



Sakhalin Microcredit Program

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Table of Contents

1. Acronyms	3
2. Executive summary	4
3. Introduction	4
4. Country Overview	6
5. Sakhalin Microcredit Program Overview	6
5.1. Creation of SSEDF and SSBSC	7
5.2. Geographic expansion	9
5.3. SSEDF strategies and accomplishments	11
5.3.1. Client selection	11
5.3.2. Effective marketing	11
5.3.3. Staff performance	12
5.3.4. Adapting to the regulatory environment	13
5.3.5. Lending strategies	14
5.3.6. Building relationships with local banks	15
5.3.7. Broad based training	18
5.3.8. Sustainability: revenue diversification	21
5.3.9. Management Information Systems (MIS)	22
5.4. Effects of the financial crisis	24
5.5. MCRIL review of the SSEDF/SSBCS operations	25
5.6. Response to MCRIL rating and the financial crisis	26
6. How the credit Program was extended as the “North Sakhalin Microcredit Program” (NSCP)	27
6.1. Building new strategies for NSCP	27
6.1.2. Meeting borrowers needs	28
6.1.3. Credit activities	29
6.1.4. Reaching out to indigenous enterprises	32
6.2. NSCP Training	32
6.2.1 Networking component: accessing key markets	36
Nogliki Entrepreneurs Secure Transportation Contracts with O&G companies	37
6.3. Lessons learned: Building a Special Marketing Approach for the Northern Business Community	38
6.4. NSCP Impact on the Commercial Credit Market in North Sakhalin	40
7. The Nogliki Tymovsk Credit Program (NTCP)	41
7.1. Tymovsk Contact Office Official Opening Ceremony	42
7.2. Credit activities	43
7.3. Products tailored for Northern Sakhalin	44
8. Sakhalin Wild Natural Resources	45
8.1. Establishing a Competitive Berry Processing Company	45
8.2. SWNR Trade Mark Registration	47
8.3. Farmer to Farmer Volunteer helps SWNR upgrade	47
8.4. New equipment will ensure SWNR product quality	48
9. Lessons Learned	49
10. Lasting Impact	50

1. Acronyms

GDA	Global Development Alliance
GDP	Gross Domestic Product
FI	Financial Institution
FtoF	Farmer-to-Farmer Program
LOC	Line of Credit
MFI	Micro Finance Institution
MIS	Management Information Systems
NSCP	North Sakhalin Micro Credit Program
NTCP	Nogliki Tymovsk Credit Program
RABTC	Russian American Business Training Center
RLOC	Revolving Line of Credit
SSBCS	Sakhalin Small Business Credit Society
SSEDF	Small Enterprise Development Foundation
SME	Small and Medium Enterprise
USAID	United States Agency for International Development

2. Executive summary

In May 1999, USAID chose ACDI/VOCA on a competitive basis to implement a new regionally focused micro finance program for Sakhalin Island in the Russian Far East; for an initial period of three years, followed by an extension to a total of 10 years. The program aim was to develop a network of micro finance institutions on Sakhalin Island to provide a micro finance component to the overall US government Regional Initiative effort in the region.

The success of the Micro Finance Institution in Yuzhno Sakhalin led to the expansion and the creation of operationally sustainable Branch Offices in North Sakhalin; Nogliki and Okha under the North Sakhalin Credit Program (NSCP) and the Tymosk office under the Nogliki Tymosk Credit Program (NTCP). Since the inception of the program, 2,154 Sakhalin small business entrepreneurs received 9,522 loans worth \$29,638,722, which helped them create or sustain over 14,258 jobs. In addition, 3,027 entrepreneurs from all of the branch offices received and benefited directly from trainings and consulting available through the training program.

The program successfully met its most important benchmark by demonstrating to the local commercial banking community that SME loans are good business. Throughout the last decade the Sakhalin Small Enterprise Development Fund (SSEDF) has been an active part of the growth of a diversified SME sector and the rise of a more friendly business environment on Sakhalin Island. SSEDF takes pride in its impact and in its role creating an enabling environment for businesses in the Russian Far East.

