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BUILDING A MICROFINANCE CULTURE IN GEORGIA

Final Report

AUGUST 2005
This publication was produced for review by the United States Agency for International Development.
It was prepared by Chemonics International Inc.

IVAN KHARADZE

New hardware and software enabled loan officers to track portfolios more accurately.

COVER PHOTO: USAID's program helped Georgia's micro lenders attract new clients.

BACK COVER PHOTO: Micro loans have helped thousands of businesses create jobs and growth.

PHOTOS: Ivan Kharadze

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Final Report

Georgia Microfinance Stabilization and Enhancement Activity
Contract No. 114-C-00-03-00142-00

IVAN KHARADZE

Small businesses like this convenience store account for 10 percent of Georgia's GDP.

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EXECUTIVE SUMMARY

MICROFINANCE IN A TRANSITION ECONOMY

Georgia's ongoing transition to a market-based economy has forced people to surrender their expectations of lifelong employment in a state-owned enterprise. Many large factories stand idle or work at a reduced capacity. Unemployment exceeds 10 percent, and more than half the population lives below the poverty line. These numbers would undoubtedly be greater were it not for more than 37,000 micro, small, and medium enterprises that create jobs and generate income for thousands of ordinary citizens.

MICROENTERPRISE BUSINESS REVENUE BY SECTOR

SECTOR	BUSINESS REVENUE	ESTIMATED HOUSEHOLD INCOME	BUSINESS INCOME AS % OF HOUSEHOLD INCOME
Trade	9,596	11,520	83.3
Service	3,786	4,854	78.0
Production	2,856	3,575	79.9
Agriculture	1,982	3,016	65.7

Source: GMSE Microfinance Demand Survey

Georgia's small businesses — most of them microenterprises employing fewer than 10 people — account for more than 10 percent of Georgia's GDP. Until recently, small entrepreneurs struggled at the fringes of the shadow economy, often with no fixed premises, no bank account, and no insurance. Unable to meet the collateral requirements of commercial banks, they often borrowed from family members or usurers to grow their businesses.

In the late 1990s, a number of nonprofit foundations and associations began lending to microenterprise clients. These microfinance institutions, or MFIs, enabled thousands of micro and small entrepreneurs to raise productivity, create jobs, and bolster the economy. However, the geographic reach of Georgia's MFIs was limited. Their legal status was unclear, which made it difficult for them to access commercial credit and forced them to rely on grants to fund their operations — not a reliable or renewable source of capital. Legally unprotected, they had to compete with subsidized lenders. And operating in isolation from one another, they were unable to advance the shared interests of MFIs and their clients.

In 2003, USAID launched a program to develop the microfinance industry. The Georgia Microfinance Stabilization and Enhancement program helped clarify the legal environment, strengthened the operational and financial sustainability and institutional stability of partner MFIs, established linkages between institutions, and raised awareness of how small enterprise growth helps alleviate poverty and fuel economic growth. The program was implemented by Chemonics International Inc. with partners Bankworld Inc. and Shorebank Advisory Services from August 2003 to August 2005.

BY THE NUMBERS: ACHIEVEMENTS OF THE PROGRAM, 2003-2005

- Helped draft an amendment to the Georgian Civil Code, passed in February 2005, that defined microfinance institutions and legalized the operation of microlending foundations and associations.
- Helped draft a Microfinance Law to be submitted to Parliament in October 2005.
- Established a Legal Action Committee to identify measures to improve the operating and regulatory environment for MFIs.
- Helped five partner MFIs achieve consistent operational sustainability of 100 percent or greater as of May 31, 2005. Operational sustainability means the ability to cover all non-financial costs of lending, such as salaries and administrative costs, depreciation of fixed assets, the cost of loan principal lost to default, and the effects of inflation, out of program fees and interest charges.
- Published and distributed a Georgian-language Corporate Governance Manual.
- Trained more than 150 loan officers in sustainable microfinance theory and practice.
- Conducted the first nationwide credit demand survey, which revealed a $238 million gap between demand and supply of micro loans.
- Enabled seven MFIs to join the MIX Market in 2005. MIX links MFIs worldwide with investors and donors to promote investment and the flow of information.
- Placed more than 40 articles about microfinance in leading newspapers.
- Organized 30 live radio talk shows that generated more than 200 calls from listeners.
- Produced two films about microfinance that were aired on national TV.
- Established a Georgian/English Web site that attracted more than 3,100 visitors over two years.
- Facilitated creation of a Public Advisory Council comprising MFIs and nonprofit leaders.
- Awarded $282,000 in small grants to six MFIs during 2004-2005.
- Awarded $800,000 in institutional grants to partners Constanta Foundation and Credo Vision Fund to lend to clients in Akhalkalaki and Ninotsminda regions.

To bring microfinance into the mainstream economy, the program made legal reform a key focus. Technical assistance, training, and small grants helped MFIs attract commercial financing, develop as institutions, broaden their product offerings, and expand their reach beyond Georgia's urban markets and bazaars. Today, MFIs operate with a clear legal status to lend, and with greater access to commercial credit. Institutionally stronger rural MFIs offer a greater diversity of products and services. And there is greater awareness of the role MFIs play in alleviating poverty and creating employment, a critical need in Georgia's rural regions.

Today, thanks to this USAID program, Georgia's small entrepreneurs enjoy greater opportunity to access loans to grow their businesses, create jobs, and contribute to the national economy.

The program succeeded in strengthening partner MFIs to the point where they are able to access commercial credit. As donor funding comes to an end, MFIs need to look to private investors to fund their long-term growth.

CHAPTER ONE

ASSESSING THE MARKET

Georgia's 11 MFIs are an important part of the integrated financial services sector, providing financial products and services to micro and small entrepreneurs not served by banks. As of June 30, 2005, more than 50,000 micro and small entrepreneurs had received approximately $40 million in MFI loans, and some 36,000 active clients held $19.7 million in outstanding loans. Approximately 120,000 jobs were created or retained as a result of MFI loans.

