

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

**Quarterly Report**

**01 October – 31 December 2002**

**1. General Situation**

The overall situation was calm. Nevertheless, several factors need mentioning: dissatisfaction on the part of the population – especially from the Southern regions – continued. Crime levels in Bishkek increased: especially robberies and assault. Although these attacks are not exclusively aimed at foreigners, foreigners remain a prime target. The employees of several public enterprises organized strikes or demonstrations in Bishkek resulting in a two-week delay in providing heating to most parts of the city. In Osh, blackouts and intermittent supply of heating are the norm. In November, a group of several hundred demonstrators from the South marched on Bishkek and demanded the resignation of the government. Although the situation did not result in widespread unrest and was resolved by security forces within a few days (by apprehending the demonstrators and sending them back to their homes in buses) these incidents clearly show that all is not well in terms of political stability or economic development. In December, seven people were killed and over 20 injured in an explosion on one of the largest Bishkek markets. Although initially attributed to a faulty gas cylinder, subsequent investigation proved that the explosion was due to a 'hexogen-based explosive device'. Whether this explosion was politically motivated remains unclear. The explosion on the "Dordoi" market affected some of the MSFF clients: overall turnover on the market decreased and two of the MSFF clients could not access their containers or operate their businesses until well into the first part of January.

The overall socio-political situation in Osh was calm throughout the period of the report. During the latter part of the year, local elections marked everyday life in Osh. The MSFF consultant on location reports an increase in tensions between the different ethnicities living

in the region. Whereas these factors did not impact program implementation, the situation regarding partner banks did: due to internal developments at Kazkommertsbank in Kazakhstan as well as delays in the licensing procedures of the new Kazkommertsbank Kyrgyzstan (former Avtobank), and subsequent repercussions for MSFF lending activities at Avtobank, lending at this bank was not possible throughout the period of this report – neither in Bishkek nor in Osh. Nevertheless, training of the loan officers continued. The bank and the MSFF used the time to go through all policies and procedures and adapt them to the needs of efficient MSE lending. The delays in establishing the Ineximbank branch in Osh also negatively impacted lending in Osh. However, the MSFF negotiated and implemented a lending-triangle involving Ineximbank Bishkek for loan processing and Demirbank for physical disbursements of the loans in Osh. This allowed for first loan disbursements to clients in Osh in November.

Overall MSFF implementation moved forward. During the period of this report 212 loans for a volume of 390 810 USD were disbursed. In November, first loans were disbursed in Osh. At the end of December there were 312 loans for a volume of 566 085 USD outstanding, including 27 loans for a volume of 22 757 USD in Osh. Noteworthy is the fact, that overall interest rate levels under the MSFF and at some MFO in Bishkek, e.g. FINCA, were lowered during the period of this report. Some MFO (again, foremost FINCA) made some changes to their lending conditions, making loan products more similar to those of the MSFF. The current interest rates at the MSFF range between 18% p.a. and 28% p.a. in USD and 28% p.a. and 40% p.a. in KGS.

Demand levels were satisfactory. As evidenced by the number of disbursements and average loan sums, foremost micro loans for up to 2000 USD (1000 USD in Osh) were in demand. Primarily, individuals and sole proprietors – classic one-man or one-family shows - applied for financing. Although some legal entities applied, most of these applicants proved not creditworthy and/or had completely unrealistic projects. The vast majority of applicants was engaged in trading activities and required means for increasing turnover and/or purchasing of equipment (e.g. refrigerators, shelves, cars or trucks). The need for micro-finance in Kyrgyzstan remains high. Most applicants work on the basis of a “patent”, i.e. a simplified registration as sole proprietor, which is usually purchased on a monthly basis. The fee usually includes most taxes and makes accounting towards the authorities superfluous. Consequently, most applicants have no or only very limited documentation on their activity.

