

FINAL REPORT

Ukraine Micro Lending Programme
Grant Agreement # 121-G-00-98-00617 between EBRD and the USAID
Regional Mission to Ukraine, Moldova and Belarus

December 2005



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1. The UMLP: Achievements to Date

Since the launch of the UMLP in 1997, a total of nine Ukrainian banks have joined the program, but in the meantime the participation of three of these banks has been terminated due to an insufficient level of activity. Today six banks are participating in the UMLP. The first two banks to join the program, Bank Aval and PrivatBank, have been involved in the UMLP since 1997. They were followed by ProCredit Bank, which joined in February 2001; Bank Forum, which became a partner bank in November 2001; and Bank Nadra, which has been involved in the UMLP since April 2002. The newest partner bank, CreditProm Bank, initiated its co-operation with the UMLP in March 2004.

The portfolio as of October 31, 2005 amounted to USD 365.4 million, representing 75,644 loans. Besides the steady growth in both the outstanding portfolio and monthly output, another particularly noteworthy feature is the high quality of the portfolio: as of October 31, 2005, the portfolio at risk (PAR) figures were 1.1 per cent over one day and 0.7 per cent over 30 days.

Table 1: UMLP portfolio breakdown by partner bank (as of October 31, 2005)

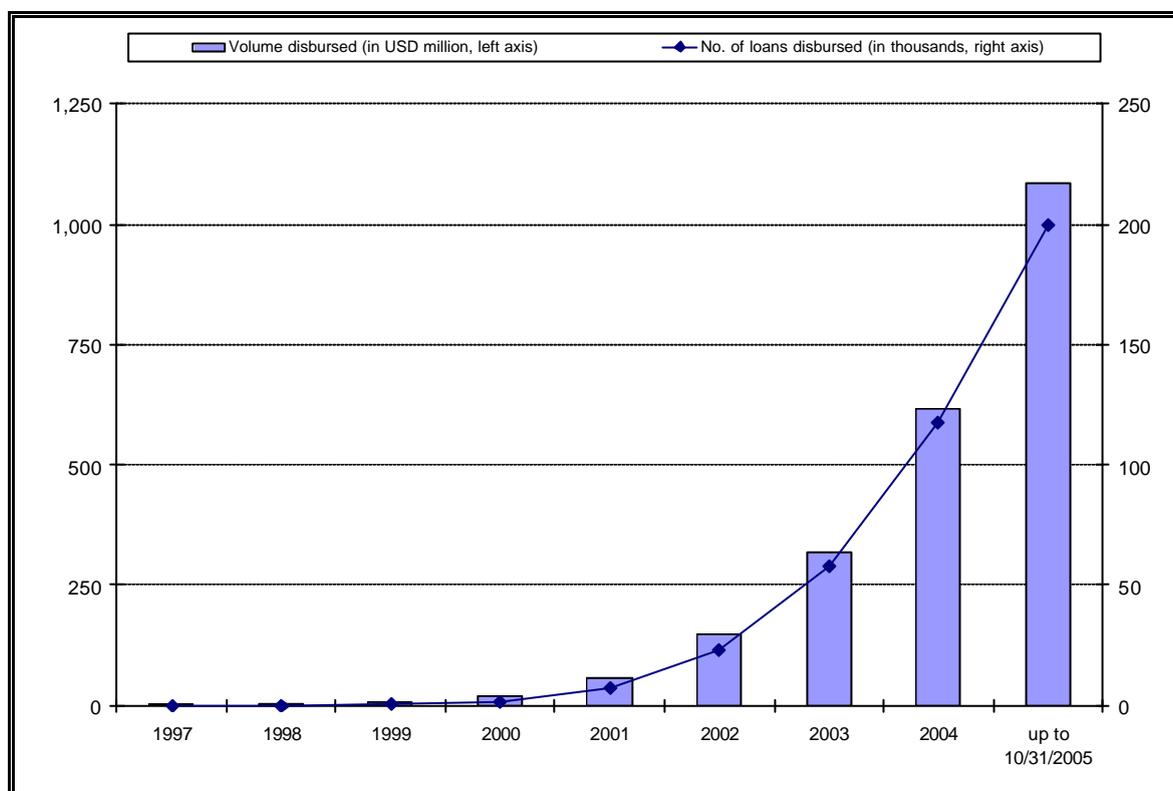
Bank	Loans		Volume		Av. loan amount in USD	PAR >1 day %	PAR >30 days %
	No.	Share in %	in USD	Share in %			
Bank Aval	9,299	12.29%	61,873,882	16.93%	6,654	1.2%	0.6%
CreditProm Bank	1,805	2.39%	8,961,705	2.45%	4,965	1.6%	1.0%
Bank Forum	3,615	4.78%	16,510,226	4.52%	4,567	0.4%	0.3%
Bank Nadra	6,909	9.13%	29,668,643	8.12%	4,294	0.5%	0.3%
PrivatBank	29,107	38.48%	134,572,518	36.83%	4,623	0.6%	0.4%
ProCredit Bank	24,909	32.93%	113,783,064	31.14%	4,568	1.8%	0.3%
Total / Average	75,644	100.00%	365,370,038	100.00%	4,929	1.1%	0.7%

Source: IPC/UMLP statistics

1.1. Disbursement performance and portfolio growth

Since 2001, the program's disbursement figures have improved significantly and it has reported strong portfolio growth. While this upward trend has clearly been attributable in part to the positive GDP growth rates that Ukraine has achieved since 2000, it has been primarily a result of the substantial increase in competition among the individual partner banks. This competition was spurred in particular by the establishment of ProCredit Bank – an institution which has, by its example, shown how much potential there is in the micro and small enterprise (MSE) sector in Ukraine, and how effectively this potential can be exploited by a bank that specializes in serving this target group.

Figure 1: UMLP cumulative disbursements (April 1, 1997 – October 31, 2005)



Source: IPC/UMLP statistics

**Table 2: UMLP cumulative disbursements, breakdown by year
(April 1, 1997 – October 31, 2005)**

	MICRO AND SMALL		MICRO AND SMALL, CUMULATIVE	
	No. of loans	Volume (in USD)	No. of loans	Volume (in USD)
Total 1997	54	1,403,547	54	1,403,547
Total 1998	138	2,617,654	192	4,021,200
Total 1999	324	4,032,550	516	8,053,751
Total 2000	1,227	13,258,438	1,743	21,312,188
Total 2001	5,237	38,181,784	6,980	59,493,972
Total 2002	16,408	88,522,954	23,388	148,016,926
Total 2003	34,633	172,065,954	58,021	320,082,880
Total 2004	59,742	295,390,589	117,763	615,473,469
2005 up to Oct. 31	81,760	470,346,532	199,523	1,085,820,001

Source: IPC/UMLP statistics

1.2. Target group orientation

The objective of the UMLP is to provide bank loans to those enterprises that are normally denied access to the formal credit markets, i.e. micro businesses and female entrepreneurs. In transition economies like Ukraine, owner-managers make an essential contribution to social welfare, as these individual entrepreneurs ensure that members of their families have work and create additional jobs for others too. These types of business thus serve as a means of reallocating labor in accordance with the principles of a market economy and are often the only employment opportunity for people who have lost their jobs as a result of the restructuring or closure of inefficient state-owned enterprises. The UMLP offers this underprivileged sector, which many commercial banks wrongly believe to be unreliable, a dependable source of financing.

