

**EBRD Micro and Small Enterprise Finance Facility Kyrgyzstan
(MSFF)**

Quarterly Report

01 July – 30 September 2002

1. General Situation

The overall situation in the region was calm during the period of this report. However, the disagreements between the supporters of Mr. Besnazarov and the government in Bishkek continued and increased in intensity until a compromise was agreed to in August, which – at least for the time being – has relaxed tensions in the south of the country. During the summer an increase in crime levels was noticeable in Bishkek. In addition to the assassination of a Chinese diplomat and a South Korean couple (motivation in both cases unclear), it is especially petty theft, break-ins and street robberies that are increasing in numbers.

Program operations during the summer were concentrated on the signing of a first credit agreement under the MSFF, preparing the expansion to the south, building confidence in MSE lending at the partner banks, identifying additional potential partner banks, giving the first generation of loan officer candidates experience, selecting and training the next generations of loan officers, and establishing the independent MSFF office.

Output of loans during the reporting period was lower than anticipated. This concerns especially expectations for September. The lower results can be attributed to several factors: the liquidity situation at Ineximbank and AKB Kyrgyzstan and the uncertainty concerning the actual date of signing of the credit agreements with EBRD had resulted in controlled disbursements from May onward and a reluctance on the part of the banks to engage in massive advertising or accept large numbers of applicants. In spite of the signing of a first agreement with Ineximbank on 08 July, this had repercussions for the July lending results. This situation was exacerbated by seasonal components. July and August are traditional vacationing months and overall demand for loans was relatively low in spite of advertisement efforts. Unexpected, and, apparently atypical, was the next to non-existing demand for loans during the first half of September. According to available information, demand for all

banking services was surprisingly low during the first part of September. Explanations put forward by the counterparts range from the population having no money after vacationing and equipping the children for school to everyone was busy with the harvest. During the second half of September, however, effective demand picked up and the outlook for October is promising.

2. Brief Chronology

July

On 08 July 2002 First Vice President N. Doyle signed the first credit agreement with CJSC Ineximbank in Bishkek. The event was covered by the media and welcomed by the government. As stated in the report for the previous period, AKB Kyrgyzstan was reluctant to sign the agreement in the proposed form and wanted to restart negotiations. During the ensuing meetings it became apparent, that – although AKB Kyrgyzstan had by then agreed to accept and sign the agreement in the proposed form, the overall situation of the bank had deteriorated to a degree making a postponement of signing an agreement desirable from the point of view of EBRD. In a meeting with Chairwoman Ms Sadebakasovna, E. Lefting from the EBRD Small Business Group, representatives of the local EBRD Resident Office and IPC, the decision was taken to preserve the status quo for the time being and give the bank an opportunity to improve its overall situation. In concrete terms this meant that the MSFF would continue to provide technical assistance to the two branches currently included in the program and AKB Kyrgyzstan would continue to finance these loans from its own resources. All plans for expansion to other branches were put on hold.

During July two more strategic decisions were taken: Demirbank, already identified as a possible partner for the MSFF, agreed to start proceedings for inclusion in the program and a due diligence was conducted in mid-July. In parallel, premises for the MSFF were prepared and loan officer selection commenced. Initially, the bank preferred selecting loan officers from those candidates the bank had already tested and identified as potential interns/trainees. The consultants agreed to test these candidates. However, overall results were disappointing. By the end of July Demirbank and the MSFF had only selected one loan officer candidate. Later selections included a wider circle of candidates. After initial training in already operative MSFF branches the loan officer took up his post at Demirbank at the end of the month.