In spite of overall satisfactory demand levels, disbursement levels under the MSFF were lower than expected. In part seasonal factors (holidays and the related closing of customs at the borders, weather conditions) played a role. More important, however, was and is the situation regarding partner banks for the MSFF. As detailed below, the number of available banks/outlets was lower than expected. Active lending with Avtobank/Kazkommertsbank (planned for October) proved impossible during the period of this report and will only commence in January 2003. The shareholders' meeting of Demirbank, a prerequisite for wider-scale lending with this bank and possible inclusion of the Demir branch in Osh, did not result in a full approval of MSFF participation. The branch-opening of Ineximbank took significantly longer than anticipated by the bank (or the MSFF) and at the time of this report the branch is still not fully operational.

**Disbursements and Outstanding Portfolio of EBRD MSFF Micro and Small Loans for the last quarter of 2002 (in US\$)**

	DISBURSEMENTS				OUTSTANDING PORTFOLIO		
	Number of loan officers	Number of loans granted	Volume of loans granted	Average loan amount granted	Number of loans outstanding	Volume of loans outstanding	Average loan amount outstanding
<b>Bishkek</b>							
Oct	20	66	113,368	1,718	178	376,027	2,113
Nov	21	60	138,518	2,309	230	470,571	2,046
Dec	24	58	113,162	1,951	285	543,328	1,906
<b>Total Bishkek</b>		<b>184</b>	<b>365,048</b>	<b>1,984</b>	<b>285</b>	<b>543,328</b>	<b>1,906</b>
<b>Osh</b>							
Oct		0	0	0	0	0	0
Nov	4	11	7,322	666	11	7,322	666
Dec	4	17	18,440	1,085	27	22,757	843
<b>Total Osh</b>		<b>28</b>	<b>25,762</b>	<b>920</b>	<b>27*</b>	<b>22,757</b>	<b>920</b>
<b>GRAND TOTAL</b>		<b>212</b>	<b>390,810</b>	<b>1,843</b>	<b>312</b>	<b>566,085</b>	<b>1,814</b>

\* for internal accounting reasons at the bank, one of the loans issued to an Osh client will not be transferred to the Osh branch. It will be treated as a Bishkek loan. The other loans will be transferred to the balance sheet of the branch as soon as possible.

The different banks accounted for disbursements as follows:

**Disbursements and Outstanding Portfolio of EBRD MSFF Micro and Small Loans per Bank for the last quarter of 2002 (in US\$)**

	DISBURSEMENTS				OUTSTANDING PORTFOLIO		
	Number of loan officers	Number of loans granted	Volume of loans granted	Average loan amount granted	Number of loans outstanding	Volume of loans outstanding	Average loan amount outstanding
<b>Ineximbank</b>							
Oct	7	30	39,988	1,333	89	220,015	2,472
Nov*	11	34	58,440	1,719	118	248,670	2,107
Dec*	11	40	59,998	1,500	157	285,725	1,820
<b>Total</b>		<b>104</b>	<b>158,426</b>	<b>1,523</b>	<b>157</b>	<b>285,725</b>	<b>1,820</b>
<b>AKB Kyrgyzstan</b>							
Oct	6	31	62,880	2,028	83	142,302	1,714
Nov	7	34	82,100	2,415	114	211,014	1,851
Dec	10	31	60,850	1,963	142	252,791	1,780
<b>Total</b>		<b>96</b>	<b>205,830</b>	<b>2,144</b>	<b>142</b>	<b>252,791</b>	<b>1,780</b>
<b>Demirbank</b>							
Oct	3	5	10,500	2,100	6	13,711	2,285
Nov	3	3	5,300	1,767	9	18,209	2,023
Dec	4	4	10,754	2,689	13	27,569	2,121
<b>Total</b>		<b>12</b>	<b>26,554</b>	<b>2,213</b>	<b>13</b>	<b>27,569</b>	<b>2,121</b>
<b>GRAND TOTAL</b>		<b>212</b>	<b>390,810</b>	<b>1,843</b>	<b>312</b>	<b>566,085</b>	<b>1,814</b>

\* includes loans disbursed to clients in Osh.

## 2. Co-operation with the Partner Banks

### **Ineximbank**

During the last quarter 104 MSFF loans for a volume of 158 426 USD were disbursed. The outstanding portfolio as of 31 December 02 was 157 loans for a volume of 285 725 USD.