Table 3: UMLP poverty loans, by year

	POVERTY LOANS			
	No. of loans disbursed = USD 1,000	% of total disbursements	No. of loans disbursed = USD 10,000	% of total disbursements
Total 1997	0	0.00%	9	16.67%
Total 1998	0	0.00%	39	28.26%
Total 1999	16	4.94%	203	62.65%
Total 2000	126	10.27%	882	71.88%
Total 2001	1,105	21.10%	4,423	84.46%
Total 2002	4,817	29.36%	14,647	89.27%
Total 2003	11,392	32.89%	31,017	89.56%
Total 2004	16,084	26.92%	53,620	89.75%
2005 up to Oct. 31	16,914	20.69%	72,960	89.24%

Source: IPC/UMLP statistics

Women entrepreneurs are another target group of the UMLP. Although female entrepreneurs are not victim to obvious discrimination in Ukraine, the project aims to support the systematic and sustainable strengthening of women's rights. Women form over 51% of the Ukrainian population and play a key role in economic life. However, in rural regions especially, there is still a significant discrepancy between the ideal of gender equality and the reality. The dangerous combination of rural depopulation, ignorance, lack of advisory services, underpaid work and insufficient efforts to combat organized crime is a reflection of the backwardness of the social institutions. The task of the UMLP is to ensure that female entrepreneurs receive an equal standard of service at the partner banks participating in the program. In recent years, the number of loans issued to women has increased steadily as a percentage of total disbursements, and in the meantime very closely matches their share of the population as a whole.

Table 4: UMLP loans to women, by year

	LOANS DISBURSED TO WOMEN			
	No. of loans disbursed to women	% of total disbursements	Volume disbursed to women (in USD)	% of total disbursements
Total 1997	7	12.96%	157,411	11.22%
Total 1998	27	19.57%	338,903	12.95%
Total 1999	60	18.52%	361,714	8.97%
Total 2000	268	21.84%	1,343,391	10.13%
Total 2001	1,644	31.39%	6,228,499	16.31%
Total 2002	6,604	40.25%	21,588,982	24.39%
Total 2003	16,067	46.39%	53,874,815	31.31%
Total 2004	29,209	48.89%	103,555,428	35.06%
2005 up to Oct. 31	40,595	49.65%	176,336,425	37.49%

Source: IPC/UMLP statistics

An important indicator of target group orientation is the sectoral breakdown of the portfolio and the development of this indicator since the inception of the program. Investments in trade have grown continuously over the past eight years, and over 73% of all disbursed loans have gone to this sector. The typical borrower operates a small kiosk at the roadside, or a stall at the bazaar, and uses his or her loan to finance working capital. The share of loans issued to the service sector has remained largely unchanged in recent years, at roughly 20% of the total. In these two sectors – in contrast to the production sector – relatively small investments in fixed assets are needed, which is why trade and services are the types of activity favored by micro-entrepreneurs. In March 2005 the UMLP began to extend its outreach into rural regions, and this is reflected in the increase in the number of agricultural loans issued.

Table 5: UMLP loans by sector, by year

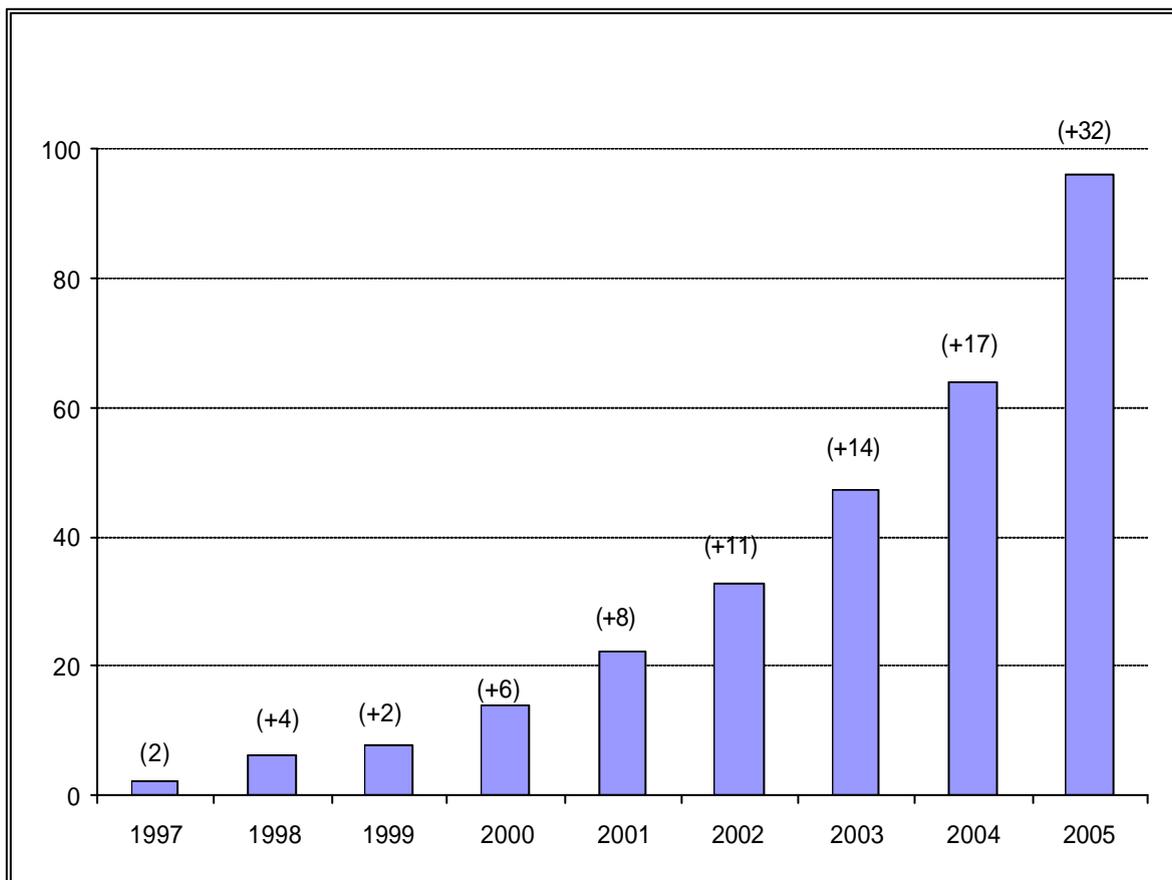
No. of loans disbursed to	productio n	share of total	agriculture	share of total	trade	share of total	services	share of total
1997	29	53.7%	0	0.0%	3	5.6%	22	40.7%
1998	42	30.4%	0	0.0%	24	17.4%	72	52.2%
1999	74	22.8%	0	0.0%	134	41.4%	116	35.8%
2000	300	24.4%	2	0.2%	611	49.8%	314	25.6%
2001	739	14.1%	62	1.2%	3,212	61.3%	1,224	23.4%
2002	1,881	11.5%	171	1.0%	10,897	66.4%	3,459	21.1%
2003	2,939	8.5%	124	0.4%	24,819	71.7%	6,751	19.5%
2004	3,882	6.5%	193	0.3%	44,085	73.8%	11,582	19.4%
2005 up to Oct. 31	4,672	5.7%	850	1.0%	59,903	73.3%	16,335	20.0%

