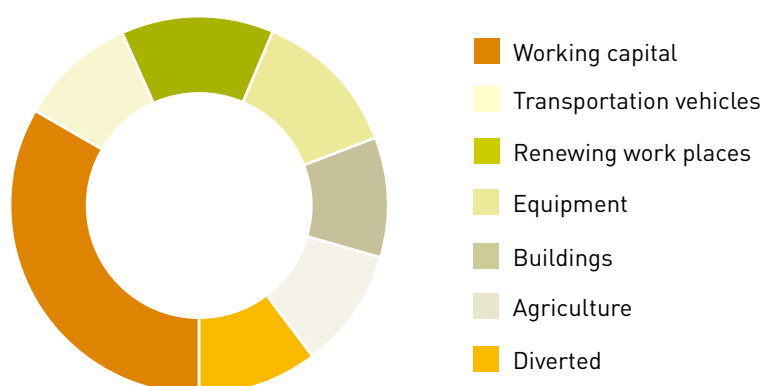
Business and income generation loans

Most of the business and income generation loans in the sample were used for trade, for working capital or fixed assets for shops, food services (restaurants, cafés, fast food outlets, etc), provision of services (like hairdressers, tailors, taxis and carwashes), and businesses selling or producing construction material including doors and windows. Only three loans were invested in the agricultural sector. In most cases loans are invested in working capital (11 cases) but also in fixed assets like cars and transportation vehicles (4 cases), the renewal of work spaces (4 cases), or equipment (4 cases). In two cases loans were used to purchase buildings/salon, and sometimes the loans were used to pay outstanding bills, as in the case of one pensioner living on a very limited income.

³¹ That is families with children living at home.

³² Only one interview was conducted with a client who used a consumption loan. Findings from this visit have been excluded from the analysis.

Diagram 5 Purposes of LIDER loans.

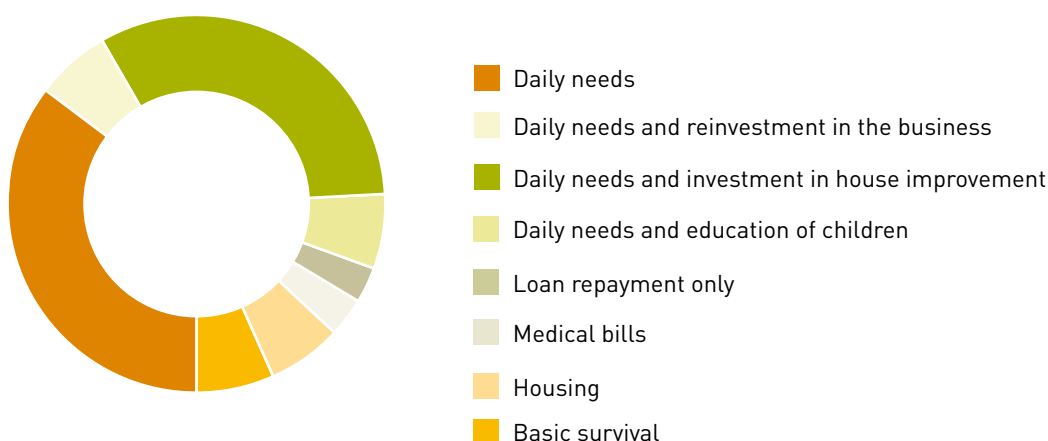


Four loans for income generation and businesses were diverted for other ends, in three cases for housing and one for a son's driving license. In at least one case a business loan was taken instead of a housing loan because the interest rate was lower. In some cases people took loans for others: one man borrowed for his father, since he is retired and could not take a loan, another for his brother who has liquidity problems, one for his son to build a house, and one woman gave money to a friend for family needs.

Around half of the LIDER sample had active loans from LIDER at the time of the review. The vast majority of the borrowers feel that the loans were beneficial, and improved their income, although it was difficult for most of them to calculate how much income actually improved. Three of the cases in the sample reported that it was difficult to collect money for paying the instalments, yet none were late with loan repayments at the time.

Currently 54% of the LIDER sample have some other source of income, either very small, such as an old-age pension (sometimes a parent's), or larger as do some war veterans or decorated soldiers. Some had income from a spouse or an unmarried child. Of the 39 clients who took loans for income generation or a business, 19 said that they had increased their income due to the loan, while the rest have kept the operation at the same level and continue to have the same incomes. Only a few clients were able to quantify increases, which range between KM 100 per day, for a loan invested in a transportation vehicle for a bakery business, and KM 550 a month, for a trade shop in Sarajevo that invested in goods, to KM 200 earned from cattle breeding. It is interesting to note that even though the number of registered businesses in the LIDER sample is greater than in the EKI sample (nearly three times as many respondents), and loans were not made as long ago, it was no easier for clients to quantify improvements in their income due to the loan.

Diagram 6 Uses of income generated by LIDER loans.



In the case of LIDER clients, too, loans led to an increase in household wellbeing as measured in expenditures, fixed assets, and savings. Twenty-three clients have been able to increase fixed assets with the loan. If housing were added as an increase in fixed assets, almost 70% of the sample has increased fixed assets as a result of Sida funding. Such a high placement of the loans in fixed assets might be due to many businesses still being relatively young and requiring investment in basic business premises, vehicles, equipment and machinery.

From the total portfolio of KM 443,100 disbursed to 31 businesses in the sample, six clients had been able to provide full time employment for seven people and two part-time employments in bakeries, an engraver, and the wood industry. One might thus conclude that a disbursement of circa KM 55,000 creates one employment.

Thirteen clients said that they are able to save, of which only a few have savings in cash. Savings are much more likely to be reinvested in the business and kept in stocks and inventory, while there are two cases of savings in health insurance. All agree that these days it is difficult to save, and more profitable in any case to invest any surpluses.

Surprisingly, most of the businesses with construction materials did not feel the consequences of the crises and maintain the same level of sales; we deduce that this is because most of them work locally with small clients, and are not suppliers to large builders who are feeling the crisis. On the other hand, small trade shops and service providers have had a significant drop in sales. The main problems they are facing nowadays are a lack of cash, as suppliers have in many cases decided to stop providing goods and materials on credit.

2.5 Multiple Loans and Client Concerns

The MCO clients we interviewed have a high degree of loyalty to the MCO they work with, although this was more notable with EKI clients than with LIDER clients. Often they had started to borrow from EKI because it was first to move into an area, and then, having built a relationship with a loan officer, continued to borrow from the organization. They cited the ease and rapidity of the loan process as something that they looked for when taking a microcredit, only a handful said that they compared interest rates. LIDER clients were more concerned with rates, however, and many believed that LIDER had the best rates in the market. Others claimed that all the organizations are much the same regarding rates. Clients seem to approach other organizations when they need more money than they can get from their MCO, or need it for a different purpose than for which they usually borrow. Some small businesses such as kiosks and hairdressers used many loans from different organizations, often having three or four simultaneously, borrowing from different organizations in different cycles.

As noted above, the issue of multiple loans and over indebtedness has come to the fore within the microfinance industry as late payments and delinquency have risen during the past year. Part of the premise of microfinance is to retain clients, so that they build a credit history and gain access to larger loan sums as their incomes grow, but clients who take loans with multiple organizations make it difficult for loan officers to assess their repayment capacity. In our sample, 51% of all EKI clients acknowledged having more than one loan simultaneously, while the figure for LIDER was lower at 45%. Only four EKI clients and 10 from LIDER have had only one loan and not borrowed again; often clients were repaying current loans to be able to take a new one. Thus there needs to be appropriate monitoring to assure that new loans are not a result of liquidity problems due to a previous loan. Yet multiple loans need not lead to repayment difficulties; they can also be a consequence of relatively strict lending regulations, or participation in the grey, undocumented economy, which is substantial in BiH.

Diagram 7 Percentage of clients with bank loan.



Supposedly microfinance is targeted at low-income people who are unable to access formal credit such as bank loans. While some clients had applied for a bank loan but been rejected as ineligible for one reason or another such as lack of a regular income, an insufficient income, or lack of a guarantor with a state job, we found that a surprising number of clients did have bank loans, often simultaneously with their microcredits. Bank loans were used for housing, cars, business premises, and business equipment. There was one case of leasing. The figures for LIDER and EKI are quite different - probably because of differences in the sample, as the LIDER sample contained more registered businesses and was more concentrated to urban areas, and possibly also due to the timeframe, as banks lowered their lending requirements in 2007-8. Other clients with unregistered businesses or income generation activities said they found the banks procedures too complicated, and that they knew they could not meet the criteria. Some relatively large businesses also said that they did not approach banks because application procedures were too complex and time-consuming.

Registered businesses appear to decide to continue taking microcredit loans because they are loyal to the credit organisation, have a credit history with them, and the loans procedures are fast and simple. Those with bank loans also use MCO loans because of the fast and flexible procedures, as additional credit for a larger investment, or sometimes to cover some sudden costs or obligations in unpredicted situations.

In general, trust in the banks for savings is low among clients in the sample. Only 27% think savings are safe in banks. A quarter of all interviewees did not know or did not have a comment, while many others say it is better to invest in the business, or invest in properties as this generates more income.