Although overall program implementation at the bank moved forward, there are several areas for concern. The following can be characterized as positive developments: the bank, satisfied

with their performance, hired three of the MSFF loan officers in October and a fourth one in November. The bank agreed to the MSFF's suggestions regarding contract terms and salaries. For the time being, bonus payments remain with the MSFF. As agreed at the start of program implementation, the bank initially only formalized basic changes to internal procedures to give the program and the bank an opportunity to gain local expertise and experience in efficient MSE lending. In November, the bank and the consultants started 'putting on paper' experiences gained to date, i.e. editing and revising the credit and collateral policies of the bank in detail to accommodate program needs. The new policies are expected to be adopted by the bank in January. Cooperation with the new manager of the bank, M. Kunakunov, improved. He is open for suggestions. This was exemplified when E. Lefting (EBRD) and D. Mitov (IFC) visited the bank in November and the branch opening in Osh was discussed. The bank continued its efforts to open a branch in Osh and, finally, received its license during the later part of November.

On a larger scale, Ineximbank will fuse with Temirbank (Kazakhstan). While, this will increase the size and possibilities of the bank, it will also mean renewed internal reorganization of the bank during the first half of 2003.

In spite of these overall positive developments, there are several factors that give rise to worry. From the point of view of the program lending results at the bank should and could be higher. There is a lack of understanding of and support for the program on the middle-management level. This concerns especially the head of credit, the deputy head of credit, the bank's legal advisor and the head of the MSE sector (selected by former manager L. Lugma and presented to the MSFF upon arrival in April). Credit committees are as of yet a two man show (loan officer and consultant) with the Ineximbank representatives being passive listeners. Active understanding of and support for the program is missing. On several occasions, the MSFF has discussed this with the management of the bank and has expressed its dissatisfaction with the performance of certain personnel. Although the management acknowledges the issues, reprimands staff (which leads to a temporary improvement of performance), the management is – as of yet – reluctant to take more substantial measures. In part, this is a direct result of the expected changes related to Temirbank: since everyone expects a major reshuffling, why should they change something now?

At the same time, the manager is striving for coordination and agreement with the program representatives. Cooperation in serving clients in Osh is good. The upcoming involvement of Temirbank may bring some improvement in terms of personnel, organization and procedures. However, it will also mean renewed reorganization. This may, at least temporarily, negatively impact operations of the bank and, subsequently, of the MSFF at the bank.

### **AKB Kyrgyzstan**

During the last quarter 96 MSFF loans for a volume of 205 830 USD were disbursed. The outstanding portfolio as of 31 December 02 was 142 loans for a volume of 252 791 USD.

There are no significant changes to report for the last quarter of 2003. The MSFF continued to operate under the status quo conditions decided in the summer, i.e. the MSFF continued to operate out of both branches already included in the MSFF but did not give any consideration to inclusion of any additional branches. The bank continued to use its own (scarce) resources for lending, and EBRD continued to monitor the overall performance of the bank. In a November meeting between S. Sadebakasova (head of AKB Kyrgyzstan), the EBRD (E. Lefting of the Small Business Group, F. Pillonel and other representatives of the EBRD RO), and the MSFF (A. Lepp, M. M. Scheck), it was agreed to await the audit of the operations in 2002 before making fundamental changes to the current situation.

In view of improving indicators at the bank, EBRD conditionally lifted suspension of the TFP program and agreed to look at requests on a case-by-case basis.

Given the overall situation at the bank, program operations at the bank were satisfactory. Credit committees were active and the bank appears to have a basic understanding of the needs of MSE clients. A first client in difficulties arose in December (major damage to the client's taxi and necessary repairs) and will show to what degree institution building has developed at the bank.

In spite of the satisfactory cooperation on the operational level of the program, the overall situation of the bank, the weaknesses in its internal organization and management still give rise to worry. The required international audit of its operations in 2002 will be forthcoming. At this time, the future of AKB Kyrgyzstan as a long-term MSFF partner with potential for geographic outreach remains unclear.

## **Demirbank**

During the last quarter a disappointing 12 MSFF loans for a volume of 26 554 USD were disbursed. The outstanding portfolio as of 31 December 02 was 13 loans for a volume of 27 569 USD.