Source: IPC/UMLP statistics

1.3. Regional expansion - Rural lending

Increasingly, the UMLP's focus over the past few years has shifted toward the development of the program in small cities and rural regions. The main challenge was to build efficient working processes and structures at the partner banks. It was true of all of the partner banks that their branches and offices in small cities were not geared to active, wide-ranging lending operations. The training tasks of the UMLP were therefore not confined merely to the newly recruited loan officers, but almost without exception also included the management staff of the branches or offices. In the meantime, not only has a department been set up at the head office of each bank with explicit responsibility for overseeing regional development; each bank's main regional branch now also employs Regional Managers whose task is to manage the intraregional expansion of the program. In 2002 the first institutional steps toward the installation of this structure were taken and in the meantime all of the partner banks are very well equipped, in terms of both staff and organizational structures, to undertake regional expansion, a process which will take several years more to complete. In many of the smaller branches, the micro loan (ML) portfolio is now the largest component of the branch's overall portfolio and the bulk of the customer base was acquired by the loan officers (LOs) working under the UMLP.

Figure 2: UMLP - New cities added by year (1997 - 2005)



Source: IPC/UMLP statistics

In order to achieve an even higher levels of market penetration, the Lending in Rural Areas program was launched in 2005. A credit technology specifically designed for rural lending was introduced at the partner banks, enabling them to issue micro loans in regions that had previously been without any banking services at all. Mobile branches enable the LOs to analyze or monitor up to 15 customers per day. Rural areas naturally tend to have a higher-than-average proportion of agricultural enterprises. This meant not only that efficient procedures had to be developed, but also that additions had to be made to the credit technology. For this purpose, the UMLP is currently training a whole new generation of loan officers who – in contrast to the banks' existing personnel – are able to analyze harvest and production cycles and thus recommend loan terms and conditions that are optimally suited to small agricultural enterprises and farmers. Although this development is relatively recent, the portfolio in rural areas as of October 31, 2005 already amounted to USD 2.8 million, representing loans to a total of 771 borrowers.

Table 6: UMLP disbursements in rural areas

	RURAL LENDING			
	No. of loans disbursed	Volume disbursed, USD	No. of loans outstanding	Volume of loans outstanding
Jan 2005	12	151,313	115	607,772
Feb 2005	8	141,634	120	720,615
Mar 2005	84	337,456	196	998,457
Apr 2005	176	623,449	364	1,593,375
May 2005	117	342,577	382	1,409,668
Jun 2005	92	300,927	465	1,657,988
Jul 2005	110	380,600	560	1,943,956
Aug 2005	130	471,212	631	2,219,834
Sep 2005	139	552,804	695	2,398,850
Oct 2005	160	817,824	771	2,765,400

Source: IPC/UMLP statistics

2. Institution Building Measures at UMLP Partner Banks

2.1 PrivatBank

PrivatBank, which has been collaborating with the UMLP since 1997 and is thus one of the oldest partner banks, has been more successful than the other participating institutions in redefining its strategic orientation, i.e. in branding itself as a bank for SMEs. Its monthly output of over 4,100 loans totaling over USD 25 million is a clear indication of this. Since it first joined the program, PrivatBank has disbursed over 74,000 loans, representing a total of USD 400 million. The main factor behind this success is the assessment by the bank's management that when, as is to be expected, international banks with superior funding opportunities enter the Ukrainian market, it will not be possible for PrivatBank to acquire and retain the business of Ukraine's large-scale enterprises. As early as 2001, at the instruction of the bank's chairman Mr. A. Dubilet, microlending was placed under the direct responsibility of the First Deputy Chairman, Mr. V. Yatsenko. All strategic decisions, such as the schedule for regional expansion, the introduction of the express loan, the launch of rural lending and the upgrading of the ML departments to full-scale SME departments with a broad range of products, were discussed and approved at this high level. With ML deeply rooted in the bank's overall structure, excellent branch management and substantial internal training capacity, the bank meets many of the important preconditions for bringing the technical assistance project to a successful conclusion.

The Microlending Department at the Head Office, which is staffed by employees who all started out as loan officers, has been managed for four years by Mr. T. Ponomar. It has 10 staff members, including the manager. The three sub-departments – Credit, Regional Management and Training/HR – satisfy the current requirements. The Credit unit is headed by Mr. E. Eromin. Its task is to inspect applications for loans exceeding the decision-making limit of the branch in question. These loans are approved in consultation with the First Deputy Chairman. In addition, Mr. Eromin is responsible for regional management, focusing on the Eastern Regions. He works alongside three other Regional Managers, Ms. O. Korshunova, Mr. A. Kostyshin and Ms. T. Shiba. In the past, the task of the Regional Managers was to build ML departments in the regional main branches. With the exception of four regions, Chernigov, Sumy, Kirovograd and Ivano-Frankovsk, ML departments were set up at all main branches, which in turn succeeded in all but a few cases in setting up further departments within their respective regional branch networks. Accordingly, the task profile of the Regional Managers has recently started to shift away from implementation toward monitoring of the departments. Mr. A. Polevoy is responsible for overseeing product design and coordination at the branches. Mr. V. Shevchuk was hired specifically for the establishment of Lending in Rural Regions, which was launched in March 2005, and he works exclusively in the regions. The Training/HR department is managed by Ms. V. Pavlova. A key component of this department is the ML Training Center, which went into operation in June 2004. All course content is coordinated by the head of the Training Center, Ms. M. Shevchenko, who presents the subjects in a manner designed to maximize the efficiency of the learning process, in collaboration with ML staff from the regional branches and other bank staff members. Ms. Shevchenko's duties also include the coordination of on-the-job training at the existing branches. Since June 2004 more than 800 participants, ranging from trainees to deputy branch managers, have received instruction in financial analysis, personnel management, general management techniques and sales. Ms. Pavlova is in charge of pay-related issues and personnel development. Mr. ?.