GEORGIA: A SNAPSHOT

Population	5.2 million
GDP per capita (constant 1995 US$)	$622
Unemployment	17% of labor force
Gross domestic savings	5.9% of GDP
Population earning less than $2/day	12%
Size of the informal sector	40% of the economy (1999)

Source: The Microfinance Gateway, www.microfinancegateway.org, July 2005

USAID's program was instrumental in laying the foundation for long-term sustainable development of the microfinance sector. This chapter describes early challenges and how they were overcome.

MAPPING STUDY

When USAID's program was launched in August 2003, Georgia's MFIs were registered as foundations and associations. Technically, they were violating the law by engaging in lending and risked having their registrations revoked.

GEORGIA'S MFIs

- Business Assistance Initiative
- BBK Financial
- Constanta Foundation*
- Vision Fund Credo Foundation*
- Crystal Fund*
- FINCA-Georgia
- Georgia Rural Development Fund*
- Small Business Development Fund*
- Support for Development
- Society Development Association
- Union of Trust

* Program partner MFIs

Besides the uncertain legal framework, MFI managers cited high operating costs, lack of capital, client default, and inadequate training as challenges to financial sustainability. They expressed a need for training in governance, internal auditing, portfolio management, debt collection, and general business and banking skills. Managers said MFIs faced competition from banks, and most were unaware of the possibilities of linking with other MFIs to promote a common industry agenda.

No study or survey of the microfinance sector had ever been undertaken, so managers had no idea of the potential demand for micro loans. No one had gauged public attitudes toward microfinance or its role in economic development.

As a critical first step, the team assessed the market for microfinance services using questionnaires, surveys, and focus groups. The results helped the team design a work plan around the following goals:

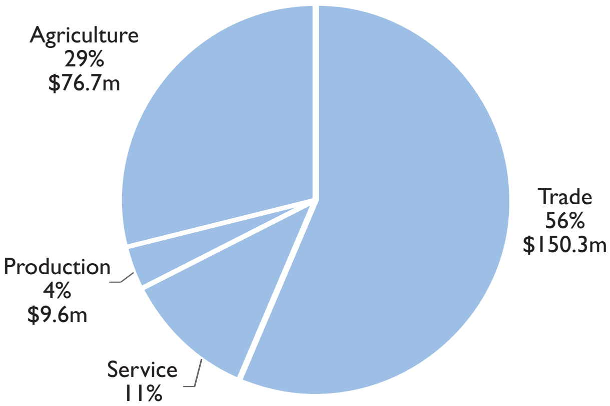
- Promote MFI sustainability and growth by establishing a clear legal framework.
- Ensure operational sustainability of each partner MFI supported by the program.
- Increase micro and small entrepreneur access to financial services.
- Establish stronger partnerships between banks and MFIs.
- Train MFI practitioners to improve institutional stability.
- Inform stakeholders and the public about the role of microfinance in economic growth.

CREDIT DEMAND SURVEY

The mapping study revealed the need for a survey to quantify unmet demand for micro loans. The team commissioned the Georgian Institute for Polling and Marketing to conduct the survey. Their interviews of 1,000 entrepreneurs in 11 regions yielded valuable data for the program, MFI practitioners, and other stakeholders, including USAID and the government of Georgia. Among the important findings:

- Effective demand for micro loans was estimated to be in excess of $238 million.
- Only one-third of microenterprises were availing loans, and more than 90 percent of effective demand was unmet.
- The average microenterprise loan size was $4,870 overall, $6,014 at commercial banks, and $1,256 at MFIs.
- MFIs met only 3.2 percent of microenterprise demand for agricultural sector loans.

EFFECTIVE LOAN DEMAND BY SECTOR



Source: GMSE Microfinance Demand Survey

PUBLIC ATTITUDES SURVEY

In December 2003, the team commissioned the Georgian Institute of Polling and Marketing to survey public awareness of and attitudes toward microfinance and MFIs. Among the highlights:

- Just over half of those polled said they had heard of microfinance and microfinance organizations.
- More than 75 percent of respondents said they had a positive view of microfinance and MFIs.
- Nearly 75 percent of respondents said they considered microfinance and MFIs effective in alleviating poverty.
- More than two-thirds of those polled thought micro and small businesses would continue to grow and create more jobs if they got more funding from MFIs.

The survey, the first of its kind, provided valuable information for designing the program's public information campaign. The public's positive views of microfinance and MFIs helped convince legislators, a critical stakeholder group, to enact legislation enabling MFIs to diversify their products, expand their reach, and attract commercial funding.

GUIDING PRINCIPLES

Based on the assessment results and program goals, the team identified five principles to guide implementation:

- *Establish a microfinance culture and industry.* To promote sustainable, long-term development of the microfinance sector, the team worked with all constituent groups — government officials, legislators, MFI practitioners, commercial banks, and donors — to promote understanding of the role of microfinance in economic growth and support for its development.

RELATED USAID PROJECTS

Our team facilitated meetings between partner MFIs and other programs working to improve entrepreneurs' access to financial resources. Collaborators included:

- AgVantage, implemented by ACDI/VOCA. AgVantage strengthens the capacity of Georgia's agricultural sector to respond to export opportunities.
- The Georgia Enterprise Growth Initiative, implemented by BearingPoint. GEGI fosters public-private dialogue and civil society participation to accelerate the development and growth of private enterprise through policy reform and increased access to finance.
- The Georgia Employment and Infrastructure Initiative, implemented by CHF International. GEII develops infrastructure services and generates income for citizens.