As stated in the previous report, TA has been provided to the bank since the end of the summer 2002 although the official go-ahead as sanctioned by the bank's extraordinary shareholders meeting could only be expected in November. Consequently, active lending during the period of this report was limited by the bank manager's decision-making authority and the currently valid credit policy and procedures. These limitations in combination with the manager's reluctance to engage in large scale advertising or canvassing of the program negatively impacted program performance. The performance of the bank under the program has to be characterized as unsatisfactory.

Although the consultants could witness a certain improvement in the bank's understanding of the needs of efficient MSE lending during the first three months of cooperation, the bank started becoming more conservative as the shareholders meeting started drawing closer. In a meeting in November, E. Lefting (EBRD), D. Mitov (IFC) and the MSFF representatives (A. Lepp, M. M. Scheck) discussed this with the management and reiterated the needs of efficient MSE lending. The management reconfirmed its interest in developing MSE lending and expressed interest in designing cooperation with the MSFF in such a way that the bank, initially, would be using its own resources – even after full implementation. E. Lefting welcomed the suggestion and stated that such a concept could be considered. At the same time, however, the management referred to the limits set by the current policies and reiterated its position that full implementation could only commence after having received the approval of the shareholders. The management was not in a position to give any information on the general attitude of the shareholders concerning the bank's wish to move 'down market'.

The shareholders meeting (25 Nov. 2002) did not wholeheartedly endorse program participation, but only conditionally approved participation pending further clarification. The bank's management was tasked with preparing more detailed information for the BOD, which

then would make a final decision. In December, the management forwarded a 'feasibility study' to the BOD for due consideration. A reaction is still outstanding.

After the shareholders meeting active program operations at the bank became tedious and difficult. The management became very conservative and reluctant to use its decision-making authority. There is a tendency to over-collateralize loans and to take loan decisions without concern or regard for associated transaction costs both for the bank and the client. The bank became less willing to even discuss possible changes to credit or collateral policy. In spite of the fact that the bank witnessed the needs of the local market in terms of needed loan sums and terms the bank started backtracking and trying to push back up-market. At the same time, the consultants received the impression that the bank wants to engage in MSE/SME lending and wants to cooperate with the MSFF – however, without making any true changes to current procedures and policies. In several meetings, M. Scheck made the management of the bank aware, that this is impossible and that the program cannot provide TA indefinitely under the given conditions. In a meeting in mid-December, the consultant informed the bank that the situation has to be resolved by the end of January 2003.

## **Kyrgyz Avtobank**

The developments at Kyrgyz Avtobank have to be characterized as highly unexpected and the most dissatisfactory during the last quarter of 2003. Due to internal reshufflings at Kazkommertsbank in Kazakhstan, repercussions for the staff designated to work in Kyrgyzstan and unexpected difficulties in receiving its license as Kazkommertsbank Kyrgyzstan from the Kyrgyz National Bank, the start of active lending at this bank had to be postponed. The license for operations in Bishkek was only received in December while the re-registration of the branch in Osh was still outstanding at the end of December. At the end of December, key personnel of the bank were still undergoing National Bank testing and approval procedures. At the time of this report, only money-transfer and exchange operations were being conducted on a business as usual basis. Other services such as lending were restricted to VIP-clients.

In spite of this set-back the MSFF and the bank used the interim to go through all relevant policies, procedures and documents and redesign them to allow for efficient MSE lending and rapid MSFF implementation once the licensing/registration procedures would be finalized. Selection and training of loan officer candidates continued.

The MSFF loan officers in Osh continued to use the Avtobank premises. In a meeting between E. Lefting (EBRD), D. Mitov (IFC), the MSFF (M. M. Scheck) and the bank in November, it was agreed to restart active lending – pending receipt of the license, either at the beginning of December 02 or in January 03. At the time of this report, active lending at the bank is planned to start from 20 January in Bishkek and from 03 February 03 in Osh.

### **3. Seminars and Training**

During the period of this report 3 loan officer selection cycles were conducted, resulting in the selection of an additional 15 loan officer candidates in Bishkek and 13 in Osh. In addition to ongoing on-the-job training measures and evening mini-seminars on selected issues, a ‘big’ micro loan seminar was conducted in Bishkek for LO candidates from both Bishkek and Osh in November. 11 loan officers were sent to Kazakhstan for on the job training and/or attendance the micro loan seminar in Almaty.