A small Kyrgyz bank, Kyrgyz Avtobank, was purchased by a long-term partner of EBRD: Kazkommerzbank. In a meeting between the management of Kazkommerzbank and EBRD, cooperation of the MSFF and the Kazkommerz-daughter was identified as desirable. Consequently, the decision was taken to permit the MSFF to provide technical assistance to Kyrgyz Avtobank. The MSFF and the Deputy head of the bank, A. Ramazanov, a Kazkommerz employee and previous counterpart of the Kazakhstan Small Business Fund (KSBF), agreed to start selecting loan officers in August and send them to Kazakhstan for training while initial internal reorganization of the bank and other purchase-related issues would be resolved. Active program implementation was scheduled to start at the end of September or beginning of October. Kyrgyz Avtobank also agreed to launch program implementation simultaneously in Bishkek and Osh.

In view of these developments, the MSFF consultants, M. Scheck and Jhon Manning, who joined the team in July to be in charge of implementing the program in Osh, visited the south to meet with the local Kyrgyz Avtobank branches in Osh and Dzhahal Abad and initiate loan officer selection proceedings.

In terms of training, July saw the Kazakhstan Small Business local consultant seminar at which M. Scheck presented the Kyrgyzstan MSFF, an AKB conducted workshop for branch managers at which M. Scheck presented the program approach as well as an MSFF internal weekend seminar for all loan officers on legal and economic issues.

In parallel to the above, the MSFF also set-up and equipped its own office and hired N. Nejporeva as office manager.

August

Preparations for the project launch in Osh continued. A first group of 6 loan officer candidates was selected. For personal reasons one of the candidates rejected the option of receiving training in Kazakhstan or Bishkek. Five were sent to the KSBF project in Chymkent for training. At the same time preparations of potential premises at Kyrgyz Avtobank Osh started.

In Bishkek several rounds of loan officer selection were conducted with a view of recruiting potential loan officers for Kyrgyz Avtobank, Demirbank and 'fresh blood' for the already existing MSFF departments. As has been the experience from the outset, recruiting qualified candidates in Bishkek, continued to be challenging. Out of five selection rounds (involving

several hundred applicants) conducted in July and August only 8 candidates were identified. Three remained in Bishkek for training while four were sent to the KSBF project in Karaganda. At Kyrgyz Avtobank program preparations continued while the bank was tending to its internal reorganization and its licensing issues. It became apparent that internal reorganization and licensing procedures were not going as smoothly as originally anticipated by A. Ramazanov. In addition to issues related to the licensing procedures, it also became clear that the Head of the bank, Mr. Kanat Mamakeev, an old business partner of Kazkommerz and prominent Bishkek businessman, and Deputy Head A. Ramazanov do not see eye to eye on many issues. The disagreements on strategy, personnel and business policy, handicapped operations at the bank and slowed down reorganization. At the end of August the existing disagreements were brought before the management of Kazkommerz in Almaty.

At Ineximbank August was marked by serious changes to the organizational and personnel structure bringing it back home to the old structure of the "Eridanbank" days. Since the end of August the bank has a new supervisory board resembling the 'old' supervisory board of Eridanbank in terms of personnel composition. The bank has a new manager, Murat Kunakunov, who used to be the manager of Eridan and only one Deputy Manager instead of three. The bank is planning on cutting personnel and streamlining procedures.

Active program implementation started at Demirbank with the first selected loan officer candidate and a first loan was approved at credit committee on 27 August. Within the constraints of the currently valid credit policy and procedures the bank proved willing to engage in the 'experiment'.

At AKB Kyrgyzstan, there were no significant developments. MSFF lending operations ran smoothly. At the same time the MSFF consultants received the impression that the management of the bank had not fully understood the seriousness of the situation. The bank was operating and conducting meetings with the MSFF representatives as if signing of the agreement was forthcoming and a bit of window dressing would suffice to satisfy EBRD's requirements for improving the financial situation of the bank.

September

Mid-September the EBRD Board of directors visited Kyrgyzstan. The EBRD Board of Directors visited both Bishkek and Osh and had the opportunity of meeting with an MSFF micro client producing furniture. The biggest concerns of some members of the Board of

Directors were the current levels of market interest rates for lending in Kyrgyzstan and the question of money laundering.