- *Emphasize outreach to underserved populations.* Technical assistance to partner MFIs emphasized diversification of financial products and services to enable expansion to underserved rural regions. Outreach to rural areas and underserved populations broadened the MFI client base and increased their operational and financial sustainability.
- *Build capacity and leverage Georgian resources to ensure sustainability.* Technical assistance, training, and small grants strengthened the institutional capacity and sustainability of MFI partners, enabling them to gain greater access to commercial resources. As a result, two partners accessed funding from Georgian commercial banks: one negotiated a debt financing arrangement and one secured a loan from an external investor.
- *Coordinate with other USAID projects.* The team met with other USAID implementers to discuss the new tax code, the role of microfinance in small enterprise sector development, formation of a credit bureau, creation of a microfinance association, educating MFIs interested in expanding to the rural sector, providing market information, and training. Implementers worked together to create synergies, avoid duplication, and extend the reach of good materials and projects. For example, the team shared market studies developed by AgVantage (see box) with partner MFIs.
- *Consolidate gains.* Mindful of USAID's significant investment in many Georgian MFIs, the program blended technical assistance with training to take partners to the next level: consistent operational sustainability. Georgian and expatriate consultants shared methodologies based on international best practices, adapted to the Georgian environment.

CHAPTER TWO

CLARIFYING THE LEGAL ENVIRONMENT

The ambiguous legal status of Georgia's MFIs was the single biggest impediment to long-term sustainable development of the microfinance industry. MFIs operated on questionable legal ground and risked having their operations liquidated. Although these entities were registered with the Ministry of Justice as foundations or associations, Georgian Civil Code regulations prohibited them from engaging in lending or entrepreneurial activities as their main functions.

MFI practitioners and international donors tried unsuccessfully to convince Georgia's legislators to allow MFIs to engage in lending to poor clients based on existing legal definitions (associations must serve the public interest or the interest of their members; foundations must serve a socially useful purpose). They argued that enabling MFIs to access commercial financing and make loans to the poor would grow businesses, create jobs, and raise household incomes.

MFIs DISCOVER COLLABORATION

Before they joined the Legal Action Committee, Georgia's microfinance practitioners viewed each other as competitors and were reluctant to work together. Just a few committee meetings convinced them of the value of collaboration to advance a shared agenda. Today, they continue to interact freely and openly, and in June 2005, five leading MFIs created an Association of Georgian Microfinance Organizations to promote long-term development of the microfinance sector.

LEGAL ACTION COMMITTEE

In December 2003, the team organized a Legal Action Committee of microfinance practitioners, civil society leaders, and donor representatives to identify measures needed to improve the operating and regulatory environment for MFIs and map out an action plan. Initially, some committee members supported drafting a special law on microfinance, while others favored amending existing legislation. After some debate, the committee unanimously agreed that amending existing legislation was the preferred short-term approach to achieving a clear legal status for Georgia's MFIs.

The committee submitted its recommendations to the Georgian government and Parliament for comment. When some policy makers expressed a preference for a specialized law on microfinance, the committee turned to the team to help develop a public relations and marketing campaign to promote its approach. The team organized a series of meetings with key policy makers in government, Parliament, and the National Bank of Georgia. One prominent legislator emerged as a "champion" who worked diligently to win unanimous support from the Cabinet of Ministers and helped push the recommended amendments through Parliament (see page 11).

CIVIL CODE CHANGES

In February 2005, legislators and the Cabinet of Ministers took up discussion of the committee's recommendations. Committee members provided statistical information about the industry and answered questions. The two-week process concluded with the unanimous support of the Cabinet of Ministers and a presentation by the committee to the full Parliament. On February 25, 2005, legislators voted 110-1 to amend the Civil Code. The amendments introduced three major changes:

- A new article (Article 1511) defines "microfinance organization" and "micro loan" and obliges noncommercial micro lenders to register as microfinance organizations by April 1, 2005.
- Article 1511 obliges the National Bank of Georgia to introduce a specialized microfinance law in Parliament by November 1, 2005.
- Article 35 relieves registered microfinance organizations of the threat of having their registrations revoked for engaging in lending or entrepreneurial activities.

With their status clarified, MFIs can operate with confidence that they will not be shut down and begin to think long-term. They can develop strategic business plans to diversify their products, expand their geographic reach, and attract investments. Local commercial banks that have excess liquidity, and external investors interested in the growing microfinance market, may find Georgia's MFIs less risky and, therefore, more attractive.

MICROFINANCE LAW

Article 1511 of the Civil Code obliges the National Bank of Georgia to submit a microfinance law to Parliament by November 1, 2005. The team worked with the bank to draft a law that distinguishes between noncommercial and commercial MFIs. Noncommercial MFIs that do not take savings deposits from the public and use them to fund lending operations will not need a license or be subject to prudential regulation. Commercial MFIs that take savings deposits and lend these funds to borrowers will be obliged to obtain a license from the National Bank and will be subject to prudential regulation. Both types of MFIs will need to submit financial reports and audits to the National Bank. They will also be required to publish their financial audits in the Georgian press.

The draft law will be sent for review to the Ministries of Justice, Economy, and Finance. Their comments will be incorporated into a final draft for submission to Parliament in October 2005. The newly formed Association of Georgian Microfinance Organizations (see page 23) will monitor the process to ensure that the final version of the law supports the continued sustainable development of the microfinance sector.

A FEW POWERFUL WORDS

It was just a small addition to Georgia's massive Civil Code, buried in article 1511. Yet passage of the "Re-registration of Microfinance Organizations" amendment paved the way for long-term development of a sustainable microfinance industry in Georgia.

The amendment allowed foundations, associations, and other noncommercial organizations to register as microfinance institutions and operate legally for the first time. This opened the doors to affordable credit to poor borrowers from underserved and remote rural regions.

Before the amendment, Georgia's microfinance institutions, or MFIs, violated the law. They were not allowed to disburse loans and faced the threat of having their registrations revoked. Investors were reluctant to enter the sector because of its vague legal status.