Month	No. of LO candidates selected
October	13
November	7
December	8

The current distribution of loan officer candidates is as follows:

<b>Time in Program/ Bank</b>	<b>More than 3 months</b>	<b>1 – 3 months</b>	<b>Less than 1 month</b>	<b>Selected but not yet in training</b>	<b>Total</b>
Inexim	5	3		1	9
AKB Kyrgyzstan	7*	4		2	13
Demir	3	2			5
<b>Total Bishkek</b>	<b>15</b>	<b>9</b>		<b>3</b>	<b>27</b>
Osh	4	5		6	15
<b>Total</b>	<b>19</b>	<b>14</b>		<b>9</b>	<b>42</b>

\* incl. 1 LO on maternity leave;

#### **4. Regional Expansion**

The situation at the partner banks directly and negatively impacted regional expansion of the MSFF. The MSFF consultant J. Manning and the MSFF loan officer team in Osh had started accepting applications from clients at the end of September. The unexpected developments at Kazkommertsbank and Ineximbank delayed the processing of these applications by a few weeks. Nevertheless, active lending started in Osh and first loans were disbursed to Osh clients in November. For the time being, loans are only being disbursed with Ineximbank. For the period of this report loans were legally disbursed in Bishkek and transferred to Osh via Demirbank. The first priority for 2003 will be to transfer full loan processing to Ineximbank Osh as soon as the branch will be fully operational.

In parallel, lending at one additional partner bank (Kazkommertsbank) in Osh will be developed as soon as the branch will have received its re-registration (planned start February 03). Regretfully, other reliable partners for lending in Osh cannot be expected within the next few months.

In view of the overall situation concerning the partner banks, the MSFF is giving some consideration to trying to use the “triangle” approach (disbursing the loan in Bishkek, but transferring the loan through a third bank) for establishing MSFF spin-offs in other cities in the Chuy region during the spring.

## 5. Other Banks

At this time, the only other bank under concrete consideration for potential program participation is Ecobank. As stated in the end-of-June report, the local EBRD office had identified this bank as a potentially interested partner (even before the consultants team arrived). However, there were legal and financial complications related to conducting the required audit. In addition to these delays, or, possibly as a result of these delays, the attitude of the management towards the MSFF changed. Whereas, during the spring and early summer, the bank continued to express its interest in developing MSE business as a strategic priority, in July, in a meeting with M. Scheck, the manager of the bank, A. Abdraev, informed the consultant that the bank was no longer that pressing interested in participation, especially not at the conditions offered by EBRD.

During the late summer of 2002, the management of the bank changed. And, during the fall, an international auditor, acceptable to EBRD, finally received a license to operate in Kyrgyzstan. At the same time, the tax-issues related to the costs of the audit were resolved. The new manager of the bank, A. Abdyvasiev, re-confirmed the bank's interest in cooperating with an international organization. On 29 November, F. Pillonel (EBRD) introduced M. Scheck to Mr. Abdyvasiev at a meeting at the EBRD RO. The agreement was reached, that the bank and the MSFF would restart program preliminaries while the bank would be fulfilling the program participation prerequisites and undergo the audit. In view of this, M. Scheck and Mr. Abdyvasiev agreed to meet the following week (i.e. in December). Regretfully, Mr. Abdyvasiev did not attend the meeting as he had to meet (short-notice) with the National Bank. Instead, M. Scheck met with the deputy head of the bank, Mr. A. Strelkin and the head of credit.

The consultant was concerned and disappointed at the meeting. Not only did the bank representatives seem to have only a limited knowledge of the issue (regardless of the fact, that the consultant had already met on several occasions with the head of credit for instance and discussed the very same issues), but, even more surprising, the bank representatives wanted to start renegotiating key issues, such as risk sharing or the right of the EBRD representatives to veto credit committee decisions on loans issued under the MSFF. In view of this, the consultant requested another meeting with the manager of the bank. Again, this meeting did

not take place. Upon arrival at the bank, the consultant was informed that the manager was in hospital undergoing an operation. Regretfully, attempts to have another meeting in December failed due to the illness of the manager and tight time schedules on both parts.