3. Introduction

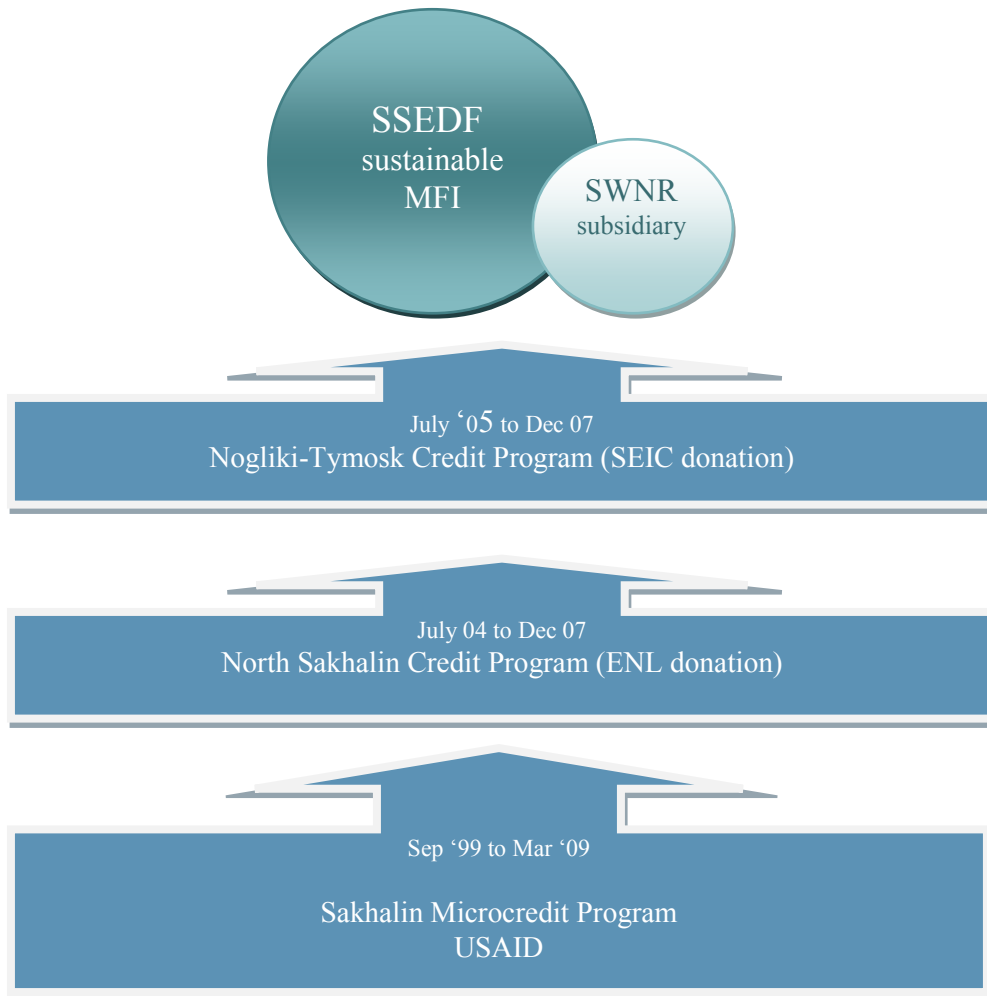
Since 1999 ACDI/VOCA has empowered Russian small business owners by not only offering them access to finance but by building a strong local economy that offers them choices in their financial portfolio. Ten years later, SSEDF continues to deliver much-needed credit.

The Sakhalin Microcredit Program drew upon individual and peer-lending methodologies to mitigate the socioeconomic impacts of uneven development in oil-rich areas. In addition to adapting financial services to the needs of local SMEs, ACDI/VOCA provided essential training and consulting services to program clients and start-up entrepreneurs. Besides offering training for entrepreneurs, four commercial banks received direct training for their loan officers and other credit analysis personnel.

Upon reflection, the project's impact is two-fold. First, the Program served as a model to local commercial banks for the provision of credit to rural and urban SME's. The local commercial banking community learned that SME loans are good business: they provide an avenue for investment into the local community and allow banks to build name recognition within a growing client base. This created a healthy and financially competitive environment for SME-specific commercial loan products. Secondly, the

Program has facilitated a strong local economy and contributed to the creation of 14,000+ new jobs. Furthermore, the program has been particularly successful in reaching out to women. Women are usually neglected by local credit institutions but on average constituted more than 60 percent of SSEDf's portfolio.

Figure 1. Sakhalin Microcredit Project Chronology



4. Country Overview

Sakhalin is a classic resource economy relying on oil and gas exports, coal mining, forestry, and fishing. Limited quantities of agricultural products are produced, impacted by the limited growing season, which averages less than 100 days per year.