On 23 September, the MSFF consultant Jhon Manning took up permanent residence in Osh. The premises at the Kyrgyz Avtobank branch in Osh were ready and the processing of first applications (already received during previous visits) started. The loan officer candidates, who had been sent to Kazakhstan for training, returned and reported for on-the-job training on 25 September.

As stated above, demand for loans in Bishkek was next to non-existent for the first half of the month. Despite increased advertisement and marketing efforts quality clients were rare. The most plausible explanations put forward by counterparts appear to be the fact that many, especially micro clients, are more or less directly involved in farming activities and were busy bringing in the harvest, and the fact that the population had engaged in heavy spending during the summer for recreation and preparing the children for school. This, in turn, would leave large parts of the population without purchasing power. Consequently, micro and small enterprises would also feel no imminent need for financing. During the second part of the month, effective demand significantly increased, allowing for overall disbursements on the same level as August. The outlook for October, in terms of loans in progress is promising.

At the banks that the MSFF is providing technical assistance to, there were no significant changes. At Ineximbank the new "old" management needed a bit of time to find its stroke. The new manager, although cooperative, has only a very limited understanding of the program activities and concept, and developed a tendency of making decisions single-handedly on issues requiring coordination and agreement with the MSFF. In regular weekly meetings the MSFF consultants are educating the management and preparing the ground for the loan officer take-over by the bank. In general, a certain degree of uncertainty on the part of the bank's staff could be sensed. Rumors of the forthcoming personnel cuts as well as the new manager's leadership style (kept very much to his office) were creating tension. Briefly, this overall development also impacted the attitude and motivation of the MSFF loan officer candidates in a negative way. However, the management of the bank and the MSFF representatives jointly resolved these issues by the end of the month.

At AKB Kyrgyzstan there were no significant changes. MSFF lending went smoothly. The management appeared to start understanding that window dressing would not suffice.

At Kyrgyz Avtobank, the problems related to the personality clash of A. Ramazanov and K. Mamakeev were (at least for the time being) resolved by a clear division of responsibilities. A. Ramazanov was put in charge of most active banking operations. Preparations for the launch of active lending continued. On 30 September the four loan officer candidates designated to MSE lending at Kyrgyz Avtobank moved into their office at the bank in Bishkek and active operations commenced on 01 October. In Osh, active operations commenced on 25 September.

At Demirbank there were no significant developments. The bank continued to oppose large-scale advertising or any deviations from the currently governing policy and procedures until the shareholder's meeting would formalize the bank's participation in the MSFF. In view of these constraints, demand for loans was very low. During the second half of September the one loan officer was joined by two more selected candidates. In spite of the constraints placed on program development, the bank proved cooperative and a first loan was disbursed and two more approved at credit committee.

3. Co-operation with the Partner Banks

Ineximbank

Although overall cooperation is going well, the repeated change in management and the reorganization of the bank temporarily impacted cooperation. (At the end of June L. Lugma had resigned and D. Bekbulatov had been named interim manager of the bank). The new manager, M. Kunakunov, has a completely different management style from his predecessors and is more of the old school of sitting in his office and taking decisions single-handedly and without consultation. However, he is open for suggestions and cooperative and agreed to M. Scheck's suggestion of having a "jour fixe" to insure timely exchange of information and reach joint decisions. Nevertheless, initially, a certain degree of tension could be sensed at the bank. The forthcoming personnel cuts as well as the reduction of salaries caused some friction among the bank's staff. Temporarily these frictions also negatively affected the motivation of the MSFF loan officer candidates. "Well meaning advisers" within the bank started demoralizing the loan officers by pointing out to them that they would either not be hired at all or hired at a salary level way below their expectations. When M. Scheck made the management aware of the development the manager was cooperative in resolving the issue. By the end of September, morale improved. Nevertheless, the 'old'-fashioned management

style of the new manager and his (as of yet) limited understanding of the MSFF as more than just a credit line require special grooming on the part of the consultants. The bank, which underwent a standard CB audit in July/August, made the report available to the consultant. The CB report rates the bank with an "overall satisfactory". However, the CB did criticize the lack of management and control in operations as well as the undue meddling of shareholders in day-to-day operations. The current reorganization and personnel changes are a reflection of the bank's reaction to these findings. Based on the request of the bank, which is truly interested in improving internal operations and cooperation with EBRD and the MSFF, M. Scheck will occasionally participate in the bank's management meetings and the 'big' credit committee. The outlook for future cooperation with the bank is good. The bank is already preparing the loan officer take-over and is willing to implement an individual-performance-pegged salary scheme.