Clients are thankful for the existence of microloans, and also have definite ideas about how these might be improved. The need for guarantors is the primary complaint; it came up in all the focus groups and most of the interviews. Guarantors are problematic for several reasons: some clients do not know many people with permanent jobs well enough to ask them, other clients feel uncomfortable requesting this favour. Those who do have jobs may already be guaranteeing others – especially their own family's – loans and not be able to take on more obligations. Asking someone to be a guarantor is like asking them for a favour, putting oneself in a position of social indebtedness. Finally, fewer and fewer people agree to take on this role today, when the newspapers carry accounts of how guarantors are increasingly having to step in to pay the loans of others – often mere acquaintances at work, for whom they have guaranteed loans. Accounts of overindebtedness and the plight of guarantors are circulating in every community; we heard numerous stories about people affected, and there were clients in our sample who were paying the loans of others in addition to their own. While clients understand the need for guarantors in the beginning when they start to borrow from an MCO, they do not understand why guarantors

are still required when they have repaid several loans successfully, thereby proving their honesty and creditworthiness. And as much of the microfinance rhetoric uses the idiom of ‘partnership’, clients do not understand why their ‘partners’ the MCO never trust them enough to forego the guarantors that are so difficult to find. Many clients have assets – business premises, vehicles, equipment, and homes – that they would like to put up as collateral instead of having to find guarantors. But this is not an alternative in most cases, which is also difficult for them to understand. Thus, better ways of guaranteeing loans are first on clients’ wish list for better products.

Second is lower interest rate. Everyone recognizes that the cost of the loans is high. While some use them anyway because they have no alternatives – ‘you can’t do anything without loans,’ was a frequent comment – others take the high cost in stride and seem to prefer paying the high price to undergoing the onerous and time-consuming process of getting a bank loan, although they qualify and it would be cheaper. What clients also object to are fees, added interest if payments are late, and the fees applied if one repays a loan before it is due and takes a new one. ‘If one of my clients buys cement, and then later comes and tells me he needs more cement, I don’t charge him for coming to buy more,’ one client reasoned, ‘So why does LIDER charge me when I come to increase my loan?’ In practice the MCO treats this as a new loan, and charges a fee.

Grace periods would also be appreciated, especially for investments in the agricultural sector. Several clients pointed out the difficulties of having to begin to repay immediately, although income was a few months off in time.

Although microcredit loan procedures are simple, some clients, particularly those from LIDER, wished for even simpler procedures, and thought that the questions asked by the loan officer were a bit too personal and probing.

Three clients also recounted cases of fraud that they wanted to resolve, but did not know how to proceed. All cases concerned pensioners, who were now responsible for repaying loans that they had not taken nor guaranteed (but not with EKI or LIDER). In one case, the loan had been taken in a client’s name without their knowledge by an ex-wife. In two other cases, loans were taken by friends, and the pensioners cited as guarantors, but they claim to not have agreed to be guarantors or to have signed the papers. The first they knew of the situation was when the MCOs called them because the client’s monthly rate was late. In all cases the sums were quite high – higher than someone with a quite low pension could reasonably guarantee – and the loan officers responsible for the loans were no longer working at the MCOs. When the victims had contacted the MCO, the situations had not been resolved, and the payments were being deducted from their already meagre pensions. Thus it seems that mechanisms are not in place to resolve cases of fraud which do occasionally arise.

2.6 Conclusions

In this impact review we have looked at the degree to which microlending in EKI and LIDER has led to improvements in income, investment in assets, job creation, and savings for clients. Hypotheses to be proved are that:

loans to businesses led to an improvement in income for the business and job creation for the beneficiary

loans to individuals lead to an increase in household wellbeing, as measured in fixed assets, expenditures and savings

Table 5 Impact of Sida loans on clients in samples at EKI and LIDER

	Clients with increased income due to loan	Clients with investment in fixed assets due to loan	Job creation due to loans	Clients who say they are able to save
EKI (60 clients)	37 (of 49 non-housing loans)	38 (excluding housing loans)	5 fulltime, 22 part-time (mainly seasonal)	13
LIDER (50 clients)	19 (of 39 non-housing loans)	23 (excluding housing loans)	7 fulltime, 2 part-time	13

As can be seen from Table 5, microloans did increase incomes for clients, although more for EKI clients than for LIDER clients. Loans also increased fixed assets. Many of the EKI loans were granted for more than one purpose (i.e., for a cow and a cowshed) which makes the investment in fixed assets quite high in the case of the EKI sample; LIDER clients were more likely to have used the loan for a sole purpose, for example, a fixed asset or for working capital. Jobs are created due to the loans; the jobs reported here were for employees that were not members of the immediate family and were thus regarded as ‘hires’; were one to consider the labour of the client and the family labour that goes into these enterprises, the numbers for job creation would be substantially higher. Savings are somewhat more problematic; clients regard savings as cash put away for the future, but are more often saving in kind, investing in the business or the home.

To sum up, income generation loan clients at EKI and at LIDER do feel that the loans improve their lives, and make more things possible for them. They create streams of income for some, or help smooth consumption during difficult periods; they create and maintain jobs for the individual, and sometimes help create seasonal, part-time and permanent jobs for others. This is entirely in keeping with the findings of earlier assessments of microcredit impact in Bosnia, such as the evaluations carried out for the World Bank LIP projects (Dunn 2005, LIP 2003). The importance of these loans for micro- and small businesses is obvious; they are used singly, or in combination with other MCO or bank loans, to create the funds needed to start enterprises, invest in infrastructure, and grow the businesses. The surpluses generated are reinvested or invested in homes, education, and used to diversifying incomes. Sometimes microloans are consciously used instead of bank loans because banks are deemed too slow, too complicated and time-consuming to work with. And the MCO loan officers are continuously visible in the area, are easy to get hold of and to discuss things with, and offer simpler, if costlier solutions than banks.

The number of microfinance clients that also have bank loans is one of the surprises of this study. It can be read in different ways: as evidence that banks have, during the earlier boom in lending, penetrated a market that was previously perceived as uninteresting, as a ‘microfinance market’; and that banks are increasingly lending to smaller businesses. Or, it can be read as a question regarding the recent growth of microfinance lending: to what degree did the growth during 2006-8 reach poor, previously unbanked clients, and to what degree did it provide loans to those who already were, or could be served by banks? On the other hand, it might also be seen as a trend towards a more ‘normal’ European economy in Bosnia: in the rest of Europe it is not unusual for entrepreneurs and families to use several sources of credit with different conditions and different costs for different purposes. Indebtedness and overindebtedness should be seen in this context: multiple loans are not the issue per se; the problem is repayment capacity, the need for a ‘cushion’ for lean times, and responsibility in both borrowing and lending. Here one might also reflect on the need for a consciousness of the benefit of savings, and attractive products for savings.

A fairly large sector of the economy, much of it composed of low-income and vulnerable people, now depends on microloans. A number of clients noted that it was more difficult to borrow now, and this

worried them. Some go to enormous lengths to repay on time even when hard-pressed, because they fear ruining their relationship with the MCO, putting an end to their access to credit. Thus, the current ongoing decrease in MCO disbursements, while necessary, may become a problem. While MCOs must put their portfolios in order and find sustainable levels of lending, this process must not harm clients who need the credits and are able to repay – MCOs must not become too risk-adverse. There must be some distinction between good clients who are hurt by the economic downturn, and those who have been taking advantage of easier credits unduly. Otherwise, MCO cautiousness may hinder clients from participating in the economic turnaround when it appears.

The use of business microcredit to finance home construction and renovation, the costs of higher education and medical interventions, as well as the combination of bank and microcredit loans speaks to a need for more products in the marketplace: leasing, different varieties of housing loans, educational loans, and micro-insurance products might all be appreciated by microfinance clients. Different ways of guaranteeing loans, besides the current demand for formally employed guarantors, seems to be something that must be made available before too long, as the current system appears to be reaching the end of its sustainability.

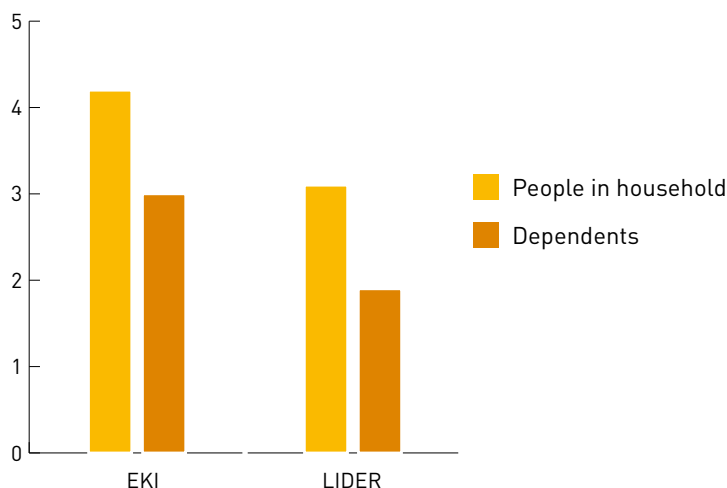
In the current crisis, several MCO leaders have noted the need for microfinance to ‘get back to its roots’. Poverty statistics have not changed substantially in Bosnia through the years, despite lending, and some national economic advances. If reducing poverty is the main goal of microfinance, there is much left to do, and it is up to the microfinance organizations to find new ways of doing it.