The amendment put the microfinance industry on the road to closing the gap between microcredit supply and demand, estimated to exceed $238 million. It also enabled MFIs to shift from short-term survival strategies to long-term business planning. Now they can diversify their products and expand to new regions. They are also more attractive to domestic and foreign investors.

The amendment defines a micro loan to be no more than GEL 10,000 for a single borrower, or about $5,400. One micro loan creates 1.5 jobs in urban areas and 4 jobs in rural areas, according to calculations by USAID— a much-needed boost in a country where only 4 in 10 working-age people are employed and more than 2 million people live below the poverty line.

For the USAID-funded Georgia Microfinance Stabilization and Enhancement program, getting the amendment passed was a major achievement. The project team worked through a Legal Action Committee of microfinance practitioners and international donors and also made the case to legislators, government officials, and the public. Nino Kalandadze, a member of Parliament and deputy chair of its committee on legal issues, championed the initiative and was instrumental in getting the amendment passed.

"We presented the fundamental facts on how MFIs are important for the development of the economy," said Giorgi Otaridze, the team's legal expert. This success helped Georgia move closer to its goals of alleviating poverty, creating jobs, and raising incomes.

CHAPTER THREE

EXPANDING SERVICES AND IMPROVING SUSTAINABILITY

The program's early assessment of the microfinance sector revealed several threats to long-term sustainable development of the microfinance industry. Identifying these threats up front ensured that the program addressed critical issues with an appropriate blend of technical assistance and training.

EXPANDING SERVICES

Before the program began, MFIs focused mainly on providing unsecured group loans to clients trading at bazaars or markets in urban and suburban areas. This was risky for several reasons:

- When municipalities closed bazaars and markets, client businesses were dislocated, resulting in loan defaults.
- Undiversified client and loan portfolios made MFIs more sensitive to external shocks, such as bazaar closures and competition from new market entrants.
- MFIs competed with each other for the same clients.
- MFIs faced competition from banks that began lending to the same client groups.

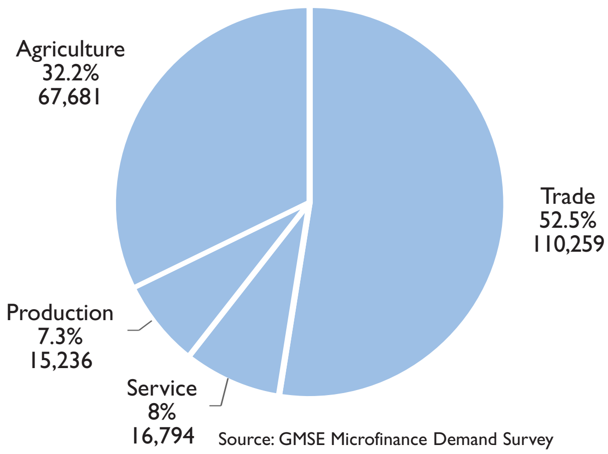
The team worked with partner MFIs to diversify their range of products and services and extend their geographic reach. A number of highly qualified expatriate consultants were commissioned to help, including Jacob Yaron, the World Bank's key rural finance specialist and the author of several books on the subject.

Marketing plan development. To expand, MFIs needed marketing plans based on data about targeted markets and competitors, knowledge of the mix of products and services in demand, and a strategy for developing brand recognition. In early 2005, a specialist led a seminar on marketing demand surveys and strategic marketing plan development for MFIs. Each participant was given a sample marketing plan and a guide for developing such a plan. The specialist then visited partner MFIs to help develop marketing plans. The plans will enable MFIs to reach out to new markets, grow their client bases, and increase their operational and financial sustainability.

New product development. To increase their profitability, MFIs needed to offer customers a broader range of products. This would enhance customer loyalty, improve client retention, and improve MFI brand recognition. Based upon information gathered from their marketing surveys, MFI managers began developing and testing new loan products. To build institutional capacity in this area, the team invited a product development specialist to work with partner MFIs. The specialist led a seminar on new product evaluation and preparation, prototype design, pilot testing, and launch. Each participant was given a handbook to guide them through the process. The specialist then met with senior managers and staff responsible for strategic planning and marketing. A particular focus was helping partner MFIs design products to serve rural markets and deepen penetration into those markets. As a result, partner MFIs expanded to such regions as Akhalkalaki, Ninotsminda, Akhaltsikhe, and Marneuli.

Rural finance. Agriculture accounts for about 20 percent of Georgia's GDP and 50 percent of employment, but the sector receives just 3 percent of all commercial bank loans. To develop this underserved market, the team invited rural finance specialist Jacob Yaron to work with MFI partners to grow their rural portfolios. Following a seminar on the topic for partners and senior Ministry of Agriculture and banking sector officials, the specialist visited each partner MFI to train managers on how to establish interest rates that will promote long-term sustainability and viability. Managers also learned how to increase loan officer efficiencies to maximize client inflow and minimize the cost per loan disbursed. Through numerical illustrations and case studies, managers learned how to deter-

NUMBER OF MICROENTERPRISES BY SECTOR



Source: GMSE Microfinance Demand Survey

mine which agricultural projects are good credit risks and which should not be funded, and why.

As a result, partner MFIs have rapidly expanded services to the rural sector, growing their rural finance portfolios and enabling many more micro and small rural businesses to expand.

Two partner MFIs, Constanta Foundation and Credo Vision Fund, were awarded program grants of $400,000 each to establish offices in the remote Akhalkalaki region, where unemployment is high and funding for income-generating activities is needed.