Potapenkov is responsible for drafting and updating internal procedures. The regular discussion meetings that take place at the Head Office, e.g. the Credit Committee, telephone conferences and personal interviews with the branch managers, always begin with a review of microlending activities; only then are matters relating to other lines of business discussed.

The attitude of the Head Office influences day-to-day operations at the branches. The strategic guidelines issued by the Head Office are implemented mostly without question – although initially they were met with a certain degree of skepticism. The majority of the regional branches are still expanding the scope of their ML operations, i.e. ML is still being rolled out successively to new branches and offices, some of which are quite small and are located in remote rural centers. In the meantime it is the managers of the smaller branches themselves who take the initiative in applying to the ML Department at the Head Office for permission to launch ML operations. The UMLP is represented in 38 out of 48 branches with 166 departments and 654 loan officers and roughly 155 ML managers. 14 branches are under the direct supervision of the Head Office, while the other 24 branches belong to one of the bank's 14 Regional Divisions. ML departments are to have been set up in the administrative centers Ivano-Frankovsk, Sumy, Chernigov and Kirovograd by mid-2006 at the latest. With a total of 1,902 branches in 500 locations, PrivatBank still has very considerable potential for expansion of the program – especially in rural areas. According to the Chairman, Mr. Dubilet, the next step will be to ensure that all 220 branches with over 10 staff members are taking part in the UMLP. The target date for achievement of this goal is end-2006. The well trained LOs and ML Managers can handle most of the operational credit business at departmental level. Lending limits of USD 100,000 are not unusual. And for all other managerial tasks, such as the recruitment and training of new personnel, portfolio analysis and the planning of the future development of the department and the region, standardized procedures and forms are in place.

Aside from regional expansion, future developments will be shaped by two main trends: On the one hand, preparations are being made to upgrade the ML departments into full-scale SME departments. That means that, in addition to the focus on enterprise analysis, the product range will be enlarged and the service aspect will continue to grow in importance. On the other hand, there is an urgent need to tighten internal control mechanisms. This issue has been raised at the Head Office level; in conjunction with the UMLP Office a work plan is currently being prepared. According to the management's planning –presupposing the successful implementation of the plan to transform the ML departments into full-scale SME units and assuming that suitable funding can be found – the ML portfolio as a share of the bank's total business lending portfolio should increase to 40%.

2.2 Bank Nadra

In the three-and-a-half years that it has been participating in the UMLP, Bank Nadra has built micro loan departments at 51 of its 460 locations. Since the start of the program, nearly 13,000 loans representing a total volume of USD 58.6 million have been disbursed. As of October 31, 2005 the portfolio comprised 6,909 loans worth a total of USD 29.7 million. After the positive development of the program was halted in 2004 by a public scandal surrounding two of the bank's shareholders, which led to a run on savings and other deposits, the micro credit business made a good recovery in 2005. The number of loan officers rose from 90 to 170 during the first 10 months of the year, while monthly disbursements increased from just under 400 loans in January to over 1,100 in October. As a relatively large number of "young" loan officers are working under the UMLP, there is room for improvement in the area of disbursement efficiency (approx. 6.5 loans per loan officer per month). A portfolio efficiency of 41 customers and a volume of USD 175,000 per loan officer also leaves plenty of room for improvement. To date, Bank Nadra has been offering micro loans through 51 departments, but plans to increase this figure to 75 by the end of 2006. In order to meet this target, the bank is also making alterations to its smallest branches to create space for micro loan officers. The decision-making hierarchies are flat, which is conducive to efficiency.

At the Head Office the ML Department was rebranded as a department for "Sales to Small Enterprises". It currently employs four staff members. The department is headed by Valentina Voloshko, who has many years' experience in micro credit. In her work she is supported by Andrey Dorozhenko, a former loan officer and regional manager. The third member of the department is Elena Zhuravleva, who is responsible for training. Product coordination with the branches is the responsibility of Andrey Buryak, former head of the ML department in Ternopol. Before the end of the year, the bank plans to fill the vacancy for the HO Regional Manager position. This person will coordinate the work of the regional managers posted by the HO throughout the country. At present there are three regional managers, in Kherson, Odessa and Poltava, and in the coming months two more loan officers will be trained to take on this position in the Ivano-Frankovsk and Lugansk regions.

In order to ensure that the next generation of loan officers is properly trained, Bank Nadra has established its own training center in Alushta. This is the venue for introductory seminars, seminars on micro, small and agricultural lending, and management seminars for the future heads of ML departments. The UMLP is active in organizing all of the seminars and provides support in their implementation: the consultants deliver a large percentage of the lectures and present the participants with practical examples. One of the positive things about this bank is that, because of its expansionist policies, hard-working loan officers have numerous opportunities to gain promotion. Of the 196 loan officers trained under the program, 170 are still working in this field, while most of the remainder have taken up positions of responsibility in other divisions of the bank.

Bank Nadra regards proximity to customers and the UMLP credit technology as strategic cornerstones of its overall structure. Internal operating processes have been adapted to the needs of the target group (flexible collateral policy, efficient decision-making mechanisms and a streamlined disbursement procedure) and this has enabled them to make a success of the micro credit business. By July 2005 the bank had already achieved the year-end targets it had

set itself for the number and volume of outstanding loans. By the end of 2005 it plans to recruit and train 180 loan officers. By the end of 2006, 320 loan officers will be working in 75 locations, and according to the provisional business plan, the portfolio will have grown to 9,600 loans totaling USD 40 million. Based on recent results, this would appear to be a rather conservative forecast.

2.3 Bank Aval

During the course of its eight years of collaboration with the UMLP, the bank has issued more than 33,000 loans totaling USD 218 million. At present Aval has over 8,400 customers in its micro loan portfolio, while the total amount outstanding comes to nearly USD 62 million. The portfolio is being managed by 149 loan officers. However, these results fall far short of what Bank Aval could achieve, given its huge potential. It is mainly thanks to the commitment of a few regional branch managers that the portfolio has grown by nearly 100% since the start of 2005 alone. The strategy pursued by the Head Office during this period was quite clearly designed to raise efficiency and profitability in order to enhance the value of the bank. Accordingly, Bank Aval reduced its payroll from 18,000 to 14,700, a cutback of roughly 18%. In the Corporate Banking division, 293 out of a total of 1,020 staff members were laid off, including 12 micro loan officers. As there have been no new appointments, only experienced micro loan officers are currently working at Aval Bank. This explains the bank's disbursement efficiency, which, at an average of 8 loans per month, is one of the highest in the UMLP. In addition, each Aval loan officer manages a portfolio of between 50 and 60 customers. Here too, Aval's figures are among the best in the UMLP, even ahead of PrivatBank, whose loan officers have 41 customers in their portfolios on average, but still far behind ProCredit Bank's figure of 108 customers per loan officer. The takeover of Bank Aval by Raiffeisen International in October 2005 opened up new perspectives, however. The new management at Head Office has expressed considerable interest in strengthening this line of business and raising staff productivity levels. At present work is underway on an action plan for bringing outdated loan terms, inefficient processes and inappropriate organizational structures into line with current requirements. If the planned changes are implemented immediately and uncompromisingly by the management staff at branch level – some of whom have been kept on – ML at Bank Aval could be taking place on a significantly larger scale within a relatively short time.