Following the collapse of the Soviet Union and economic liberalization, Sakhalin experienced an oil boom with extensive petroleum exploration and mining by large oil multinational corporations. In 1996, two large consortiums signed contracts to explore for oil and gas off the northeast coast of the island, Sakhalin-I and Sakhalin-II. In addition, Sakhalin-III-through-VI are in various early stages of development. Sakhalin's economy has grown significantly thanks to the oil and gas industry. In 2000, the oil and gas industry accounted for 57.5% of Sakhalin's industrial output, growing to 80% by 2006.

In an effort to build a more diversified and resilient economic base, since 1994 USAID has focused on small and micro enterprise development as an essential part of its overall Technical Assistance to Russia. In October 1999, USAID had already funded five micro finance programs in the European part of Russia (Rostov-on-Don, Nizhni Novgorod/Arzamas, Voronezh, Novgorod Velikiy, and Samara). As results of these programs, over 4,700 loans were disbursed to Russian entrepreneurs for the total amount of over \$7 million; over 54,500 jobs were created and/or sustained. With programs such as the Sakhalin Microcredit Program, the economic development impact on the Island can clearly be seen today.

5. Sakhalin Microcredit Program Overview

With an initial donation from USAID in 1999, ACDI/VOCA established and developed a Micro Finance Institution (MFI) in Yuzhno Sakhalin. The MFI that ACDI/VOCA established was a combination of two legal entities, the Sakhalin Small Enterprise Development Foundation (SSEDF, a fund) and the Sakhalin Small Business Credit Society (SSBCS, a specialized consumer cooperative). SSEDF was created as a wholesale lending institution to provide loan capital to SSBCS, to ensure good credit quality, and to safeguard the purpose and intent of the Program. SSBCS was designed to be an SME retail lender. SSBCS delivers credit directly to local entrepreneurs, provides credit analysis, monitoring, & collection, and makes credit decisions.

Building on the success of SSEDF and SSBCS, Exxon Mobil and Shell donated capital to extend the reach of the project throughout the island. In 2004, the North Sakhalin Credit Program (NSCP) was launched in Okha and in 2005, SSEDF opened new branches in Nogliki and Timosk under the Nogliki-Timosk Credit Program (NTCP). USAID leveraged these donations by providing SSEDF technical assistance through ACDI/VOCA in support of SME development.

5.1. Creation of SSEDF and SSBSC

ACDI/VOCA registered the Sakhalin Small Enterprise Development Foundation (SSEDF) in Yuzhno-Sakhalinsk as a Russian non-commercial non-profit organization on November 4, 2000. The Board of Trustees was elected immediately following registration. The original Board incorporated high ranking local businessmen and officials. SSEDF has served as a wholesale lending institution for credit cooperatives from the beginning. At inception, SSEDF's functions included:

- Administration (policy-procedures) and monitoring of the retail lending activities of credit cooperatives
- Securing additional loan capital through local commercial banks for the continued growth and development of a sustainable financial institution for small and medium sized businesses
- Institutional development of the retail credit cooperative
- Safeguarding the Program's loan capital

Due to legal restrictions at the time and in tandem with SSEDF, the Sakhalin Small Business Credit Society (SSBCS) was created. SSBCS was designed to act as a retail provider of loans to small businesses. Operating as a "Specialized Credit Consumer Cooperative," SSBCS functioned as a non-depository, finance institution. SSBCS's functions included:

- Service all areas of entrepreneurial development
- Growth of the loan portfolio
- Administration of loan applications and loan disbursements
- Oversight of all necessary loan documentation and other administrative tasks
- Collection management services
- Loan monitoring

ACDI/VOCA facilitated and assisted the registration of the Sakhalin Small Business Credit Society (SSBCS). SSBCS was founded in Yuzhno-Sakhalinsk on May 3, 2001. The founders for this cooperative were SSEDF, Sakhalin Alliance of Small Business Entrepreneurs and Gradient Co. Ltd.

Following the registration of SSBCS, its Interim Board of Directors was formed in June 2001. The Board of Directors was composed of four current SSEDF borrowers, and one representative, each from the original founding institutions of SSBCS.