IMPROVING INSTITUTIONAL SUSTAINABILITY

To assess the institutional capacity of partner MFIs, the team conducted diagnostic operational and financial reviews of each MFI. The reviews revealed several challenges:

- Most MFIs lacked formal corporate governance structures and independent boards of directors. Where these existed, they were inefficient and needed improvement.
- Internal controls — auditing mechanisms to ensure sound lending practices and minimize the chances of fraud — were underdeveloped or nonexistent, posing a serious threat to these institutions and the industry as a whole.
- Mediocre portfolio quality indicated a need to train loan officers so they could reach more clients and achieve better recovery rates.
- MFIs relied mostly on external sources for training, whereas internal training is less expensive and builds capacity.

The results helped the team determine an optimal blend of technical assistance, training, and grants to address each challenge. Technical assistance and training was provided by Georgian and expatriate consultants, and grants were provided through the Credit Innovation Grant Program (see page 16) to help partners improve their operations and build institutional capacity.

Technical assistance. To address the corporate governance challenge, the team commissioned an expatriate consultant to conduct governance training for senior managers and board members of all MFI partners. The consultant developed a corporate governance manual that was translated into Georgian and distributed to partner MFIs. To strengthen internal controls, the team helped partners develop policies and manuals based on international best practices. Small program grants enabled MFIs to hire internal audit staff. These efforts resulted in the creation and strengthening of internal auditing departments in all partner MFIs, minimizing the risk of fraud.

Technical assistance to partner MFIs was provided on a weekly or monthly basis according to agreements signed with each partner. Each agreement was monitored monthly to track impact and progress and modified biannually to reflect the changing needs of each institution.

Training. The team provided training to partner MFIs, worked with partners to build internal training capacity, and assessed the potential demand for training delivered by a Georgian organization.

Some 150 loan officers from all 11 of Georgia's MFIs attended three-day training courses led by the team's MFI specialist. Topics included cash flow and financial analysis of the businesses of potential borrowers, general loan analysis, and monitoring problem loans.

To build internal training capacity, specialists provided onsite training and assistance to each MFI. The team also organized a study tour to Amman, Jordan, for representatives of Constanta Foundation, Credo Vision Fund, Crystal Fund, and Georgia Rural Development Fund. The participants, occupying different positions in their respective organizations (board member, internal auditor, branch manager, or finance manager), had an opportunity to interact with their counterparts in two operationally and financially sustainable Jordanian MFIs who played a significant role in the long-term development of their organizations. As a result, Georgian MFIs created incentive systems for staff, implemented marketing and customer service measures, and began planning for new financial products and services, such as business-to-business linkages and micro insurance.

The team assessed the potential demand for external training to determine the optimal way to provide it. The assessment led to the conclusion that the best option would be to build microfinance training capacity into an existing training institution rather than start up a new institution. The team identified the Banking Finance Academy in Georgia as the organization best qualified to develop microfinance training. The team contacted the Microfinance Center for Central and Eastern Europe and the Newly Independent States to explore a possible partnership with the Banking Academy to train local trainers and develop the training curriculum. The team recommended pursuing this option as a good way to satisfy the demand for microfinance training, coupled with strengthening training capacity inside each MFI and using external trainers from the Microfinance Center for Central and Eastern Europe and the Newly Independent States, the Russian Microfinance Center, the Consultative Group to Assist the Poorest, and other organizations.

Credit Innovation Grants Program. Grant funding to support targeted initiatives and general development of the microfinance sector was an integral part of the comprehensive technical assistance provided by the program to partner MFIs. While the original contract envisioned an award of at least one large institutional development grant in the first year of implementation, it became apparent that many MFIs did not have the capacity to make efficient use of large grants. Meanwhile, the team identified an urgent need for small (up to $100,000), short-term grants targeting specific needs such as management information system upgrades, external and internal audits, development of new loan products and marketing strategies, and targeted market demand research. In response, the team introduced flexible grant award parameters.

The grants program was based on the principles of open competition, disclosure, transparency, and accountability, guided by a comprehensive grants manual and supported by documentation. In the first year of implementation, the program received 29 grant applications, of which 19 were selected for closer review. Nine applications with a combined value of more than $250,000 were approved for funding by an evaluation committee comprising professional staff from the program and USAID. Projects included staff training and development, external and internal audits, and the installation of new management information systems (see below). Each project contributed to the goal of improving the operational sustainability of partner MFIs and making them more attractive to commercial investors.

NEW SYSTEM MAKES LOAN TRACKING EASIER

Mary Chachanidze's job as finance manager at the Georgian Rural Development Fund became much easier following installation of a new management information system at this microfinance institution.

Previously, Mary used an outdated module to keep track of client loans, and information from branch offices was updated only once a month. Using the new system, Mary can access daily updates on loans disbursed from the fund's four regional offices, allowing her to better monitor operations.

The new system enables staff to track repayment schedules, calculate delinquency rates for missed payments, and put together more informative reports on the fund's portfolio, collateral, and borrowers. Under the old system, portfolio information from the field offices was hand-delivered to headquarters in the capital, Tbilisi, once a month, making it difficult for top management to catch the early signs of problem loans and take timely action.

Following the purchase and installation of new hardware and software, staff across the entire network were trained to use it. Among the purchases were four digital cameras to record pictures of borrowers and collateral as part of a new, enhanced loan security system.

Besides allowing managers to monitor the fund's portfolio on a daily basis, the new system enabled creation of a loan officer incentive system based on performance.

The fund was founded in 2003 and inherited a credit cooperative system portfolio operated by a U.S. organization, ACDI/VOCA. Currently the largest agricultural lender in Georgia, the fund had 917 active loans in 17 regions in June 2005.

The new management information system was purchased with a small grant from the USAID-funded Georgia Microfinance Stabilization and Enhancement program.

The team also evaluated three proposals for large institutional grants totaling $3.5 million. Applicants requested funding to expand their loan portfolios and improve operational and financial sustainability. In June 2005, two applicants were asked to submit revised proposals and budgets for work in the remote and impoverished Akhalkalaki region. The revised proposals were approved, and two MFIs (Vision Fund Credo Foundation and Constanta Foundation) were each awarded $400,000.