At the end of September the bank had identified potential premises for a branch in Osh and had drawn-up a short list of potential key personnel. A final decision on both premises and personnel is expected for October. The bank has also started investigating the possibility of opening a branch in Dzhahal Abad.

AKB Kyrgyzstan

Although the bank continues to be cooperative in implementing MSFF lending, the same problems as outlined in the previous report remain. In addition, the overall financial situation of the bank appears questionable. Although the bank is working on improving its indicators, fundamental changes in attitude or approach could not be sensed during the period of this report. Amongst potential clients the reputation of the bank appears to be deteriorating. Some potential clients do react negatively to the bank and seem to be convinced that loans cannot be received at this bank without incurring "additional expenses". During a monitoring visit to a client with an outstanding loan, this client put forward the story that he had been invited to the bank after disbursement by a rather high-ranking individual who suggested that he should pay a 'fee' of 10% of the received loan. However, the client refused categorically to go into any details or repeat this allegation before witnesses. As this was not the first instance of such allegations, M. Scheck addressed the issue with the management of the bank as a general warning. At the time of this report the future of cooperation with this bank is unclear. For the time being, the MSFF continues to provide TA to the bank. The EBRD Resident Office continues to monitor the overall situation of the bank.

Demirbank

During the July visit of E. Lefting to Kyrgyzstan, the decision was taken to start proceedings for signing a credit agreement between Demirbank and EBRD. A due diligence was conducted in mid-July. At the same time, the decision was taken to start providing TA under the facility and start disbursing MSFF loans using the banks own resources. As outlined above, this resulted in premises being made available to the MSFF in July, first rounds of loan officer candidate selections and the start of active lending from the end of July. The MSFF provided three computers and a printer.

However, current program operations are only taking place within the framework set by the bank manager's decision-making authority and the currently valid credit policy and procedures. In addition, the manager has some apprehensions about advertising the program too heavily or giving more concrete consideration to a program launch in Osh until the shareholders of the bank have officially sanctioned program participation. These constraints slow down efficient program implementation and limit potential lending. Consequently, demand for the reporting period was limited and the processing of received loan applications tedious resulting in only one disbursed loan in September. An extraordinary shareholder's meeting, at which the issue of signing a credit agreement with EBRD under the MSFF is to be addressed was initially expected to take place at the beginning of September, but has been postponed twice. According to available information this meeting now is scheduled for the second part of November. In spite of these constraints, overall cooperation is going well. The local personnel has clearly understood the importance of engaging in micro and small business lending. Economic understanding of presented cases is good. However, the lack of experience in lending in general and in efficiently processing applications can be felt. Thus the bank still has difficulties understanding where its current procedures concerning, for example, credit committees or loan decision documentation prevent efficient processing of micro and small loans. However, the management is open-minded and step-by-step changes improving processing procedures are being accepted. At the end of September, the consultant also finally managed to convince the bank to allow for newspaper ads advertising the availability of micro and small loans at Demirbank.