3. Lessons Learned

1. In the light of the Sida country strategy, a goal of which is to focus on the fight against poverty, one lesson learned is that direct support to microfinance organizations that is directed toward specific target groups and poverty-alleviation programs is likely to have a greater impact on the poor than general funding to MCOs. To judge from our samples, the World Vision/EKI program reached more vulnerable groups, and helped more low-income families than support for LIDER’s lending did. In our sample a number of loans from LIDER were unusually large: KM 55,000 and KM 45,000 were the largest. Close to three quarters of the LIDER clients also had access to bank loans as compared to a quarter of the EKI clients, who were, on the average, responsible for three dependents (3.1), while the LIDER clients were responsible for two dependents on average (1.9). Some of LIDER’s clients took a microfinance loan to add to a lump sum for investment; for example, they had a bank loan for machinery and needed to borrow for a work space or vice versa. Usually their savings were also invested in these ventures.

Although these loans are useful for clients and serve a purpose, one can question to what extent they serve the mission of microfinance, and Sida's primary goals. The same can be said of some loans granted for consumption purposes. Perhaps targeted support would be more useful in reaching poorer entrepreneurs?

Diagram 8 Number of dependents per client.



Listening to some businessmen discuss their reasons for using microcredit, it appears that the quick and relatively simple loan procedures are the attraction of these loans. They are needed and provide useful flexibility in financing small businesses. But should Sida's support for microfinance be used to this end? LIDER could also have built its sustainability by lending 'down market' to more needy categories. Looking at the BiH microfinance sector as whole and considering that close to 50% of the population is poor or vulnerable, and this number is likely to grow in coming months, one can argue that direct support for programs that encourage MCOs to 'lend down market' more effectively instead of lending 'up market' still have an important role to play.

Targeting clients is controversial as Helms (2006:35) has pointed out. It can be wiser to allow MCOs building their sustainability to provide financial services to a broader range of clients, mixing lower-cost larger loans to less-poor with higher-cost, very small loans to poorer people, a strategy that allows them to attract larger amounts of capital and grow faster, increasing outreach. Poverty outreach can rather be monitored through performance indicators. Such was the policy with LIDER, which has achieved sustainability. However, at present BiH has 12 sustainable MCOs, all well able to obtain commercial, unrestricted funds for on-lending, and it appears that they have largely been competing for the same market segment of clients. Programs that oblige organizations to stretch themselves and lend down market, to reach new needy beneficiary groups and deliver useful products, still have a role to play in poverty alleviation in Bosnia.

2. The growth of MCOs must be managed in the interest of both organizations and the public, and to this end effectively functioning meso-level institutions (credit bureaus, accounting, supervision, consumer protection and information organizations and groups, etc) must be in place in the financial system. In 2005 when World Bank support was ending there was concern that the MCOs would lack the funding for continued growth. As it turned out, funding overwhelmed them, and they grew too fast. People took advantage of easier credit terms – from both MCOs and banks - and some borrowed more than they could manage, with little or no 'cushion' for economic downturns. As indicated there are several factors which contributed to this situation, including the lack of a credit registry and the then-unclear situation regarding what the new law on microfinance would contain.

Organizations have their own interests and needs shaped by their missions and the thinking of the individuals who lead them; they act accordingly. Staff may have dissonant goals; incentives to disburse may have contributed to overlending in the past period. And the clients/public has its own agenda, each individual with strategies and motivations of their own. There need to be strong knowledge-generating institutions situated between the organizations and clients: credit registries, consumer protection agencies and civic groups, as well as appropriate legislation and supervisory capabilities.

3. The microfinance sector in BiH was primed for growth and diversification. Since its inception, arrows all pointed upwards. When a downturn came, they had to learn – and are still learning – how to deal with this new scenario. To what degree does microfinance training and expertise prepare organizations for severe downturns? How much should or can they be prepared, and in what ways? How does one deal with human resources in such situations? This is an area in which it appears that much remains unknown and undocumented, not only by organizations facing crisis, but by the industry as a whole. Perhaps the research, texts and training needed are being elaborated only today.

4. During rapid growth, it is difficult to control organizations. When staff increases quickly, as it did between 2006 and 2008, nearly doubling, how does one know that new comers all are ‘in tune’ with the ethos and goals of the organization? Internal controls become very important, and staff incentives must be balanced carefully. Today we see the results of less careful lending, and the occasional reports of fraud by interviewees indicate that even in our quite small sample, some illegal, unethical or irresponsible practices occurred (although none of the reports implicated EKI or LIDER). Monitoring and checking is important all the time, but more so in times of rapid growth.

4. Recommendations

1. The microfinance industry in BiH still needs support. But credit lines are not the greatest need at this time. In coming months, many of the organizations are going to be taking decisive steps regarding their futures. Some will remain foundations and seek their niche in the market. Others are likely to join forces, creating new constellations and groups of competencies. What they need is technical assistance and training that will help them increase their institutional capacity for long-term development – the tools to shape their institutions for the future. The challenges include issues of transparency and disclosure, risk taking, and dealing with international investors and with shareholders. At an AMFI workshop which brought together microfinance leaders with international investors and the Banking Agencies, one MCO requested technical assistance for negotiating the process of consolidation, mergers and acquisitions. Organizations that remain foundations may also need technical assistance to focus activities and compete in the changing arena. To provide such technical assistance Sida might partner with other institutions – for example EBRD, EFSE, or KfW – that are now taking an active role in supporting a consolidation process; or with an industry organization such as AMFI.

2. There is a need for policy dialogue at the level of the Finance Ministry and the Banking Agencies. At present the law on microfinance is being applied differently in the RS and the FBiH, creating unfair competition. Neither application is ideal, however; while foundation status and a loan ceiling of KM 10,000 limits the MCOs in the FBiH, the KM 50,000 limit in the RS might seem too high a ceiling for microfinance. Discussion and greater consensus is needed, but the communication between stakeholders is not functioning well, so it is necessary to find channels that can resolve the current deadlock. While amending the legal framework will take time, by-laws can be changed more rapidly by the Banking Agencies. The EBRD is involved in policy discussions, and could be a partner in this area.

3. The FBiH Banking Agency is in need of more human resources, TA and training to supervise and regulate the microfinance sector appropriately and effectively. With only two employees, one currently on maternity leave, the microfinance section of the agency is clearly understaffed and also appears to be squeezed between the demands of the MCO directors and their own duty to apply the letter of the law. The USAID Partnership for Advancing Reforms in the Economy (PARE) program which works on support to the banking sector might be an entry vehicle for USAID-Sida collaboration on a program with the microfinance section of the Banking Agencies. The World Bank has also expressed some interest in supporting the area of regulation and supervision, and would work towards mobilizing resources for consultancy services to fine tune the legal and regulatory framework for microfinance in BiH, were this to be requested by the Banking Agencies.

4. The Association of Microfinance Institutions in Bosnia and Herzegovina – AMFI – is a potential resource that is underutilized today and could serve the sector much better. With a staff of one and little funding, much of the strategic work of the organization is carried out by MCO directors, who have their own organizations to run. Ideally, a business association supports its members, and is not managed by them. AMFI could do much more to support the industry. Policy, advocacy, and MCO staff trainings are all areas which can be developed. Research of benefit to the sector as a whole, such as research on microfinance downsizing, and public relations work could also be undertaken. The Bosnian bankers' association that was established in 2003 is an asset to the banking industry, and AMFI might follow their example. Worldwide, there are several support associations and networks that provide the kinds of services AMFI could, one is the Pakistan Microfinance Network (PMN). Another idea would be for AMFI to work at a regional level; an understanding with associations from other Balkan countries was signed by AMFI in October 2009. Part of the KfW refinance line is to be used for TA, and AMFI is expecting to undergo an evaluation supported by this funding. Based on the outcome of the evaluation there could be an excellent opportunity for Sida to support the development of an institution that can have substantial value for the continued development of the sector.

As a member of CGAP, Sida could also advocate for research on how to successfully downsize an MCO. The research could be conducted by CGAP at a global level or at a local level in partnership with AMFI.

5. Financial education is another area in which investment can be beneficial. It will be interesting to see how the current initiative for financial counselling centres works out. However, financial understanding and know-how needs to be disseminated across the population. Bank products are not sufficiently transparent. Most people do not read fine print, much less understand it. Recent months have seen a surge in negative media reports about the financial sector. This is not a productive situation. There is much to be done by banks, in making services and fees transparent and easy to understand, and by the general public in increasing their knowledge about the workings of the financial system and the costs, advantages and disadvantages of participation. The Bankers Association, AMFI, and consumer groups are all possible partners for support to educational initiatives, and another profitable avenue could be to work through youth groups to promote financial understanding among young people.