CHAPTER FOUR

COMMERCIALIZING MFIs

This USAID program was an integrated effort to strengthen MFIs so they could access commercial credit. Clarifying their legal status freed MFIs of the threat of shutdown and made them more attractive to investors. Improving their operational sustainability and institutional capacity enabled them to focus on the challenge of commercializing the industry. As donor funding comes to an end, MFIs need to look to private investors to fund their long-term growth.

BANK AND MFI COOPERATION

Previously, MFIs had limited interaction with banks, using them mainly for disbursements and repayments. Neither MFIs nor banks seemed willing to take the first step to establish a partnership. MFIs feared losing clients to the banks, and banks perceived MFIs as small, poorly managed organizations making handouts to the poor, not as potential business partners.

An assessment by the team confirmed that banks did not fully understand the operations, reach, products, and services of MFIs but were willing to discuss possible partnerships. The team organized a roundtable meeting where MFIs delivered presentations about their operations to bank representatives. The event was a success and sparked interest among the banks in partnering with MFIs. A direct result of this meeting was a partnership between Vision Fund Credo Foundation, an MFI, and People's Bank that minimized money transfer delays for Credo's clients and allowed People's Bank access to new potential clients.

MFI STANDARDIZATION

Before the program began, each MFI had its own way of calculating operational and financial sustainability, portfolio at risk, active clients, and other performance indicators. The lack of standardization made it difficult for donors and investors to compare MFI performance and determine their investment priorities.

With this in mind, the team established a partnership with the MIX Market, an international nonprofit that promotes information exchange in the microfinance industry. Under the agreement, MIX provided tools and technical expertise to help the team develop a performance monitoring and benchmarking system to standardize MFI reporting, facilitate MFI benchmarking, and strengthen relations with socially responsible investors. Results of the partnership included greater standardization in reporting, greater transparency for potential donors and investors, and the addition of seven Georgian MFIs to the MIX Market, bringing the total to nine. Another achievement was publication of a benchmarking report on the microfinance market in Georgia.

ACCESSING COMMERCIAL CREDIT

Increased operational and financial sustainability achieved by program partners enabled them to access new sources of commercial funding. Crystal Fund received debt financing from TBC, a Georgian commercial bank, while Vision Fund Credo Foundation was able to negotiate deals worth $300,000 with two Georgian banks, including a $150,000 credit line with the Bank of Georgia and a $150,000 short-term loan from TBC. Other partners, including Constanta Foundation and Georgia Rural Development Fund, held initial discussions with local banks and international lenders.

The team also helped develop two Development Credit Authority concept papers, one for portable guarantees for four MFIs (Constanta, Crystal Fund, FINCA-Georgia, and Vision Fund Credo Foundation) to help them access local or international commercial funding, and one for banks to stimulate investment in Georgian agriculture and agribusiness. The team envisaged that $5 million in portable guarantees would help these MFIs leverage $10 million in commercial domestic or international financing or a combination of the two, reducing their dependence on donor funding.

CHAPTER FIVE

BUILDING PUBLIC AWARENESS

Stakeholder awareness is critical for development of a sustainable microfinance sector. The most important stakeholders in Georgia are government policy makers, members of Parliament, and the general public. Officials and legislators need to be knowledgeable about microfinance to pass laws that support long-term development of a sustainable industry. The public needs to know about microfinance so that they can access loans to develop their small businesses, create jobs, and increase household income.

Recognizing the importance of public awareness, the team made it a key pillar of the program. The section below explains how various activities were used to promote the values and principles of sustainable microfinance.

PUBLIC ATTITUDES SURVEY

The team contracted with the Institute of Polling and Marketing in December 2003 to measure public attitudes toward microfinance and MFIs. The survey was undertaken to establish the first-ever baseline data on public perceptions of microfinance and to provide information for developing the program's public information strategy.

The results of the survey showed that about half of those interviewed knew about microfinance and had a generally positive impression of the industry and MFIs. The team recommends that the new MFI Association, AGMO (see page 23), undertake a follow-up survey in the fall of 2005 to measure changes in public perceptions.

WEB SITE

Recognizing the need to establish a strong public information program early on, the team launched English and Georgian versions of its Web site in December 2003. A comprehensive information source about the program, the Web site contained up-to-date and in-depth coverage of major program achievements and activities, as well as information for policy makers and tools for MFIs. As of May 31, 2005, the Web site had attracted more than 3,100 visitors.

PUBLIC INFORMATION ADVISORY COMMITTEE

In January 2004, a Public Information Advisory Committee comprising microfinance practitioners, representatives of civil society organizations, and media representatives was formed to develop a microfinance public information program. The committee worked together to design a coordinated, multifaceted strategy using the mass media, seminars and workshops, special events, and face-to-face meetings to promote the values and practice of sustainable microfinance and raise awareness among the various stakeholder groups.

MORE JOBS, FEWER SOCIAL PROBLEMS

“ One of our goals is to improve the living standard of socially vulnerable people by ensuring their employment. The aim of microfinance is to improve the business of micro clients and micro enterprises, which in turn helps alleviate social problems ”

NIKA KUTATELADZE, CREDO FOUNDATION

MEDIA OUTREACH

The program used print, radio, and TV to get its message across. Through contractual relationships with two major Georgian-language newspapers, *Resonance* and *24 Hours*, and one English-language newspaper, *The Messenger*, the team published more than 50 articles about the program and the microfinance industry. The team also organized a roundtable discussion about the future of the microfinance industry. The event was held in the offices of *24 Hours* and attended by representatives of Constanta Foundation, Georgia Rural Development Fund, Credo Vision Fund, BBK Financial, and Caucasus Credit, a foundation uniting three western Georgian MFIs. Following the roundtable, the newspaper published a full-page transcript of the meeting

The program facilitated Georgia’s first live television talk show dedicated to microfinance. MFI practitioners were invited to answer questions from viewers. The event generated good publicity about microfinance and its role in alleviating poverty, creating jobs, and raising living standards. The program also supported five additional TV broadcasts about microfinance.