As discussed with EBRD, the MSFF consultant has some concerns about the position and attitude of the bank as exemplified by the December occurrences. The consultant will meet with the manager in January to clarify the situation. In parallel, the bank should be undergoing the required audit.

## **6. Other Issues**

The MSFF had a number of visitors during the period of this report: most noteworthy are the visits of the IFC Vice President Operations, A. Jabre, the visit of D. Rzehak of SECO, of K. Rosen (USAID Almaty), and the visit of E. Lefting (EBRD) and D. Mitov (IFC) in November.

Together with F. Pillonel and J. Galieva, M. Scheck met with the National Bank Governor U. Sarbanov in November to discuss issues related to the National Bank's position on accepting certain forms of personal moveable property as collateral (jewelry) and update the National Bank on MSFF activities. In early December, J. Galieva and M. Scheck met with Vice President (and EBRD Governor) J. Otorbaev to give him an update on MSFF activities.

M. Scheck also gave interviews to two radio stations.

The MSFF hired IT specialist, B. Pasko in October. After three weeks of training in Kazakhstan, he is now looking after the IT needs of the MSFF. In addition to assisting the team in improving data security and reporting formats he has started working on the design of a MSFF web page.

In December, M. Scheck attended an ACDI/VOCA organized seminar on MFI. Under the new law regulating and formalizing MFO, all MFO currently operating in Kyrgyzstan will have to register as one of three theoretically possible MFI. As opposed to Mercy Corps and Baytushum who are apparently planning on staying exclusively with lending activities,

FINCA is planning on registering as a Micro Finance Company. As such they will have the possibility of taking deposits in addition to engaging in lending activities.

The TACIS project designed to assist in establishing a Credit Information Bureau continued and became more concrete. Although most financial institutions opted for a “holding pattern” to wait and see how the CIB will work, enough initial members were identified to go ahead. M. Scheck was suggested as one of the board members. With the agreement of the EBRD Resident Office, she accepted the candidacy and was elected to the board.

## **7. Outlook**

In view of the overall situation with regards to partner banks, disbursement levels under the MSFF were satisfactory. However, in view of the economic situation in Kyrgyzstan and the potential market for MSE loans, results are not satisfactory. The availability of reliable partner banks with a perspective and potential for outreach and large-scale sustainable MSE lending remains the most pressing issue. With the uncertainties related to the participation of Demirbank, the future of AKB Kyrgyzstan in the program as well as the reorganization related potential frictions in Kazkommertsbank and Ineximbank projections for the next three months are difficult. Nevertheless, the MSFF plans to increase the number of lending outlets in the two regions already included and expand the MSFF to at least one more region during the first half of the year by using the “triangle” approach. After implementing MSFF lending at Kazkommertsbank in both Bishkek and Osh, the first priorities will be to bring MSFF loans into Uzgen and Dzhalal Abad in the South and into at least two more cities in the Chuy region.

## Workplan 2003

### USAID / EBRD Kyrgyz MSE Finance Facility

	Osh only		March	April
	January	February		
<b>Lending Results</b>				
Number of loans disbursed	15	20	120	150
Volume of loans disbursed	30,000	40,000	240,000	375,000
Number of loans outstanding	42	60	160	260
Volume of loans outstanding	35,000	65,000	1,000,000	1,196,250
Arrears level over 30 days in %	0	0.2	0.2	0.5
<b>Operational Results</b>				
Seminar for New loan officers		1		1
Seminar for Advanced loan officers			1	
Seminar for Consultants		1		
New loan officers in training	4	3	16	15
Total loan officers in KMSEFF	13	16	62	77
New MSE departments set up	1	1	1	1
Total MSE departments operational	1	2	8	9
Number of partner banks	4	4	3	3
<b>Coordination with USAID</b>				
Contractor meetings				
Coordination in cities with Pragma				
General coordination with Pragma			update	



December	Total
400	2,405
1,200,000	6,535,000
2,360	2,360
4,005,957	4,005,957
1	1
0	5
	4
	4
5	108
147	147
0	10
15	15
4	4
update	