The micro credit unit at the Head Office of Bank Aval currently has a staff of five: the head of department, Elena Rudik, who was a loan officer for four years, and head of a micro loan department for another two years; Natalya Dubko who is responsible for the bank's own micro credit program¹; Alexander Ratushnyak, who is responsible for the regions Poltava and Sumy; and two assistants. For the time being, there are no plans to expand this department. After the bank's own micro credit program has been completely incorporated into the structure of the UMLP micro credit departments, Ms. Dubko and Mr. Ratushnyak will be responsible for supporting different regions.

¹ The bank set up its own micro credit program in 2000 as the management took the view that it should immediately start to offer micro loans in all of its regional divisions, even though it lacked internal training capacity.

As the second largest Ukrainian bank Aval has a presence in more than 1,400 locations across Ukraine, 49 of which offer micro loans in collaboration with the UMLP. Six branches were transferred from the bank's own micro credit program to the UMLP: the Zhitomir, Chernigov, Sumy and Poltava branches in April, followed by Ivano-Frankovsk and Uzhgorod in July. The work of the micro loan departments at these branches is characterized by a high degree of autonomy. The structure of the credit committees is firmly in place, and the heads of departments have been assigned approval limits of between USD 10,000 and USD 125,000. This ensures that credit decisions are made quickly in most cases. However, there are branch managers in some regions who have not given sufficient attention to the progressive credit technology of the UMLP. Wherever they participate in the credit committee meetings, they tend – despite the favorable experiences to date and the excellent quality of the portfolio – to impose too many additional demands regarding collateral, or order unnecessary checks to be carried out by the security service.

Despite the fact that Aval has been collaborating with the UMLP for many years, the bank has not installed a systematic training program or a training center. Seminars are organized on an ad hoc basis, as the bank's top management is extremely reluctant to spend money on such measures. Against this background it becomes clear why training has mainly taken place on a decentralized basis, provided by UMLP consultants, which in turn explains why the bank has numerous highly trained credit specialists working within its structures. This means that trainers for the necessary training measures can now be recruited internally. However, given the absence of an institutionalized training system, there is a danger that the knowledge and experience of employees who leave the bank will be lost.

The future of the micro credit business at Aval depends primarily on the new owner. Over a period of 8 years, the UMLP has succeeded in transferring the necessary know-how to Bank Aval to enable it to continue developing the micro credit business successfully on its own. This success is reflected, not least of all, in the fact that on the basis of the UMLP credit technology a new product was recently developed under the name "Business Expresskredit". This loan, which can be up to USD 1,500, is issued to small entrepreneurs in small towns where there is no micro credit department. The loan officers in the locality analyze the business and prepare a loan summary which is sent to the head of the micro credit department in the nearest city. If he/she approves the loan, it is disbursed in the applicant's locality. The product is backed by collateral, but the approach to loan security is relatively flexible. For example, the borrower can secure a loan with the working capital that he/she financed with the loan. This development shows that, with its existing capacity, Bank Aval is quite capable of processing customer enquiries in a professional manner. As the new owner appears to recognize the strategic significance of this line of business for Bank Aval, there is nothing to stand in the way of a successful continuation of micro lending. However, there are still substantial deficiencies in the bank's small enterprise credit operations. For example, the bank currently refuses to introduce the new unsecured express loan in the six new departments. Similarly, Aval has also declined to adopt the most recent development within the UMLP, namely the introduction of loans for agricultural enterprises and other businesses in rural areas. This shows up once again the reluctance of the bank to invest in the micro credit business, even though the contribution margin of the ML departments for the first three quarters amounted to USD 1,800,108.

The most important task in the immediate future – apart from the implementation of the action plan – is to standardize the micro credit business. UMLP consultants are involved in this process: they are monitoring the correct application of the credit technology, and are training the loan officers in all relevant matters. Once this integration process has been completed, UMLP support can be confined solely to reporting and monitoring.

2.4 Bank Forum

In terms of total assets and branch network, this is the smallest of the downscaling banks, and was accepted into the UMLP at the end of 2000 for the strategic purpose of developing the Kiev branch into a strong MSE institution. It did not prove possible to realize this project, however, because the management were not sufficiently interested in serving the target group and training the staff that would have been needed to do so. As of the end of 2003, i.e., after the program had been running for three years, fewer than 20 LOs were working for the bank in its Kiev, Mykolaiv and Dnepropetrovsk branches. Ultimately, the management was asked to state its position on whether the MSE business was still in line with the bank's long-term corporate planning. However, with the approval of an action plan and the appointment of a new Chairman, Mr. Y. Kolesnik (the former Deputy Chairman) in November 2003, much greater emphasis was placed on the significance of ML for Bank Forum. In 2004 average monthly disbursements rose to 166, more than double the previous year's average, and in the first three quarters of 2005, 3,703 loans were issued, nearly three times as many as during the same period in 2004. In the meantime, the bank employs 97 loan officers and 25 ML managers. The portfolio as of Oct. 31, 2005 consists of 3,615 loans with a total volume of USD 16.5 million. Over the entire duration of the program to date, 8,092 loans representing USD 42.9 million have been disbursed.

It was not until the end of last year that Bank Forum was ready to set up an ML coordination department at the Head Office. As well as a lack of understanding of the need for product-specific support, the main reason for this reluctance was the desire to keep costs down. However, the present unit covers the main sets of tasks very well. The ML Department is managed by Ms. Irina Chantseva. Ms. Chantseva, a former LO at Bank Agio, has been an employee of Bank Forum for more than four years, and reports on behalf of her department directly to the First Deputy Chairman, Ms. O. Kushnir. She is supported by two Regional Managers, Ms. A. Galat and Ms. A. Slabunova. Since the start of 2004 these Regional Managers have set up ML departments in 11 branches. Thus, they work exclusively in the regions, even though they are actually Head Office employees. Another focal point of the team's work is the provision of in-house training and CPD. In contrast to PrivatBank and Bank Nadra, Bank Forum has organized its training center as a mobile unit, i.e., the Head Office personnel travel to the branches or regions wherever there is a need for training. This approach is appropriate to present needs, but in the foreseeable future the increasingly important seminars will have to become embedded in a fixed organizational unit within the Head Office ML Department. The first step in this direction has already been taken: in June 2005 Ms. V. Baramak, until then a loan officer at the Kiev Branch, was given the task of preparing seminar plans and lists of participants for personnel development measures.