6. The data collected through interviews and focus groups indicated that microfinance loans are being used in a variety of ways – to augment bank loans, build homes, pay heating bills, provide health care in emergencies, fund economic activities that provide for a child's high school or university education. This indicates that clients could make use of financial products that are not yet widely available – such as leasing, student loans, micro-insurance – and MCOs should be able to provide their clients a greater diversity of products.³³ However, product development is a risky and demanding process, which may

³³ For example, a recent article in the *New York Times* describes an organization, Vittana, that is building a student loan business for microfinance organizations, based on the Kiva model. See 'College Loans as Development Aid,' *New York Times*, 5 December 2009.

also require changed legislation. Sida could support product development either through direct support for programs similar to the World Vision/EKI project, or through support to a research and development facility located in AMFI and for the benefit of all AMFI members.

7. Although the outlook concerning the funding of microfinance in BiH looks positive at this time, the situation may change depending on how the economic crisis evolves in BiH during the coming year, and how the MCOs manage. In planning for the long term, it is therefore not out of place to consider how funding might be enhanced. As an MCO's loans from local banks must be fully collateralized, a loan guarantee scheme could play a role in enabling local banks to lend larger sums to MCOs. At least one MCO has noted the usefulness of such a facility. USAID has set up a loan guarantee scheme for SME lending, and might be a possible partner; international financial organizations may also be interested.

8. Sida's strategy for development cooperation with BiH states that "The aim of Sweden's development cooperation with Bosnia and Herzegovina is to create conditions that enable poor people to improve their lives and the Swedish programme is to proceed from both a poverty reduction perspective and a rights perspective." In this context, all work for a regulated economic space and rule of law is of great importance to microcredit clients. Clients lose investments due to late subsidies, suffer from bankruptcy when participating in agricultural schemes (such as snail farming) that turn out to be scams, are unable to use their assets as collateral for loans, and have limited access to justice when they are cheated. The inability to put up property as collateral, for example, is a result of, among other things, the inefficient court system and the lack of a functioning pledge registry. Due to the lack of efficient government institutions, opportunities are limited, and hard work sometimes comes to nothing. Thus all support for an improved business infrastructure is support that directly or indirectly benefits micro-entrepreneurs. Microfinance clients are businessmen, and are still waiting for that 'business-friendly environment.'

Annex A Terms of Reference

Terms of Reference – Review of impact of Sida's microfinance support in BiH

1. Background

1.1 General information about Sida in BiH

The objectives of the Swedish Cooperation Strategy with Bosnia & Herzegovina (BiH) 2006–2010 are poverty alleviation and European integration. The two priority sectors are: 1. Good Governance and Democracy and 2. Economic Development and Employment Creation. The 2008 annual budget for BiH amounts to 220 MSEK. Swedish International Development Cooperation Agency (Sida) is a Government agency responsible for implementing Swedish development policies. The Sida Office for BiH is an integrated part of the Swedish Embassy.

1.2 Co-operation partners overview

Swedish/Sida partners in the BiH microcredit sector are the following:

Microcredit foundation “EKI”

Through five projects since 1998, Sida supported World Vision in establishing one of the largest microcredit providers in the country, EKI. At the present time there are no active projects with World Vision, but the microcredit activities are continuing through EKI, which was one of the ultimate objectives of the support. Approximate total support for loan funds to EKI from Swedish sources is around 2.3 MEUR.

Microcredit foundation “LIDER”

Through 3 projects since 2000, Sida supported CHF International in establishing a sustainable microcredit provider, LIDER. These projects are now over, however the micro crediting continues with LIDER as it does with EKI. Approximate total support for loan funds to LIDER from Swedish sources is around 1.5MEUR.

The overall objectives for both EKI and LIDER projects mentioned above was income generation through microcredit, piloting new microloans (such as for home improvement) and for building up the sustainability of the LIDER organization.

“Microcredit refinance” through KfW in BiH

Since 2006 most donors had stopped direct grants to MCOs. However, active donor support is still present in the form of refinance lines. Most are managed by the European Funds for South East Europe (EFSE), a vehicle which combines donor and commercial sources. Because EFSE was not yet fully operational, in late 2005, Sida entered into a project with KfW, by providing a 5 MEUR refinance line which is aimed at helping the commercial relationship between banks and Microcredit Organizations. The line is placed through Raiffeisen Bank in BiH to 4 microcredit institutions in BiH. The line is still active and is intended to last until 2012.

Recently (in June 2009) Sida reclassified the agreement it has with KfW from a grant into a conditional loan due to government instruction. The new instruction states that all conditional loans will eventually be transferred from Sida to Swedfund. Sida is starting the process of assessing how, and/or, if a transfer will be completed. If a transfer is not negotiated within the next 6-8 months, Sida will probably start negotiation with KfW on the closing of the project and repayment of refinance line fund adjusted of course for any losses that may occur within the activity period.

2. Contract Objectives

The primary objective of this Contract is to perform a review of impact of Sida's direct beneficiaries of microcredit support: "EKI" and "LIDER". The result will be to provide independent input to Sida on past support to microcredit sector in BiH. Sida may use this information during the upcoming period of writing a new Country Assistance Strategy.

A secondary objective is to review existing information on development impact of the microcredit sector. The part of the assignment shall also include a discussion of the impact of the global financial crisis on the microfinance sector and how it has affected microcredit clients.

The analysis should look into what lessons can be learned from this project, in light of the current Country Strategy. The Consultant should comment on the overall relevance of further support to the financial sector in BiH.

3. Scope of Work

3.1 Tasks

3.1.1 *Determining impact for EKI and LIDER beneficiaries*

The review should segregate the beneficiary by type (i.e. a business or individual) and check the following hypotheses:

For a business; that participation in the projects lead to an improvement in income for the business and job creation for the beneficiary

For an individual; that participation in the projects lead to an increase in household wellbeing (as measured by fixed assets, expenditures and savings)

The main tool to be used is direct survey using structured interviews. A random sample of individuals and business clients should be made. The level of ambition for this task is the following: Interview time is estimated at up to 20 days. Preparation time is estimated up to 5 days. Reporting is allowed up to 5 days. In total 30 man days.

3.1.2 *Determining impact of the refinance line for the sector*

This task will be to interview banks and MCO clients directly and determine the impact that the line has on their operations. It would be good to get a view on what would happen if once the refinance line is withdrawn for the final clients but also for the bank and MCO client. Would the funds be replaced from other sources? What would it mean for the final client?

Furthermore, the tasks will be to visit major IFIs in BiH to discuss the impact of the global crisis and ideas of supporting the financial sector (except with revolving funds)

Total level of ambition for this task is up to 10 days, including 5 days for reporting and preparation.

3.2 Timing, budget, reporting and logistic

3.2.1 Timing and budget

The overall level of ambition for this assignment is around 40 days, of which at least 25 days will be in the country.

At the beginning and at the end of the site work, the consultant shall have a meeting with the Swedish Embassy/Sida for briefing and debriefing.

For the purposes of this assignment, the Sida representatives in Sarajevo are:

- Anders Hedlund, Counsellor, Swedish Embassy, Sarajevo
- Nedim Bukvic, National Programme Office, Swedish Embassy, Sarajevo

At latest 2 weeks after the debriefing, the consultant will deliver a draft report to Sida. After commenting and discussion a final report including the comments and suggestion of Sida/Embassy and other stakeholders as appropriate shall be delivered to Sida within 3 weeks.

3.3.2 Final Report

The final report shall be handed in English language, in 4 printed copies and one electronic version to Swedish Embassy/Sida.

The report will include the following sections:

- An executive summary
- Introduction
- Impact/results section
- Lessons learned and Recommendations
- Conclusions
- Supporting Annexes

The length of the report should be limited to 40 pages without annexes.

3.3.3 Logistic

The Consultant shall be responsible for all practical arrangements in conjunction with the trip to BiH (such as local transportation, arranging meetings, interpretation, etc.). Assistance from two MFIs regarding scheduling meetings and providing information could be expected. Details should be worked out with the managers of the respective institutions as follows:

For EKI:

Ms. Sadina Bina, email: Sadina_Bina@wvi.org

For LIDER:

Mr. Zijad Hasovic, email: zijadh@lider.ba

For KfW:

Ms. Dzelila.Hadzovic, email: Dzelila.Hadzovic@kfw.de

The Swedish Embassy in Sarajevo cannot provide logistical support.

However, local consultancy support is allowed up to 10% of the total contract amount and will be allowed as a reimbursable cost.

The development section of the Swedish Embassy in BiH will provide the Consultant with background information such as project documents, agreements, reports, and policies. Other documentation necessary for the assignment shall be collected by the Consultant.

4. Profile of the Consultant

The requirement for this assignment is a level 1 international consultant with microfinance and impact assessment expertise (minimum 7 years). A good knowledge of the regional and country microfinance environment is preferable.

The Consultant is expected to be familiar with Sida's key steering documents and methodological approaches.

5. Selection – Time Line and Criteria

Proposal including budget should be sent to Anders Hedlund at Swedish Embassy Sarajevo (anders.hedlund@foreign.ministry.se). Closing date for receipt of tender is close of business on September 14th 2009.

Required documents are: Cover letter; Technical proposal (max 5 pages not including appendices), appendix (1) work plan, appendix (2) company references, appendix (3) CVs of the proposed consultants (max 5 pages per CV); and Financial proposal.