Kyrgyz Avtobank

As stated above, Kazkommerzbank bought up Kyrgyz Avtobank, a small local bank originally related to the Ministry of Transport. In view of the successful cooperation of EBRD and Kazkommerz and the previous experience with micro and small business lending through the KSBF, the mutual willingness for cooperation under the MSFF in Kyrgyzstan was expressed. As a result, during the visit of E. Lefting to Kyrgyzstan in July, the decision was taken to provide TA to Kyrgyz Avtobank and start proceedings for the signing of a credit agreement between EBRD and the bank. For the time being, A. Ramazanov, a Kazkommerz employee from Kazakhstan and former KSBF counterpart and supporter of micro and small business lending, is acting as Deputy Head to the bank. In several meetings, M. Scheck, H. Nonnenberg and A. Ramazanov agreed to launch the program both in Bishkek and Osh at the end of September or beginning of October, identified premises for the MSFF loan officers both in Bishkek and Osh, selected potential loan officer candidates and sent them off for training to several KSBF locations in Kazakhstan. During the last week of September active lending was launched in Osh and on 01 October in Bishkek.

In spite of this timely fulfillment of plans agreed to in July, there are some areas for concern: the licensing procedures of the 'new' bank are not going as smoothly as originally anticipated. According to available information, this is directly related to personnel and organizational issues. Especially in August, internal disagreements on personnel and the distribution of decision-making authorities slowed down the reorganization on location. At the beginning of September these issues were brought before Kazkommerz in Almaty. The main issues appear to have been resolved. Mr. Ramazanov will be in charge of most active banking operations. However, there are some indications that the reorganization continues to cause friction. A certain reluctance of the Kyrgyz Avtobank staff and the Kazkommerz staff to cooperate efficiently can be sensed. According to available information relations between Mr. Ramazanov and the new head of the bank, Mr. K. Mamakeev, remain strained. Information does not flow freely between the local staff and the Kazkommerz 'outsiders', communication seems tedious and guidance is lacking. Local staff often does not know where to find the Kazakhs and the Kazakhs do not necessarily brief the local staff on where they can be reached or when they will be available. At the same time the Kazkommerz representatives are frequently absent, i.e. in Almaty. The potential difficulties this may cause for active program implementation became especially apparent at the end of September when, as agreed active lending operations were launched in Osh and there was no guidance on interest rates, local lending limits, loan currencies or loan terms. Mr. Ramazanov's alternate promised to tend to

the issue. Instead of receiving the promised answers, the consultants then learned that she too had left for Kazakhstan without leaving coordinates where she could be reached or clear information on when to expect her return. When active operations were launched in Bishkek on 01 October, neither Mr. Ramazanov nor his alternate had returned. At the time of this report, both the MSFF offices at Kyrgyz Avtobank Bishkek and Osh are accepting client's applications and processing them without being able to quote final interest rates, loan currencies or terms, or being able of bringing the cases into credit committee.

In spite of these reorganization related issues, overall cooperation is satisfactory and the outlook promising. Mr. Ramazanov has not only understood the importance of micro and small business lending in general but the specific importance of this kind of lending for the Kyrgyz market. As exemplified by the timely implementation of loan officer selection and preparation of premises, the bank is interested in getting MSFF lending within the bank off the ground as soon as possible.

4. Seminars and Training

| Month | No. of LO candidates selected | Date On-the-Job Training started | No. of LO candidates that attended Micro Loan Seminar: |
|-----------|-------------------------------|----------------------------------|--|
| July | 1 | 29.07.02 | |
| August | 12 | 26.08.02 | 8 |
| September | 3 | 29.09.02 | |

In addition to on-going on-the-job training, the MSFF conducted several on-location short seminars on specific issues, such as legal framework, registration and taxation issues (July/August). Also a weekend refresher seminar on financial analysis was conducted. M. Scheck and H. Nonnenberg organized a Saturday-workshop for the consulting team at which experiences with the local market were discussed and overall lending guidelines established (July). The MSFF consultant M. Scheck also participated in the KSBF seminar for local

consultants in July and presented the MSFF. At an AKB Kyrgyzstan seminar (July) for the branch managers M. Scheck presented the MSFF lending approach. During the period of this report 16 new loan officer candidates were selected. Of these ten candidates are from Bishkek and six from Osh. For personal reasons one of the Osh candidates can only start training in the fall. Together with four candidates from Bishkek the remaining five candidates from Osh were sent to the KSBF locations of Chymkent and Karaganda for on-the-job training, of these, eight successfully completed the micro loans seminar conducted in Almaty in mid-August.