Bank Forum can be described as an extremely risk-averse institution. As of year-end 2004, only 0.22% of the overall loan portfolio was in difficulties, a figure which sets Bank Forum

apart from the other Ukrainian partner banks, in some cases quite significantly so. This credit policy is also reflected in the statistics for the ML portfolio, where only 0.4% of the outstanding loans were in arrears as of Oct. 31, 2005. The bank is equally cautious in extending limits to the branches, and indeed, when a new ML department was opened in Sevastopol, in the first month even loans smaller than USD 3,000 still had to be approved by Head Office.

Although Bank Forum was actually founded as long as 11 years ago, it is only within the last two years that it has begun to systematically develop a branch network. In the preceding years, branches or offices were only opened in order to serve a few large customers. This was particularly problematic insofar as the personnel for the branches were not selected and trained to develop the cost-intensive bulk business. Thus, for example, the manager of the Dnepropetrovsk Branch was not appointed for his qualities as a banker but because of his personal connections with the then Governor of the National Bank. In the meantime, however, the management and above all the shareholders have understood that the requirements for the job have changed, and have modified the selection criteria accordingly. The improved quality of the branch management is intended to enable the bank to open another 12 branches within the coming two years, extending its country-wide presence to 31 branches. There are currently 53 outlets, and their number is intended to grow further. To date, a total of 26 ML departments have been created in 14 of the 19 branches. The UMLP is now consulted each time a new branch is opened, because ML is a particularly good product with which to enhance Bank Forum's visibility in the city in question, and build up a significant core of customers within a short time. All of the branches are monitored at regular intervals under the supervision of Ms. Kushnir and Ms. Chantseva. During their on-site visits, all outstanding issues relating to ML are dealt with, and solutions to any problems are found. The objective of these monitoring visits is to optimize the lending process and create the best possible conditions for the loan officers to work in.

Bank Forum shows considerable interest in attracting additional investors. To date, 10% of its shares have been sold on the secondary market. In addition, 25% are to be sold to a strategic investor. According to the Chairman, Mr. Y. Kolesnik, this is the only way to withstand the increasing level of competition over the long term. In parallel with efforts to sell shares in the bank, collaboration with foreign investors is supposed to make it easier for the bank to gain access to low-interest funding opportunities. The management emphasizes that the UMLP has made an important contribution to the introduction of standards in the credit business, and will therefore continue to pursue the present expansionist strategy in the coming years.

2.5 CreditProm Bank

In terms of total assets and equity, CreditProm Bank is one of the 20 largest banks in Ukraine. It was founded in 1997 and at that time its five branches in five large cities focused on doing banking business with large industrial companies. In 2004 the bank began to actively implement a reorientation of its business strategy, turning instead toward bulk business. Since then the branch network has also expanded dynamically. At present the bank has branches and/or outlets in 17 regions. On top of its branch network expansion and its reorientation toward bulk business, the bank has had to bear the additional burden of further restructuring measures, in particular the separation of Head Office functions from the functions of the Kiev branch.

CreditProm Bank has been participating in the UMLP since March 2004, and is thus the youngest of the partner banks. Up to and including the end of October 2005 a total of 2,496 loans with a combined total volume of over USD 13.7 million had been disbursed and a loan portfolio of USD 8.96 million had been built up. The average outstanding loan balance of USD 4,965 shows that the target group is being reached. Above all, the bank's management expects the micro credit business to be profitable and to help it to diversify its customer base. Responsibility for the development of this line of business lies with the vice president and head of the Investment Division, Mr. V. Perepelitsa, but in the near future it will be handed over to the head of Retail. In the struggle for limited resources (investments in premises and jobs) and for customers, the micro credit business competes primarily with the consumer loan business, which also occupies an important place in the bank's retail strategy. Although the portfolio has grown substantially by USD 7.33 million to USD 8.96 million since the start of the year, the ambitious USD 17.5 million target for the portfolio set by the business plan will not be achieved. This is mainly due to the fact that it was not possible to train or recruit qualified managerial staff sufficiently quickly. Other staff members failed to live up to expectations, and had to be replaced. The bank's management has learned from these mistakes, and has instructed the branch managers to systematically develop a management personnel reserve.

At Head Office level a department has been set up which is responsible for developing this line of business throughout the bank, above all with regard to such issues as planning, coordination, monitoring, product and personnel development, and marketing. The department is headed by Ms. A. Demchenko, an experienced UMLP loan officer. She leads a team of three: Ms. R. Yovko is responsible for training and marketing; Ms. J. Shevchenko is responsible for the coordination of the branches in Kiev and for the documentation of the working processes; Ms. S. Maison serves as Regional Manager. Her task is to organize the establishment of new micro credit departments in the field. The department reports directly to Mr. A. Perepelitsa.

Micro loans are now offered in 10 regions (Dnepropetrovsk, Donetsk, Kharkov, Kherson, Kiev, Kremenchug, Lviv, Lutsk, Odessa and Vinitsa) via a total of 13 ML departments staffed by 62 loan officers. Seven branches only began micro lending during the course of 2005. As the branch network is only now in the process of being built up, it is not unusual for the start of micro lending to coincide with the opening of the branch itself. Particularly in these cases, the micro credit business serves not merely to restructure the credit business as a whole, but indeed to make the existence of the bank known locally and to build a customer base. With the exception of Donetsk (where the lending limit is USD 50,000) the branches are authorized to

decide on loans up to USD 30,000. Loans exceeding this amount are decided at Head Office level. Additional rules apply to the micro credit business. Nearly all branches have installed credit committees which can decide on Express Loans up to USD 5,000. Depending on their level of experience, the limits of the local branches' decision-making authority range from USD 5,000 to USD 30,000. Whenever a loan application exceeds the respective limit, the UMLP consultant, Ms. Demchenko or Ms. Maison is called in.

In 2005 the bank decided to pay more attention to training, which was to be organized centrally from Kiev. In the medium term, premises are to be created for this purpose. The bank is already investing in its own seminars (a seminar on customer acquisition has taken place, and a management seminar is planned), which are held at weekends in the bank. A personnel development plan has been drawn up, defining the various levels of qualification and the knowledge required for each one. Regular written exams are organized in order to monitor whether the training goals are being achieved. The bank is still receiving intensive support from the UMLP in this area. During the course of the collaboration, a total of 16 specialist seminars have been carried out for loan officers, group leaders, heads of credit departments, and branch and outlet managers.

The bank remains strongly interested in micro lending. Some branches, even those that have been in existence for a relatively long time, were still operating at a loss or were only just earning a profit at the start of the year. The wide margins in the micro credit business are helping to make branch-level business more profitable. Whereas in 2005 the main emphasis was on expansion to new cities, the bank now wishes to concentrate, in addition to expansion into further new regions, on establishing stable structures and raising the skills levels of the staff. Another important task here, in our view, is to modify the organization of the Business Development department so as to ensure better control of the branches and timely responses to local problems. In the medium term there are also plans to upgrade the present micro loan departments to corporate customer departments.