A consultant within the framework agreement for financial sector development will be contracted to carry out the assignment. In evaluating proposals the following indicators into account:

- Explanation of the methodology (30%)
 - consultant demonstrates understanding of the assignment
 - details the methods and techniques to be used for data and information collection and processing
 - demonstrates understanding of constraints, discusses validity and objectivity
- Relevant professional experience and qualifications, minimum 7 years (60%)
- Offered price (10%)

Language Requirement

English

Deadline for submission of reply

September 14th 2009.

Deadline for carrying out of the assignment

November 23rd 2009

Annex B References

- AMFI (Association of Microfinance Institutions in Bosnia and Herzegovina). 2005. *Strategic Plan for the Association of Microfinance Institutions – AMFI (BiH)*.
- AMFI, 2009. *Cumulative Performance Indicators of 12 Microcredit Organizations (2005–2009)*.
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World Vision/EKI. 2008. *Final Report, Credit and Business Support for Housing and Economic Development*.

Annex C Methodological Approach

Data collection methods

Several methods were used in this evaluation: a review of the available background material, open-ended in-depth interviews with microfinance institutions, AMFI, Raiffeissen Bank, international financial institutions, donor organizations and NGOs, structured interviews with a total of 110 microfinance clients (60 at EKI and 50 at LIDER), and six focus groups with a total of 47 participants.

The first five days of work consisted of background reading, which included general articles on the financial system in Bosnia, reports on the current situation from international financial institutions, and project reports from the EKI and LIDER regarding the support they have received from Sida. During this time interview guides for meetings with IFIs, and the bank and MCOs involved in the refinance line were designed as well as for questionnaires for meetings with EKI and LIDER and their clients.

The first week on-site in BiH was occupied with meetings with IFIs, Raiffeissen Bank, MCOs, and some bilateral donors and NGOs (see Annex F for List of Institutions and People Interviewed). In addition to discussions about the impact of the international financial crisis on the microfinance sector and its clients, information about the refinance line was collected through interviews with key personnel. The consultant was also able to attend a workshop that AMFI held for its members and the representatives of the Banking Agencies and international investors, which proved very informative. During this period the local support consultant was occupied in making the samples of EKI and LIDER clients with the help of staff of these organizations, and began to organize travel and interviews for the following four weeks.

For the following two weeks, on-site visits and structured interviews with 60 EKI clients, and 3 focus groups discussions were conducted. Thereafter, two weeks were dedicated to interviews with 50 LIDER clients and three more focus groups. Structured questionnaires were used during the interviews, notes were taken, and each evening responses to questions were coded into spreadsheets for analysis.

Sampling

Prior to client selection, the local support consultant, working in consultation with the international consultant, selected offices for the review. The geographical spread was taken into account and eight offices were selected from the regions of Northern, Central and Eastern BiH. Since LIDER is only working in FBiH, three selected offices in EKI were from RS and one from FBiH in order to provide a balanced entity sample in the study as a whole.

Table 1. Geographical areas covered by the evaluation of MCO clients

LIDER		EKI
RS		Bosanski Brod, Vlasenica, Modrica
FBiH	Sarajevo, Ilijaš, Zavidovići, Kakanj	Gradačac

At these offices individual clients were randomly selected from lists of clients. The funding for EKI was part of a specific project with the main goal of increasing access to housing and to business loans in rural areas of BiH to provide sustainable livelihoods. Tracking clients funded from the Sida/KFW funds was possible, while funding to LIDER went into general lending without any specific tracking of Sida funds. This made the samples in EKI and LIDER quite different; LIDER clients came from a broader range of activities and many were business clients as LIDER is quite unique in that it works

closely with business organizations. Thus while the EKI funds were lent mainly in rural areas, LIDER supports urban entrepreneurs and more registered businesses.

Characteristics of the sample

Beneficiaries of loans were segregated into the following types: business clients, individual clients for income generation (IG) activities and housing clients. The sample was controlled for the variables of gender, age and target groups such as returnees or war veterans according to the following information provided by the MCOs.

From the information provided, EKI reached more clients in the RS with the Sida/World Vision project than in its usual performance. Lending from the Sida funding is almost 20% higher in rural areas than the overall EKI performance, indicating that the fund enabled them to reach clients from more remote areas. This figure rose during the implementation of the project, since EKI was increasing activities in the rural areas over the period. The majority of the funds were used for the provision of housing loans, and to target groups like returnees, war veterans, invalids.

Table 2. Characteristic of the EKI and LIDER clients

	Percentage of beneficiaries of Sida funding at LIDER ³⁴	Percentage EKI clients, total lending	Percentage of beneficiaries for EKI's Sida funding
Individual loans (unregistered IG activities)	22.3%	83.69%	12.21%
Housing loans	38.4%	6.59%	86.17%
Business loans	20.7%	9.72%	1.62%
Consumption loans	18.6%	0%	0%
Men	54.5%	59.73%	70.24%
Women	45.5%	40.27%	29.76%
Younger than 35	22.8%	28.06%	21.98%
Aged 35-55 years	49.2%	55.21%	57.05%
Over 55 years	28%	16.72%	20.97%
Target groups such as returnees, war veterans, invalids etc.		15.23%	81.24%
RS	0	38.25%	58.57%
FBiH	100%	53.43%	41.32%
Brcko District		3.80%	0.00%
Unknown		4.52%	0.11%
Rural	45%	43.33%	60.19%
Urban	55%	28.21%	9.94%
Unknown		28.46%	29.88%

Source: EKI and LIDER

Breakdown of the types of loan beneficiaries received

From the lists of clients, beneficiaries were randomly selected for visits/interviews, or focus groups discussions and replacements were also randomly selected (in the event that the members of the sample were unavailable). Replacement clients could be females, target groups and businesses. The selection of clients for the categories of housing and businesses does not represent the situation in MCOs, but was

³⁴ Because the funding to LIDER went into general lending, the random sample follows the pattern in the institution, with the exception that more registered business were chosen for the sample.

done intentionally to spread the sample through different types of businesses, and to have better sample of the impact of loans on businesses.

Table 3. Breakdown of the sample per the types of loans beneficiaries received

	EKI		LIDER	
Income Generation	38	63,3%	8	16%
Business	11	18,3%	31	62%
Housing	11	18,3%	11	22%
Total	60	100%	50	100%

Source: Questionnaire forms

Gender and Age Breakdown of the Sample

Business clients in LIDER are recorded by the business name, making control of gender difficult. Also, although most of businesses are family owned, more male members were present at the interviews. Additionally, more clients aged 35-55 were present at interviews.

Table 4. Gender breakdown of the samples

	EKI		LIDER	
Men	42	70%	32	64%
Women	18	30%	18	36%
Total	60	100%	50	100%

Source: Questionnaire forms

While in EKI, we had a representative number of females and age groups in the sample:

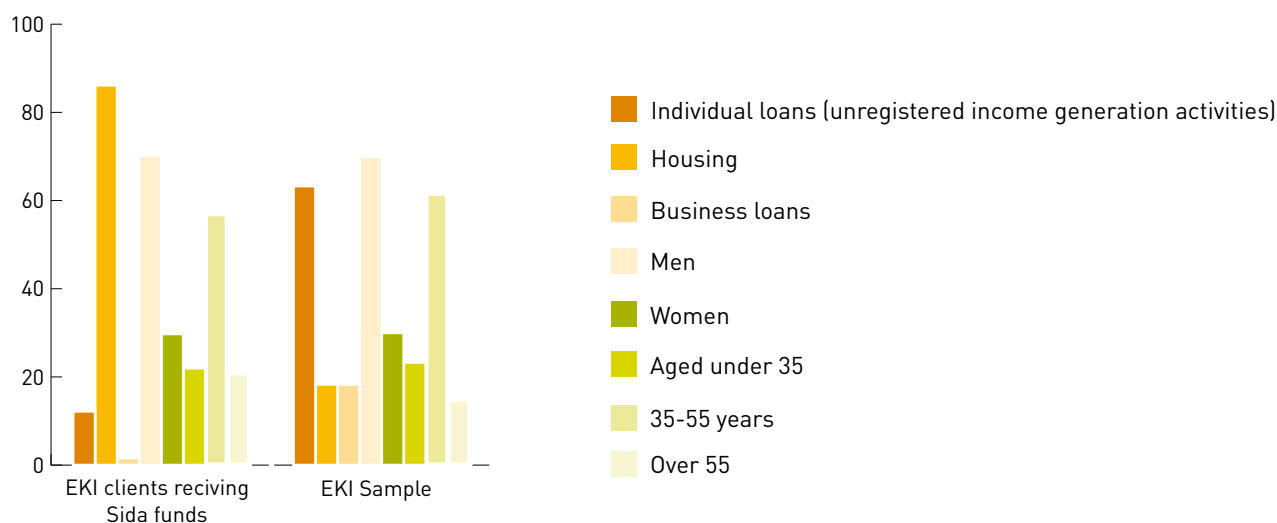
Table 5. Age breakdown of the samples

	EKI		LIDER	
Under 35	14	23,3%	8	16%
Aged 35–55	37	61,7%	30	60%
Over 55	9	15%	12	24%
Total	60	100%	50	100%

Source: Questionnaire forms

A total of 60 interviews at EKI and 50 at LIDER were conducted, and 6 focus group discussions held with clients of each MCO. Two focus groups each were held with housing, income generation and businesses clients. A brief summary of the findings from the focus groups can be found in Annex E.