The program helped produce two films about the impact of microfinance on the lives of Georgia’s micro and small entrepreneurs. The films were broadcast on national and local television stations. Video copies of the films will be given to the MFI association, AGMO, for future use to build microfinance awareness and support.

Through a contract with Radio Fortuna in Tbilisi, the program sponsored weekly one-hour live radio programs about specific issues related to microfinance. Thirty Friday-night talk shows generated more than 200 calls from listeners.

SPECIAL EVENTS

The team organized special events to mark notable program achievements. One event publicized the first credit demand survey ever conducted in Georgia (see page 6), another unveiled the Georgian-language corporate governance manual (see page 15), and a third celebrated the passage of amendments to the Georgian Civil Code (see page 11). All the events were well attended and attracted positive media coverage.

DIALOGUE WITH TBILISI CITY HALL

The program took a leading role in building relations with officials at Tbilisi's city hall and urged them to establish dialogue with MFIs operating in the city. When officials decided to close street bazaars, resulting in the dislocation of many MFI clients, the team facilitated meetings between MFI representatives and city officials to discuss the situation. The parties agreed that city officials would inform MFIs of pending bazaar closures ahead of time so that MFIs could monitor affected clients and anticipate potential loan repayment problems. On April 12, 2005, the team arranged for MFIs to participate in a meeting to discuss economic development in the city. After the meeting, MFIs were given a seat on a committee created by the Tbilisi City Government to discuss small enterprise development issues.

PROMOTIONAL MATERIALS

The team produced a variety of materials to educate the public about microfinance and establish the program's identity. The tag line "GMSE: Promoting Sustainable Microfinance" was used on all marketing materials. Pens and wall calendars were sent to clients and partners, the first Georgian-language directory of local MFIs was produced, and information packets about the state of the Georgian microfinance industry and a brochure on the microfinance demand survey were distributed to 10 leading Georgian nonprofits. The information packets targeted the Civil Society Institute and the Center for Strategic Research and Development of Georgia, partners of the USAID-funded Citizens Advocacy Project, to encourage them to take a more active role in advocating improvements in the legal environment for MFIs.

MFI ASSOCIATION: AGMO

Five leading MFIs founded the Association of Georgian Microfinance Organizations, which registered with the government in June 2005. This major accomplishment was made possible by the program, which brought these organizations together for the first time under the auspices of the Legal Action Committee (see page 9). Over time, a spirit of trust and cooperation developed, and MFIs recognized the power of working together to solve their common problems.

As of June 2005, AGMO's strategic business plan was in development. The team advised the founding members to define their scope and mission broadly to enable them to reach the largest possible audience, and to be as inclusive as possible when considering applicants for membership. The team is hopeful that AGMO will be successful in securing start-up funding so it can develop into a strong advocate for the long-term sustainable development of microfinance in Georgia.

CHAPTER SIX

ACHIEVEMENTS, CHALLENGES, AND LESSONS FOR THE FUTURE

ACHIEVEMENTS

With the conclusion of program activities in August 2005, Georgia's microfinance sector is significantly better positioned for long-term sustainability than it was at the start of the program two years earlier.

- With their legal status clarified, Georgian MFIs no longer have to worry about having their registrations annulled and their operations halted for noncompliance with the law.
- Legally established MFIs are more attractive to private investors and international donors. Several MFIs have successfully attracted commercial funding.
- Thanks to technical assistance, training, and grants provided by the program, MFIs are better equipped to engage in long-term strategic planning, diversify their products and services, expand to new regions and market segments, and possibly transform into regulated, deposit-taking institutions.
- Georgian policy makers and the public perceive the microfinance industry as an important element of an integrated financial sector and support its development.

CHALLENGES

Despite these achievements, the microfinance industry faces significant challenges ahead. It will be important for MFIs to:

- *Ensure passage of a microfinance law that promotes long-term development of the industry.* As of July 2005, a draft law was being circulated to ministries for review and comment before being finalized and submitted to Parliament for a vote by November 1, 2005. It is imperative that the microfinance community mobilize a coordinated effort through AGMO to advocate passage of this law and ensure that no revisions are made that would inhibit future development and growth.

- *Ensure fair tax treatment for MFIs.* Two issues need to be addressed. First, according to the recently adopted Tax Code, MFIs are unable to take a deduction for their loan loss reserve fund. This can be considered discriminatory tax treatment for MFIs that have such funds, since their direct competitors in the formal banking sector are allowed to take a loan loss reserve reduction. Second, per the current Law on Grants, grant funds used for "entrepreneurial or political activities" are not considered grant funds but "net profit" for the recipient organization. This obliges the recipient organization to pay a 20 percent profit tax on the funds. Since MFIs engage mainly in lending or entrepreneurial activities, any grant funds they receive for their main activity is subject to profit tax. This places an unfair tax burden on MFIs and acts as a disincentive for donors to make grant funds available to MFIs.

- *Ensure sustainability for AGMO.* In June 2005, AGMO was in the early stages of its development and was seeking start-up financing. Continued assistance is necessary to ensure that AGMO continues to promote microfinance best practices, build greater public awareness of microfinance, help MFIs attract private investment to minimize their reliance on donor funding, and advocate legislation that supports microfinance industry growth.

- *Compete successfully on price.* As banks continue to downscale and compete for micro and small business clients, Georgia's MFIs will need to become more efficient and bring down their high operating cost ratios — currently above 30 percent — so they can offer competitively priced products and services.

- *Secure a market niche.* MFIs must think about market positioning and the optimal product mix needed to compete with banks and attract new clients. They must strike a balance between offering too many products and services in too many regions on one hand, and being too focused and concentrated to take advantage of economies of scale on the other. Increasing competition from the formal financial sector will undoubtedly influence such decisions.