3. ProCredit Bank Ukraine: Establishing a Microfinance Bank in a Transition Economy

The creation of the UMLP was complemented by the establishment of ProCredit Bank at the beginning of 2001, another powerful response to the Ukrainian banking system's neglect of the micro and small business sector over a long period of time. The bank was founded by a group of international shareholders including three international financial institutions (EBRD, KfW and IFC), the Dutch DOEN Foundation, Western NIS Enterprise Fund and ProCredit Holding (then known as Internationale Micro Investitionen AG). It started operations under the name Microfinance Bank, and its senior management was provided by Internationale Project Consult (IPC) GmbH. According to its mission statement, ProCredit Bank is a development-oriented full-service bank, which aims to offer excellent customer service and a wide range of banking products. In its credit operations the bank focuses on lending to micro, small and medium-sized enterprises, based on the view that these businesses create the largest number of jobs and make a vital contribution to the economies in which they operate.

Supported by its shareholders and by international donors – in particular USAID and the European Commission – ProCredit Bank aimed from the very beginning to reach broad sections of the population which until then had not had access to banking products, and indeed had very little knowledge of how they could benefit from banking services. The resounding success of this strategy in Ukraine is, in part, a consequence of the fact that most of the established banks were not seriously interested in serving this target group, and also of the population's general distrust of conventional banks, a distrust which had been fuelled by several banking crises in the past. ProCredit Bank succeeded in overcoming this distrust by applying a strategy that focuses primarily on cultivating a genuine dialogue with its customers and on maximizing the transparency of its products and services.

Over the last year, ProCredit Bank invested very extensively in the training of staff at all levels. In light of a natural turnover of personnel, and given the high market value of banking experts trained by ProCredit, these training efforts have had a significant spill-over effect on the rest of the Ukrainian banking system, and in this respect the bank can claim to have contributed to a general improvement in the standard of banking in Ukraine as a whole.

The business philosophy behind ProCredit Bank is not only successful in Ukraine, but also in many other emerging markets, particularly in Eastern Europe. The bank is part of a network of 19 ProCredit Banks with very similar business policies and shareholders.

ProCredit Bank's history to date can roughly be divided into three phases which reflect the changes that have taken place in the shareholders' policies and views, and also the development of the business environment in Ukraine and the political situation in this transition economy.

3.1 Exclusive emphasis on lending (2001-2003)

The key priority during the first two years of the bank's existence was to establish lending capacity across the country, which has more than 40 cities with a population of more than 100,000. At that time, the need to mobilize retail deposits to safeguard loan portfolio growth in the future was not in the focus of attention. The main goal was the extension of more loans in the regions, which were financed by long-term credit lines made available by the shareholding IFIs on an almost unlimited basis. Thus, the issuance of loans through representative offices, many of which were nothing more than a small credit office located on the upper floors of a hotel or a business centre, was often given preference over the establishment of full-service branches in the regions, which would have been much more expensive to open, due to National Bank requirements, and much more personnel-intensive to run. Despite this pragmatic approach, which meant that a total of 11 representative offices and only a few larger branches were opened during the first two years, the bank already employed 340 people after just 24 months.

During this phase, all of the bank's resources were focused on the establishment of new lending outlets and on loan officer training in order to be able to meet the enormous demand for loans that clearly existed all across the country. The rapid expansion into 15 relatively large cities in all parts of Ukraine would not have been feasible without the "representative office" strategy, and even more staff would have been needed during the initial stage of the bank's existence if more full-service branches had been opened.

The rapid geographical expansion was also made easier by the fact that in the cities where it sought to establish a presence ProCredit Bank faced relatively little competition from other banks at that time, including the UMLP partner banks, and in terms of productivity and quality its loan officers were far superior to those of its competitors. Thus, the bank quickly became the market leader.

By the end of 2003, i.e. in less than three years, the bank had established a loan portfolio of nearly USD 60 million, serving more than 10,000 borrowers, all of which were MSEs. The branch network consisted of a total of 23 branches and representative offices in 15 cities throughout Ukraine. In 12 of these 23 locations, customers had access to the bank's full range of services, while in the remaining 11 they were offered high-quality credit services through representative offices.

3.2 Expansion and institutional strengthening (2004)

During the first phase, ProCredit Bank made enormous progress in fulfilling the vision of supplying credit to micro and small enterprises, and in doing so provided strong evidence of the existence of an effective demand for loans among Ukrainian micro, small and medium-sized businesses. Just how impressive that evidence has been is reflected in the banking sector's changed perception of micro-entrepreneurs as a group of clients. Whereas until 2003 hardly any of the Ukrainian banks showed an interest in micro lending, since 2004 even some of the country's largest banks have been making a serious effort to serve this segment of the market.

Against this background, it became more and more obvious that the initial approach of establishing purely credit-oriented branches or representative offices would soon no longer be appropriate. Firstly, in light of the ongoing strong demand for micro credit and SME loans and the sheer size of the country, the shareholders of the bank saw an urgent need for the bank to tap into other sources of funding, including domestic sources, which would help the bank to make the hryvna its predominant lending currency, removing any currency risk for the borrower and thus reducing the credit risk for the bank. Secondly, it was obvious that the persistent efforts of the consultants working in the UMLP would soon start to pay off, i.e. that lending at some of the UMLP partner banks, at least, would take off soon. The impact of the consultants' work was reinforced by the strong positive demonstration effect coming from the specialized microfinance bank, and the results were convincing enough to make some Ukrainian bank managers seriously reconsider their attitude to the target group.

Consequently, the shareholders of ProCredit Bank decided to revise their previous strategy, and to establish all of the organizational structures and products that would be needed to support the mobilization of domestic retail deposits on a large scale. This in turn would allow the bank to continue to achieve strong loan portfolio growth in the future. The decision led to the introduction of the new ProCredit corporate design throughout the bank (coinciding with the name change from Microfinance Bank to ProCredit Bank in autumn 2003) and to major investments in infrastructure (branches, IT etc.), as well as the replacement of all representative offices with modern full-service branches, located in the respective city centers.

Over the following year, the bank made considerable progress in terms of strengthening the head office structures, organizing the front and back office structures in a more clearly defined and more efficient manner, and expanding its functions in the fields of retail operations, controlling and administration. In other words, the bank was now positioned as a full-service bank in the Ukrainian market and started to reach a broader section of the population, including depositors who were looking for a safe place for their savings and a moderate return.

By the end of 2004 ProCredit Bank had generated a deposit portfolio of USD 35.5 million, and the number of deposit accounts had increased to 5,528. The outstanding loan portfolio had crossed the USD 100 million mark by this time, divided among 21,500 loans.