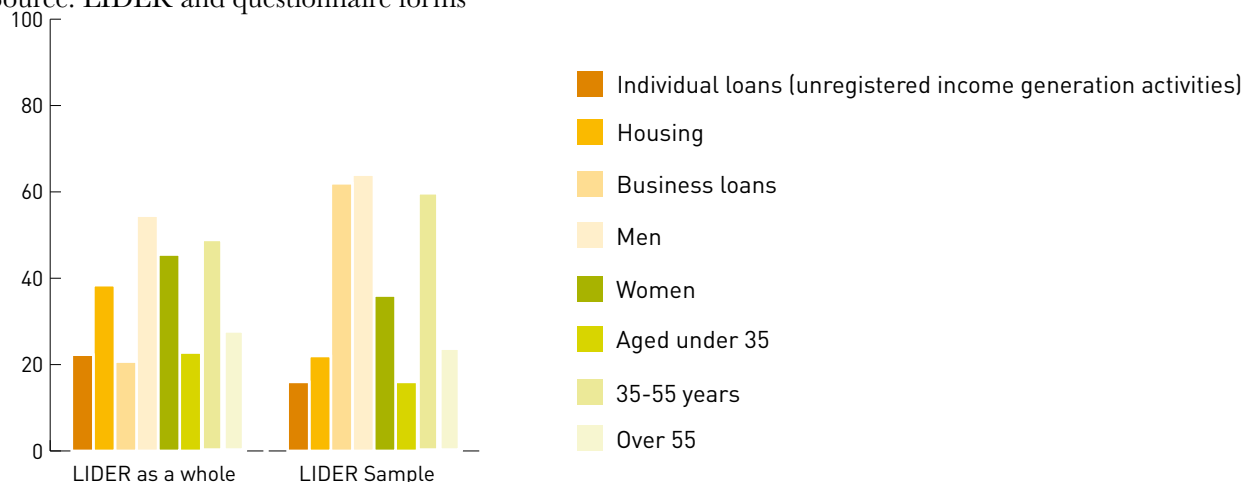
Diagram 1a. Characteristics of all EKI clients that were Sida beneficiaries vs. the characteristics of the EKI sample



Source: EKI and questionnaire forms

Diagram 1b. Characteristics of all LIDER clients vs. the characteristics of the LIDER sample

Source: LIDER and questionnaire forms



In addition to individual, business and housing loans, LIDER also has a consumption loan product, and 18,6% of all their clients have consumption loans. Several consumption loan clients were included in our random sample, but we interviewed only one. Since the data from this one client were irrelevant for the study, it was excluded from the sample analysis.

Difficulties encountered and solutions

The selection of 130 clients for LIDER was not enough to organise 50 interviews and 3 focus groups, since many clients changed contact details over the time or some closed their businesses. Also, many LIDER business clients are living in urban areas and did not want to take a part in a review or were busy and could not find time for a meeting. So, an additional list of randomly selected clients from the municipality of Ilidža was created.

A lesson learned is how difficult it is to interview clients of MCOs with their cooperation, and how difficult it is to do without their cooperation. We set out to do this review of EKI and LIDER independently, to take as little of these organizations' time as possible, and to visit clients on our own to hear their candid accounts of the benefits and drawbacks of loans. We assumed that if we visited clients together with loan officers, answers to our questions would be less candid, and that clients would hesi-

tate to be critical. While relationships between clients and loan officers are usually good, even affectionate, there is undeniably an element of power involved; loan officers can advocate for their clients and can also show leniency, or not, when payments are a few days late.

We needed the cooperation of the MCOs to provide lists of clients in order to make the sample, however, and to obtain the addresses and numbers of clients. We also had limited time to contact many clients (and substitutes) for interviews and focus groups.

EKI is a large organization, accustomed to evaluations and reviews, and gave us full support in making the sample and setting up interviews. In some cases loan officers helped out with calling clients, which made clients more likely to accept an interview as they have a relationship with their loan officers. We were also offered logistical support; loan officers offered to take time from their work to take us around to interview clients, fearing that we would not be able to locate rural clients otherwise. It was awkward to tell loan officers that we wanted to visit their clients without them. It was also difficult to say no to kind offers of assistance which would make things easier for us. In the end, one of us travelled with a loan officer who did not sit in on the interviews, and one of us travelled alone, albeit with an interpreter.

Were our results different? It is hard to tell. But the situation makes one reflect on the independence of independent reviews. Independence in an unfamiliar milieu is a struggle, and hospitable people are eager to help. What trade-offs are made?

In the review of LIDER, we were completely on our own. LIDER officers helped out with providing lists of clients, and we made the sample, called clients, and travelled on our own to visit them. The problem we encountered here was that clients were less inclined to agree to an interview, and that telephone numbers were not up to date. This made it difficult to set up interviews with sufficient clients in a limited time. We also noted that clients who had the note 'paid with problems' written in their files were less likely to agree to an interview, which probably had some impact on our end sample.

While loan officers can check their current phone lists and rely on their relationships with clients to urge them to participate in evaluations, the independent evaluator with no relation to clients encounters difficulties without MCOs support. As these issues are not discussed in evaluations and assessments, perhaps it is time to bring them up. In what ways does the assistance/ indifference of MCOs in carrying out evaluations affect findings?

Limitations and strengths

There are several limitations to impact studies of this kind, the primary one being the difficulty of attributing improvement or decline only to loan opportunities; they may also be generated by an improved national economic situation or crisis, by family circumstances, or pure chance – a bus stop moved closer to, or away from business premises, for example. Also, microfinance clients seldom keep written records of their economic transactions. What one measures is the clients' perceptions of improvement or decline, or increase in opportunities or problems in relation to loans. As there are no baseline studies, one must rely on the client's memory and good faith when one records answers. However, it is possible to ask follow-up questions, to probe memory and seek clarifications that allow one to judge increase or decrease in economic vulnerability and control over resources, as well as empowerment and voice in community, which are particularly relevant when judging the impact on certain target groups such as women and returnees. The fungibility of funds is a constant issue in microfinance, as money is easily diverted into other activities, but it is generally recognized that these difficult-to-monitor 'diversions' of credit resources may also contribute substantially to the well-being of clients over time.

The client samples we had were large enough to provide for a valid qualitative approach and to give a good idea of general trends. The chosen qualitative methods were more likely to produce representative and nuanced information than a broad quantitative study with a large sample but much less possibility for in-depth questioning, and none for the observation of actual circumstances.

Annex D Ratings and Performance Indicators for Microfinance Providers in BiH

There are a number of rating agencies that evaluate microfinance institutions around the world against a set of internationally recognized benchmarks.⁶ The BiH organizations all score very high in the ratings. Bosnian MCOs continuously receive rewards and recognitions from the World Bank and Consultative Group to Assist the Poor (CGAP) and other international organizations for a high level of transparency in doing business and financial reporting. Out of 20 institutions from all over the world receiving awards in 2007, five microcredit organizations are from Bosnia and Herzegovina. Also, five AMFI members are included on the list of 100 most successful microfinance institutions, published by the prominent US business magazine “FORBES”.

Table 1. Ratings for 13 Microfinance providers in BiH

Name	Diamonds	Gross loan portfolio in USD	Number of active borrowers
EKI	5	117,319,332	44,459
LIDER	4	6,830,607	4,849
LOK Microcredit Foundation	5	65,950,960	26,986
MI-BOSPO	5	42,546,852	30,565
MIKRA	4	22,264,357	12,403
MIKRO ALDI	5	4,317,949	3,100
MIKROFIN	5	144,578,195	51,508
PARTNER	5	117,393,155	51,982
PRIZMA	5	37,012,030	29,308
ProCredit Bank - BIH	4	238,379,699	68,752
SINERGIJA	5	26,327,128	9,778
SUNRISE	5	48,315,792	23,175
Women for Women	4	8,677,583	9,235

Source: MIX Market, 2007

According to data from Microfinance Information Exchange (MIX) from 2008, seven MCOs from BiH were among the 100 most successful in the world. This puts BiH in second place worldwide together with Ecuador, while India is in first place with 9 MCOs on the list of 100 best in the world.

Based on data received from the AMFI and Performance Indicators for 12 MCOs³⁵ as of December 31, 2005 to June 30, 2009, the following graphs were made to illustrate the development of the micro-credit sector in the period 2005–2009.