- *Attract commercial funding to sustain growth.* Until recently, Georgia's MFIs relied largely on grants and soft credits from donors. They lack experience accessing credit on the open market. They also lack collateral to secure a loan. In response, the team worked with USAID to prepare application materials for portable DCA guarantees. DCA guarantees should improve MFIs' access to commercial banks and other investors and strengthen their negotiating position to get the most favorable loan conditions. It will be important for the implementer(s) of the new USAID small and medium enterprise support activity to continue with this effort.
- *Network with regional industry partners.* The team initiated work to plan a Caucasus regional investors' fair, with the goal of introducing donors, investors, and MFIs to one another to facilitate MFI access to commercial credit. Potential invitees expressed broad interest in and support for such an event. The team recommends that AGMO pursue this opportunity and seek support from USAID and other donors.
- *Build on public awareness gains.* The program's public awareness work was instrumental in getting key legislation passed. The challenge for the future is determining who can continue this work. It is logical to expect AGMO to play this important role, but it will take coordination and significant financial resources to do so. The team recommends AGMO make public awareness activities a key pillar of its business plan. Moreover, it will be important to craft a message that emphasizes the role MFIs play in an integrated financial services sector. The loan products they offer and the markets they serve complement the products and services of other players. The goal is a mature financial services sector with a variety of products and services for all types of clients.

LESSONS FOR THE FUTURE

Development is informed by careful monitoring of results and analysis of lessons learned. To build on successes and improve the performance of future programs, we present key lessons learned during implementation of the Georgia Microfinance Stabilization and Enhancement program.

When working to promote legislative reform:

- *First, forge consensus on the agenda.* One great success of the program was persuading MFI practitioners to set aside their individual agendas and speak with one voice. The consensus-building process was not easy, but by focusing on common goals and working backward from them to tackle disagreements, the process moved forward and ultimately ended with the unanimous agreement of all Legal Action Committee members.

- *Move on multiple tracks simultaneously.* To ensure the broadest constituency of support for the policy reform agenda, the team met with more than 30 officials in government, Parliament, and the National Bank. This strategy paid off when one of these individuals became the champion of the reform initiative and introduced the amendments in Parliament.

- *Identify a champion and use that person's position and authority to build broad support among key stakeholders.* The deputy chair of the legal committee in Parliament used her position to open doors to high-ranking officials and move the initiative forward. Her guidance and advice were invaluable.

- *Target the real decision makers.* The decision maker is the best person to read a document like a policy position paper, so it is important to identify that person ahead of time and be sure to share important documents with all key stakeholders.

- *Stay focused and be persistent.* It would have been very easy to abandon the process after receiving negative feedback from the Ministry of Justice on the chosen approach (amending existing legislation). However, the team judged that the Ministry of Justice, while an important stakeholder, was only one voice in the process and continued to solicit comments from other stakeholders who turned out to be more receptive.

- *Expect setbacks.* Policy reform is complicated, and dissent should be expected. The important thing is to understand the extent of the dissent and be able to determine whether it is limited to certain quarters or so widespread that it will sink the reform effort.

- *Be flexible.* Initially, the Legal Action Committee proposed six amendments to existing legislation, but during consultations with stakeholders, it became clear that their recommendation to reduce the number to one or two main amendments would increase the likelihood of passage in Parliament. Upon receiving that information, the Legal Action Committee focused on two important amendments.

- *Clearly articulate the message.* It is imperative to articulate the intended goals clearly so that policy makers can form their opinions. The challenge was to explain that the ambiguous legal status of MFIs was hampering their ability to attract commercial funding, and that the proposed amendments to the Georgian Civil Code would remove that risk while allowing more time to develop a comprehensive microfinance regulation scheme. It was important to make clear that the goal was not to seek special treatment for MFIs, but to ensure they could operate legally and effectively in the interim period.

- *Conduct a comprehensive awareness campaign.* To build support for the policy reform agenda, the team used every means available — the mass media, face-to-face meetings, seminars and workshops — to educate policy makers and the general public about the role of microfinance in poverty alleviation, job creation, and economic development. Policy makers began to realize that MFIs could accomplish their goals only if they were allowed to register and engage in legal lending.

When providing technical assistance to beneficiary organizations:

- *Conduct due diligence at the outset to better understand the market.* Going into the project, the team knew partner MFIs needed technical assistance, but only after thorough operational assessments did the breadth and scope of the assistance needs become apparent, ranging from systems and governance to management and marketing.

- *Balance technical assistance among beneficiaries.* During Year 1, the program provided intensive technical assistance to one organization, the Georgian Rural Development Fund. While this organization was an important partner, all partners must benefit and move toward transformation and commercialization. A shift in the balance of technical assistance resulted in stronger financial indicators and better access to commercial financing for five partner MFIs.

When determining the optimum approach to project implementation:

- *Ensure that public information campaigns address individual target audiences.* The team understood the critical importance of a comprehensive public information campaign to dispel myths and misconceptions about microfinance and promote the important role it plays in the local and national economy. Specialists identified specific interest groups, such as the public, policy makers, and MFI practitioners, and developed targeted messages for each to raise awareness and build support for development of a sustainable microfinance industry.

- *Adopt an integrated approach to implementation.* Early on, the team concentrated on developing implementation strategies for each task area. While that was an effective way to ensure the achievement of deliverables under each task, it did not highlight the linkages among tasks. Success in one task is often related to or contingent upon success in other tasks, with the ultimate goal of three MFIs achieving consistent operational and institutional stability. The second-year work plan was developed based on a comprehensive approach to implementation. Greater coordination of activities in different tasks areas created a positive overall impact — for instance, by coordinating public awareness activities with policy reform efforts and MFI expansion to new regions.

CD ROM INDEX

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