In 2004, ProCredit Bank significantly expanded and improved its branch network. By the end of the year the bank was operating 27 branches in 15 cities throughout Ukraine, and only two representative offices remained to be converted.

In the course of 2004, a total of 450 new employees were recruited, bringing the total number of staff to over 850 by year-end. Although this figure included 210 loan officers, lending was not the main factor behind the increase in staffing levels; rather, it was due above all to the conversion of the representative offices into full-service branches, the greater emphasis on deposit-taking and the further strengthening of head office structures.

The significant rise in the number of employees during this time was necessary to ensure that the foundation was laid for further development, and that clients' expectations in regard to customer service could not only be met, but exceeded.

3.3 Consolidation and preparation for further expansion (2005)

The third phase of ProCredit Bank's development started in the fourth quarter of 2004 and was heavily influenced by the political instability that occurred at that time, which led to upheaval in the entire Ukrainian banking system. The political tensions which began to mount in September 2004 prior to the presidential elections peaked in the so-called "Orange Revolution", and the situation only stabilized after the third round of elections on December 26, 2004, when Mr. Yushchenko was elected as the new president of Ukraine and Mr. Yanukovich stepped down as prime minister.

During this period, ProCredit Bank's main task was to preserve trust in the institution among clients and the general public, as well as to continue to provide reliable banking services to all who needed them. ProCredit staff did an excellent job in accomplishing this task: at a time when many Ukrainians were withdrawing their money from banks, which brought the sector close to a banking crisis, ProCredit Bank was able to increase its deposit portfolio. And even more noteworthy was the fact that the loan officers of ProCredit Bank continued to disburse business loans while the whole of the rest of the banking system had frozen all lending activities. In fact, this was the most convincing argument that ProCredit Bank was able to offer to worried depositors, and it persuaded them to keep their money in the bank, or even to make additional deposits.

The bank's encouraging performance during the period of political instability was noted by many people, and it later helped the bank not only to achieve strong growth in its retail deposit business but also to attract additional funding on the domestic and even the international capital markets more easily and more cheaply. The international rating agency Fitch not only upgraded the bank's long-term foreign currency rating to "BB- Positive", but also upgraded the individual rating to "D" and even referred in their press release to the bank's performance "during the mini banking crisis in the last quarter of 2004, when the bank was able to continue lending at a time when many other Ukrainian banks were temporarily forced to stop." This high rating and the bank's strong reputation also allowed it to issue a local currency bond at favorable terms and conditions in April 2005, and since then, the bond issue has been considered a benchmark in the Ukrainian capital market.

In 2005, the management opted to focus on ensuring that recently recruited staff were fully integrated before expanding the branch network to new locations, and this decision slowed down the opening of new branches. Nonetheless, the bank grew strongly in 2005, and in a much more balanced and even way than ever before.

Performance indicators

At the end of 2004 and in early 2005 the demand for loans was relatively low, due largely to the political crisis. Many entrepreneurs, particularly in the Eastern part of the country, had experienced low sales volumes during the last quarter of 2004, or other difficulties that were connected with the “Orange Revolution”, such as transportation problems or delays in the delivery of imported goods. Consequently, the first weeks of the year were mainly spent in trying to get their business processes back to normal, and there was little interest in taking out loans.

By March 2005, however, demand had picked up again, and ProCredit Bank reported new record results in practically all fields of operation. The bank disbursed more than 2,850 business loans worth USD 17 million in March, reflecting an increase in loan officer productivity to over 14 loans disbursed on average per month. Thus, after a series of factors had slowed down the growth of the lending business – a shortage of funding that had prevented the bank from meeting the strong credit demand in May and June 2004, a seasonal dip in demand in the summer of 2004, and the political upheavals which had lasted from September 2004 until the beginning of 2005 – in March and April 2005 the bank was finally able to make effective use of its enlarged and improved infrastructure and started to generate strong growth rates, which are still ongoing. For example, the bank’s net loan portfolio grew by USD 25 million in just three months, from September to November 2005.

At the end of 2005, ProCredit Bank’s loan portfolio is expected to stand at 28,500 outstanding loans representing nearly USD 170 million, while customer deposits will have more than doubled year-on-year, to roughly USD 75 million. Today, the bank has a high liquidity ratio, has access to the domestic and the international capital markets and will produce a healthy return on equity of slightly over 15% for the year 2005. Most importantly, it already enjoys the trust of more than 30,000 permanent clients and a strong reputation as a reliable and trustworthy bank among the Ukrainian public.

Competition in lending has continued to increase further in 2005, not least of all because of the breakthrough achieved by the UMLP, operating through the extensive branch networks of its partner banks, but also because consumer lending through retail chains took off in Ukraine in 2005. Many Ukrainian banks, however, fail to present the terms and conditions of their credit products in a transparent manner, and ProCredit sees this as an opportunity to differentiate itself: it is planning to implement a transparency campaign in Ukraine in order to increase public awareness of the importance of transparency in banking.

ProCredit Bank’s strong focus on transparency and on HR development and training were the main reasons for its overall success and also for its ability to maintain an extremely low rate of arrears. Remarkably, after five years of operations and the disbursement of USD 415 million in business loans, the bank’s loan loss rate is still less than 0.5%, even if all loans currently overdue were regarded as a complete loss.

Branch expansion and outlook

While the upgrading of the remaining representative offices in Ivano-Frankovsk and Gorlovka to full-service branches and the opening of new branches in Kiev and Zaporozhe took place in line with the bank's expansion targets for the first half of 2005, initial plans to add more cities to the branch network had to be postponed until the end of the year. This decision was taken partly in response to the political situation and partly in order to enable the new staff members who had been hired in 2004 to become more strongly integrated into the bank's corporate culture prior to the recruitment of even more staff.

However, to lay the groundwork for further regional expansion, special attention was paid to strengthening the bank's position in already existing markets and in smaller cities located near mature branches. Following this strategy, ProCredit Bank opened additional branches in Lviv, Kiev and Slavyansk, which is located close to Kramatorsk, in 2005.

Finally, in the third quarter of 2005, the bank embarked on a new phase of more aggressive expansion into new regions and cities. Teams consisting of experienced staff members were created for new branches in Simferopol, Krivoy Rog, Ushgorod and Kremenchuk. The most rapid progress was made in Krivoy Rog and Simferopol, where the bank had already signed rent agreements for branch premises and hired the first local trainees at the beginning of October. Furthermore, the opening of additional branches in smaller towns near Kiev and Donetsk was approved, as increasing traffic congestion is making it more difficult for micro clients come to the branches located in the city centers.

The bank now plans to expand more quickly, both geographically and in terms of client numbers and business volumes, taking advantage of the enormous market opportunities which still exist in many Ukrainian cities and in rural regions of Ukraine. Thus, five years from now the bank plans to have nearly 100 branches across the country, which would bring the number of loan officers to over 700 and the loan portfolio to more than 100,000 outstanding micro loans.