³⁵ MI Bospo, EKI, Sunrise, LOKmikro, Partner, Mikrofin, Sinergija, Prizma, Woman for Woman, Mikro Aldi, Mikra, Lider

Diagram 1. The increase in active loans was followed by increases in number of offices and staff

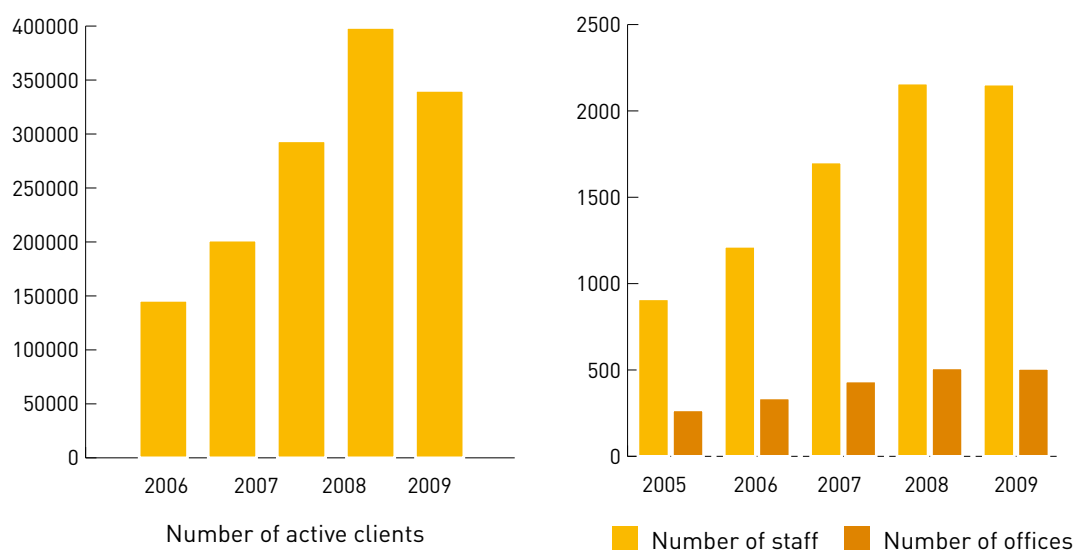
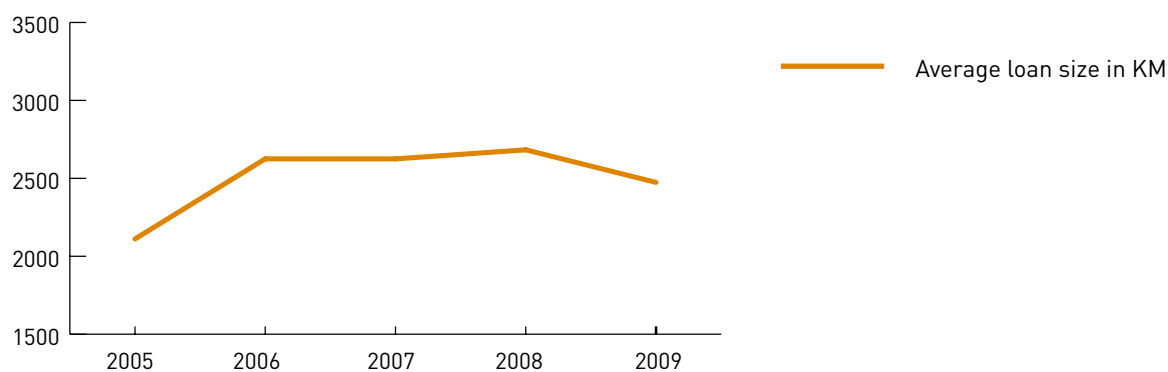


Diagram 2. Increases in average loan size



After it increased by almost KM 500 in 2006, the average loan size has not oscillated much. However, the decrease of the average loan size by KM 134 during 2009 as compared to 2008 contributed to a decrease in the portfolio by about KM 50 million.

Diagram 3. Profit of 12 leading MCOs



The first microcredit organization reported a loss from operations at end of 2008. During 2009, the number of MCOs operating with losses increased to eight out of the twelve rated.

Annex E Summaries of Focus Group Discussions

EKI – total 30 participants, 23 male, 24 female

In Gradačac, a focus group was held with recipients of housing loans - four men and eight women with diverse occupations. All the participants felt that they had benefited from the housing loans: 'We lived in two rooms, now we have the house', and 'I moved in before the cement was dry.' One man had invested his loan in land on which to build a house. 'It was so much easier to build before. My grandfather told me, "Build next to your father, and your child should build next to you."' The majority were still clients with EKI and had taken or needed further loans, and much of the discussion came to centre on the difficulties of the day. A major issue for most is the difficulty of finding guarantors in order to receive further loans: 'EKI is going to have problems; there are no guarantors that are willing to sign, these days. It is easier to borrow where you work. EKI should accept property as a guarantee, I need a loan for six thousand KM, but my house is worth 30, 000,' and 'Fifty percent of the people have the same problems, guarantors and high rates.' One man recounted that he had been able to get a bank loan within 24 hours. 'All the microcredit organizations work in the same way. Raiffeissen and the other banks are better, and they don't call you so often if you are late.'

The current crisis was of great concern: 'My husband works less now and it is hard to pay the bills, we cut the phone in order to pay the other bills,' 'My wife and I both have loans and in the winter it is hard to repay – we need firewood, there are school costs, and no extra jobs. If you need 1,000 KM it is very hard to get it,' 'There was a 10% reduction in pensions and without anybody asking,' and 'I have to try to conserve what my father left me.' The crisis takes its toll on loan repayments: 'I would like to reprogram my loan but then they will contact my guarantor, and I don't want that'. 'When you lose your job for a few months, what can you do? You should be able to get a grace period of three or four months, just pay the interest and the loan later. Grace periods are given in banks, but not in EKI.' 'Still, it is better to borrow from EKI than from friends, for then you involve the friendship.'

The focus group held in Bosanski Brod consisted of four women and six men. All had received loans for income generation activities, and most of them were involved in cattle or pig breeding, while one produced milk for sale. Employment and regular incomes had been very scarce in the area until a year ago, when the large oil refinery that had been idle since the war began operating under new ownership. Now, several were working in the refinery (or their spouses or children), but as salaries are low (the average monthly salary was said to be KM 500 or roughly SEK 2,750), these families tried to augment their incomes with agricultural activities. They were dependent on the loans in order to be able to start the investment cycle: 'You have to have cash to start something,' 'If you want to succeed, you have to invest,' and 'I started everything with the loan, it's going slowly, but it's going well.' All agreed that the loans were beneficial, whether invested in animal husbandry or in some other endeavour. Several said that their incomes were not much higher due to the loans, but that loans helped them: 'We did not earn much, but we could survive and build the house'. Thus it seemed that people here equated 'higher income' with more disposable income, rather than with income allowing them to make major necessary investments such as in one's home. A big concern was the fluctuation of agricultural prices, 'The price of pigs was good last year, this year it is different – not a loss, but not a good profit,' and the lack of purchasing power in the community: 'The problem is that people don't have money' and 'No matter what you produce, you can never sell all of it', and 'Now I had to wait for a whole month for the butcher to come and get my bull, and when he saw it he said, "No, it's too big for me."'.

Some of the participants felt that the interest rates on the loans today are very high, and indicated that much if not all of their salaries from jobs went to repay loans: 'I earn 170 KM, and pay 130 for the monthly instalment.' Several men noted that they had extra jobs (one man had five) and that 'We all

have parents to help', and 'The pensions are not paid on time, people need medicines and no one cares, only the young can survive because they can work non-stop,' and 'Young people will probably not live to pension time, they will die from work before that.' 'With a salary of 480 KM, how can one get married?' There were signs of over indebtedness: 'When they call your guarantor you always need another loan to repay that loan,' 'The microfinance organizations are breaking the rules, some call your guarantors if you are late ten days, but they are supposed to wait for a month (30 days)' and 'Some have jumped into the Sava (river) because they have no way to pay their loans.' A couple of the participants mentioned that they had bank loans, one from Unicredit and another from Volksbank. Another participant also noted that he had been able to repay his five microfinance loans with a bank loan, while yet another had tried to find the same solution for his loans, but been declined at the bank. Still, 'We always fight to work, to survive,' and 'We try to invest and get more income.'

The group in Vlasenica was made up of mainly business- and a few income generation loan recipients, seven men and one woman. The discussion here centered on the importance of the loan (and others thereafter) for business purposes, as well as the impact of the current economic crisis. Most of the participants were involved in agricultural businesses, breeding chickens, producing lambs for sale, selling milk to the local dairy, and had taken at least three loans with EKI over the years; some also had loans with other microcredit organizations and/or with banks. 'I have had three loans at EKI, my wife has a loan too, and we have a house and a cowshed now thanks to those loans. The rates are very high, but I would not be able to do anything without loans.' 'For me all the loans were starting points, I started from zero. After I repaid 5,000 KM I could borrow 10,000. Those loans opened the doors for me in banks, now I can borrow in the bank.' 'If I didn't borrow money, I couldn't buy anything. I lived with that money, producing milk. Now milk doesn't sell well, prices are low and the check from the dairy isn't on time.' 'As a returnee, microcredit is the only opportunity in both rural and urban areas, they are starting points. Some people make mistakes and others succeed.'