Six of the selected candidates remained in Bishkek where they are receiving on-the-job training in the operating MSFF departments. Of these three candidates (selected in July/August) are disbursing own loans.

In August, I. Dzhanbauova visited KMB, Russia, to learn more about the express-micro technology used by KMB.

In September renewed rounds of loan officer candidate selection started in both Osh and Bishkek. A micro seminar is planned for the end of October or the beginning of November.

5. Regional Expansion

Overall, regional expansion is limited by the availability of potential partner banks. Most Kyrgyz banks have only a limited (if at all) branch network. Nevertheless, three of the banks cooperating with the MSFF have presence in the south of the country, the first priority for regional expansion of the MSFF.

However, rapid expansion with these three banks is limited by external factors: in view of the questionable situation of AKB Kyrgyzstan and the future of cooperation with this bank an expansion with AKB Kyrgyzstan in Osh is not an issue at this time. In addition, the consultants did not receive a favorable impression of the Osh branch of AKB Kyrgyzstan (see previous report).

The Osh branch of Demirbank (visited on several occasions) is interested in cooperating with the MSFF, but here, the bank's management in Bishkek is not willing to consider introduction of the program in Osh until the official status of cooperation has been clarified.

With Kyrgyz Avtobank preparations for the launch of active operations in the south moved forward as agreed in July resulting in active lending starting at the Osh branch on 23

September. In July and August potential premises and a first group of loan officer candidates had been identified and the candidates trained. Some organizational issues still require solution, such as the question of local lending limits (see above).

Ineximbank, as of date without a branch network, continued its preparations for opening branches in Osh and possibly Dzhahal Abad. By the end of September several potential locations for the branches had been identified and a short-list of key personnel had been drawn up. The bank understands the importance of establishing presence in the south. For the beginning of October, the bank plans to make a final decision on premises and personnel. This should allow for active operations by November.

The MSFF is conducting on-going loan officer selection cycles with a view of identifying and training personnel to accommodate both Demirbank and Inexim once active program implementation at the Osh branches of these banks can start.

6. Other Banks

There are no significant changes to report. The situation regarding Ecobank or Energobank has not noticeably changed since the last report.

7. Other Issues

The MSFF moved into its office premises (rented in June) in July and hired N. Nejporeva as office manager. As agreed with the EBRD Resident Office a special logo for the program was created and introduced in September. The MSFF representative, M. Scheck, gave a TV interview to the national broadcasting company (broadcasted in September). During the period of this report the MSFF had meetings with representatives of the Worldbank, IFC, the Aga Khan Foundation, KfW, and other international organizations. The MSFF and EBRD also met with the head of the National Bank, Mr. Sarbanov, to introduce the program and share concerns on the project for amending the current law on collateral. The MSFF, in cooperation with the EBRD and advised by N. Aimenov (KSBB) drafted a letter with comments and suggestions on the project which was made available to the National Bank and the Ministry of Justice (initiator of the project). According to available information, the comments were well received and will be taken into account. Upon request of EBRD, M.

Scheck continued to participate in the TACIS project on establishing a Credit Information Bureau. Negotiations between the potential participants (banks and MFI) proved tedious and there has been no positive breakthrough.

8. Outlook

The outlook for the last quarter is promising. Current demand levels are satisfactory and should be increasing in November and December. The MSFF now has five lending departments in Bishkek and one in Osh. Three of the outlets have established initial routines and the confidence of the branch employees concerning the program approach and loan officers is increasing allowing for increased output. The addition of Demirbank and Inexim branches in Osh may be expected in the next three months. The 'first generation' of loan officer candidates in Bishkek is gaining in experience and productivity which in turn allows for faster training of 'next generations' of loan officers. In addition, the MSFF is giving consideration to the introduction of simplified loan products for the very small micro loans.