The Inaugural SSBCS Annual General Assembly was held in October 2002. During this shareholders meeting the significant agenda items were:

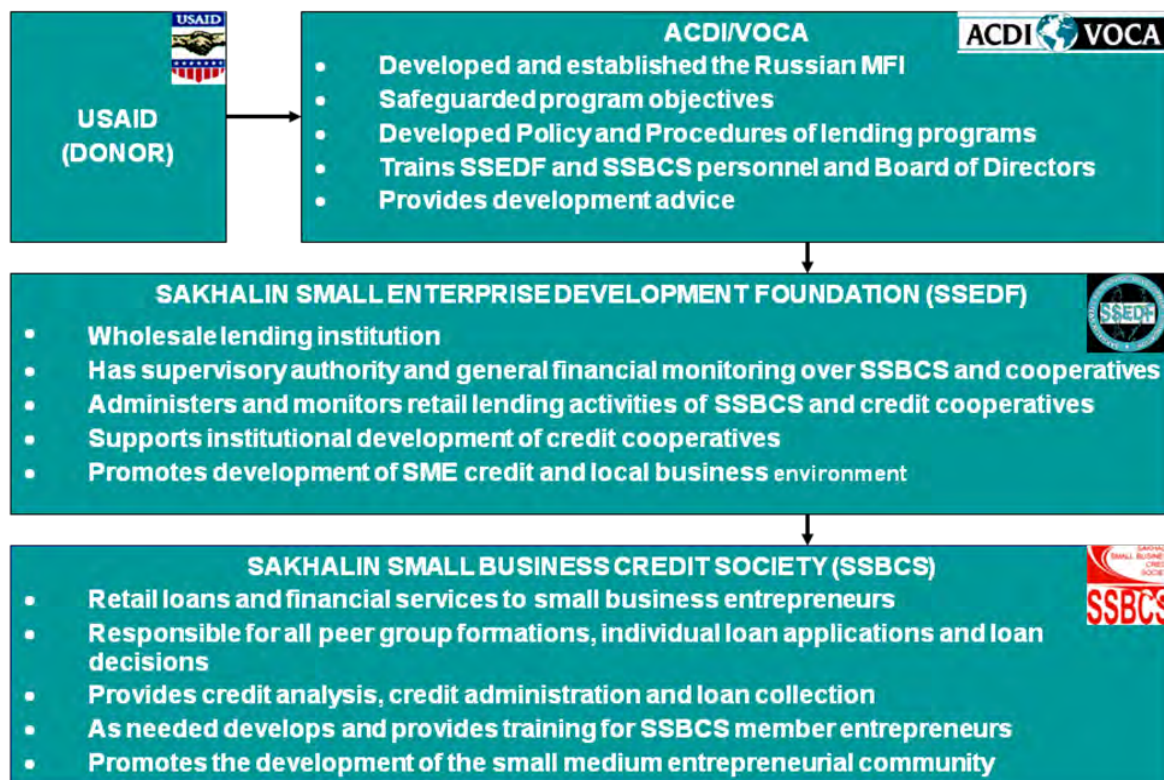
- Election of SSBCS Supervisory Board
- Adoption of SSBCS Bylaws
- Interim Supervisory Board report to Shareholders

The First Annual Meeting was a very successful event and was, as well, an excellent learning experience for SSBCS members. In particular, it enabled the shareholders to have a clear idea of how the Society is managed and helped define each member's role in this process. Finally, the Annual Meeting proved to the participants the transparent and open nature of the Cooperative. This was the beginning of yearly shareholder meetings that will continue as part of the governance of an independent and self-sustainable MFI into 2009 and beyond.

Another development milestone of the Russian MFI (SSEDF/SSBCS) was the adoption of the General Financing Agreement (GFA) between SSEDF (creditor) and SSBCS (borrower). The GFA defined the debtor-creditor relationship between SSBCS and SSEDF and provided SSBCS with conditional access to an open-ended line of credit with SSEDF. In its supervisory role, SSEDF administered and monitored the retail lending activities of the credit cooperative, supported its institutional development, identified additional sources of capital for the Sakhalin finance system, and promoted development of the local business environment.

A woman entrepreneur was, for the first time, elected to the SSBCS Board in June 2007, representing the 60% of SSEDF's clients.

Figure 2. Organizational Structure



As part of its plan for self-sustainability, SSEDF and SSBCS lending operations are not dependent upon any foreign representation office to make loans. Both institutions have been regularly audited by Russian authorities, are registered through the Russian Commission on Technical Assistance, and have the strong support of the Sakhalin Regional Administration.