These businesses employed people, but there was some discussion regarding whether work in a family agricultural business qualified as a true employment: 'I've had five employees for seven years now, and it all started with those small loans,' 'I have three people in my family working,' and 'I employed my wife with the four cows that I bought.' 'You don't have "real" employment when you buy cows, you sell the milk, it's like an employment.' 'I employed my father-in-law, he works and gets money for that, and I get money too.'

Business income beyond what is needed for the family is invested in property (cars, apartments) and in improving or diversifying the business. Most thought it was difficult to save 'As soon as you save, you need something else,' but preferred to keep surplus funds in goods: 'The only savings are in goods,' 'Or in stock (animals),' 'If you have money just reinvest in the business, that is the only way to succeed.'

In Vlasenica, too, there were complaints about interest rates and guarantors: 'High rates, that's what we don't like at EKI.' 'The banks offer you better conditions than microcredit organizations, in the banks the rates fall but the microcredit rate is always the same.' 'The hardest thing is to find a guarantor; many people have paid for others and now no one wants to be your guarantor,' 'If you pay back three microloans without any problems you shouldn't have to get guarantors,' 'Banks won't take anything as security in rural areas, I have a house and a stable and the bank won't accept them as a guarantee.' However, another problem was also mentioned: 'Now at EKI you can only borrow 10,000 KM, that's not so good,' 'For me, 10,000 is nothing,' and 'For my business 10,000 is not much, but if they can't give you more, you take what they give you.'

In this group, the crisis was felt in the form of the lost jobs of spouses and other family members, and the decreased purchasing power of the community in general: 'My problem is that when people don't work, they don't come to buy at my place.'

These three focus groups, held in different areas of the country where people are engaged in rural activities reflected common concerns; the high costs of loans, the difficulties of finding guarantors, the wish for more flexible ways of providing security for loans. Difficulties in repayment was clearly on several participants' minds; more so among the smallholders in Gradačac and Bosanski Brod than among the more well-to-do businesses in Vlasenica. Thankfulness for the opportunities provided by loans, and dependence on them for the possibility of continuing in business was also amply evident. The focus groups echoed and amplified the views expressed in the individual interviews of the sample, backing up the conclusions drawn from the interviews.

LIDER – total 17 participants, 12 male, 3 female

In these summaries, I bring up themes that were not covered much in the previous focus groups. The high costs of loans and the difficulties of finding guarantors were common complaints in all six groups, as was the appreciation of the possibilities of borrowing, but the necessity for, and sacrifice involved in paying the instalments on time.

The focus group of LIDER clients held in Sarajevo was attended by six participants, three men and three women. All had businesses or income-generation activities, among them two bakers, a gift shop owner (glassware), a bookshop owner, and a printer.

Participants noted that it was becoming more difficult to borrow money: 'Credit for working capital is harder to get now, I asked for 3000 KM and they wanted four guarantors, I pay on time but it is still difficult,' 'It is complicated to get guarantors and only guarantors matter for them, they don't take collateral,' 'We repaid early, and now we have problems borrowing again,' and 'Two years ago I got the money in 7 to 10 days, it is harder now.' They also spoke of the expense of taking microfinance loans, seeing it as a poor alternative to bank loans: 'Microcredit is only good if you are in need, it is too expensive,' and 'While waiting for a loan from HypoBank I borrowed from LIDER, I was in need.'

A considerable part of the conversation centred on the effects of the crisis on business, and what to do about it: 'I am earning 20% less than last year, but it was almost 50% less some months ago,' 'I earn 20 to 30% less now, but during the summer it was better,' 'It's not only in bakeries you feel it, we eat a lot of bread in Bosnia, if people don't buy bread, bakers don't need flour, you feel the crisis in the whole system,' 'There is more competition every day,' and 'Some people who lose their state jobs go to the private sector, they buy some machines and try to start a business, they only create problems for us.' 'We learned to survive on small amounts during the war, if you have a little more now, it's great,' 'It is important to cut your expenses,' and 'The priority is to have the money for the monthly instalment.'

In Kakanj, 3 men and 3 women attended the focus group. Most of them had borrowed money to improve their homes, and the sums were small. The discussion came to focus on the difficulties of the day, and reflected the very low salaries in the area, averaging KM 400 or 500 for a month's work. Some of the participants had taken loans to pay electricity bills, or to buy firewood for the winter heating. 'I borrowed money to pay the electricity, KM 700. In Sarajevo it's KM 50 a day for a cleaning lady, but not here. If I earn 20 I only spend 10 today, and set 10 aside so I can always repay. I needed those 700,' 'I can feel the crisis because sometimes you can't survive with the money you have,' 'Everyone has credits, in my building everyone has them,' 'There is no money, people live "on the notebook" (by buying on credit at the local grocery), 'It is getting more expensive, groceries and gasoline, you can spend your money in 5 days, and what do you do for the other 25? Buy "on the notebook."'

In Zavidovići the focus group consisted of three men who owned small businesses, one was a baker, another raspberry producer, the third had a grocery. The conversation covered the typical problems of small entrepreneurs, access to credit, tax burdens, and headaches over important business decisions and disloyal staff. All these clients had borrowed several times and from several sources, they compared

rates. Inexpensive credit was available from Razvojna Bank, but the paperwork was overwhelming 'They asked for so much that I gave up in the end,' 'I know some that gave up on a loan for KM 2 million in the end,' 'You can always apply but you have to have a contact, those loans are connected to people.'

Savings were discussed and seen as problematic: 'I started my business in 2004, and still can't save; it will be the first time, this year. All I earn goes to pay back loans. Maybe next year I will be able to save KM 10,000. You need at least five years to turn a profit with raspberries,' The baker, who had bought a new oven commented, 'You have to keep up with technology, if you save the competition will eat you,' 'It's better to invest in property than save in a bank.'

On the crisis: 'Our city is dead, definitely dead,' 'Many shops are closed, people are unemployed, buying power is low, the experts in the wood sector have all gone to Slovenia. Only pensioners and the mediocre workers remain.' 'It is hard to sell loans here,' 'Many guarantors are paying loans taken here.'

While the focus group in Kakanj exposed the worries of low-paid employees, those in Sarajevo and Zavidovići were more optimistic, and the entrepreneurs offered many gratuitous suggestions for things Sida could support, from grace periods for agricultural loans to motorcultivators in rural areas. As a whole the focus groups brought out the same themes that appeared in individual interviews, and put a human face on the predictions and observations made in the meeting rooms of MCO headquarters, and in the international financial organizations.

Annex F List of Institutions and People Interviewed

Banking Sector

Raiffeissen Bank

Mr. Michael Muller, CEO

Ms. Larisa Maslo – Baljo, Funding Relationship Manager

Republic of Srpska Investment-Development Bank

Mr. Mirko Bošnjak, Management Analysis Department

Fund for Development of the Eastern Part of the Republic of Srpska

Mr. Branislav Subotić, Director of the Fund

Donors and NGOs

Sida

Mr. Nedim Bukvić, National Programme Officer

USAID

Ms. Amira Vejzagić-Ramhorst, Development Assistance Specialist

Mr. Vlado Milin, Project Specialist

World Vision

Ms. Claudia Bade, Country Programmes Director

Government Agencies

Central Bank

Mr. Sead Bijedić, Giro Clearing Coordinator

Banking Agency of the Federation of Bosnia and Herzegovina

Ms. Nizama Cataldo, Supervisor

International Financial Institutions

European Bank for Reconstruction and Development (EBRD)

Mr. Rijad Hasić, Associate Banker

European Fund for Southeast Europe (EFSE)

Ms. Mejra Juzbašić, Investment Manager

International Finance Corporation (IFC)

Ms. Selma Rasavac, Associate Operations Officer

KfW Bankengruppe, BiH Office

Mr. Gerald Kuhnemund, Director

Ms. Dželila Hadžović, Project Coordinator

World Bank

Mr. Goran Tinjić, Country Operations Officer

Microfinance Sector

AMFI

Ms. Dragana Mehmedović, Secretary

EKI

Ms. Sadina Bina, General Director

LIDER

Mr. Zijad Hasović, Director

MI-BOSPO

Ms. Nejira Nalić, Executive Director

MIKRO ALDI

Ms. Ferida Softić, Executive Director

MIKROFIN

Mr. Braco Erceg, Financial Contoller

PARTNER

Ms. Sonja Paočoč, Finance Manager

SINERGIA plus

Mr. Željko Bogdanić, CEO

Ms. Aleksandra Fekić, Associate for Foreign Investors Relations

SUNRISE

Mr. Milan Šešelj, Executive Manager

Ms. Lana Milavić, Expert Analyst for Cooperation with Investors

Annex G Map of Bosnia and Herzegovina



Source: University of Texas Libraries, http://lib.utexas.edu/maps/europe/bosnia_pol_2002.jpg

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REVIEW OF IMPACT OF SIDA'S MICROFINANCE SUPPORT IN BOSNIA AND HERZEGOVINA

The purpose of this report is to review the impact of the Swedish International Development Cooperation Agency's (Sida's) support to the microfinance sector in Bosnia and Herzegovina (BiH) during the past five years (2005–2009)

A secondary objective of the report has been to review the existing information of the development impact of the microcredit sector as a whole, including a discussion of the impact of the global financial crisis on the sector and how it has affected microcredit clients

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