5.2. Geographic expansion

In addition to the Yuzhno-Sakhalinsk headquarters office (opened May 2001), SSEDF has expanded beyond its original target of three offices by 2004. SSEDF has the following branch offices:

- Korsakov Branch Office (opened in August 2001)
- Kholmsk Branch Office (opened in December 2001)
- Tomary Contact Office (opened in June 17, 2003)
- Nogliki Branch Office (opened in April 2004)
- Okha Branch Office (opened in July 2005)

EXTENDING OUR REACH: THE STORY BEHIND THE SSEDF TOMARY OFFICE



Current SBSCS Offices



SSEDF/SSBCS Team

Tomary is a small seaside town located 3.5 hour from Yuzhno-Sakhalinsk. Banks were uninterested in the Tomary SME market because of perceived low repayment capacity and the high costs associated with servicing such remote areas. Thus, the only source of credit for local entrepreneurs was the local black market, which offered extremely expensive credit. Originally, the Sakhalin Regional Micro Credit Program did not intend to expand its operations beyond the southern part of Sakhalin. However, the Tomary Administration and local entrepreneurs were persistent in requesting support from SSEDF. While at the outset it was not feasible for the Cooperative to keep a loan officer onsite for individual loans, SSBCS looked for other creative solutions.

Initially SSBCS approached two banks with branch offices in Tomary. Our agents offered to bring new customers to their branches in return for reduced commissions and fees for our borrowers. We reached an agreement with SakhWest Bank and with their help and that of our credit agent we introduced our borrowers to formal lending and assisted them throughout the entire application process. In a show of support, the Mayor of Tomary provided SSBCS with rent free office space in downtown Tomary. The Mayor's support also included the part time use of one of the city employees as a credit agent. This support was instrumental in establishing SSBCS's presence in Tomary.

In May 2003 SSBCS hired and trained two new credit agents at headquarters to represent the Tomary contact office. A designated Yuzhno-Sakhalinsk loan officer kept in touch with Tomary credit agents to make sure that interested and potential individual borrowers were provided with full first-hand information on the individual lending program terms. On June 17th, 2003, the SSBCS team officially opened the Tomary office which was warmly received in Tomary and the neighboring town of Krasnogorsk. Though beginning with peer group loans, the significant demand of Tomary entrepreneurs led to the disbursement of the first individual loan in August.

5.3. SSEDf strategies and accomplishments

ACDI/VOCA adapted its technical assistance throughout the life of the project to ensure that it addressed SSEDf's clients needs, conscious of the changing regulatory and economic environment. From developing and establishing policies and procedures for lending programs, to designing training strategies, ACDI/VOCA now performs an advisory and consulting role to SSEDf. Described below are the strategies that ACDI/VOCA and SSEDf/SSBCS undertook to maximize the reach of the program. A review of these strategies will also reveal the nature of the continually changing lending environment as well as the history and evolution of the project.

5.3.1. Client selection

At the proposal stage, ACDI/VOCA envisioned that business startups would form a significant portion of the loans made by the project. However, on the ground experience and collaboration between ACDI/VOCA and the USAID mission in Russia, led to the de-emphasis of this approach. This was due to high credit risk exposure and thus, the MFI focused, instead, on already established entrepreneurs. Accordingly, the loan policies and procedures of SSEDf and the SSBCS were modified. Loan applicants now needed to be operational for six months before being eligible.

Training was still provided to potential entrepreneurs, consistent with our outreach mandate from the start of the Program. Trainings programs also facilitated strategic partnerships between participants. In this way new business owners could meet and partner with colleagues and access a loan via the peer group program.

5.3.2. Effective marketing

Aside from sound financial practices, it is important to also stress the role of outreach as well as customer service as key marketing tools. At the start of the project there was no SME lending culture on the island, thus outreach was key for the successful start of the project. SSBCS/SSEDf informational meetings were initially held at future client business sites, markets, stores, wholesale operations, and even airports. These meetings targeted potential customers interested in peer lending and focused on explaining the structure of the group lending program. Potential clients told of the step by step process to finalize their new business' by-laws, name selection, a completed loan application and group approval. The Program encouraged entrepreneurs to form groups by partnering with their business acquaintances. This helped minimize group formation time, thus under normal circumstances the group formation process took just 4-6 weeks.

The Program also initiated an advertising campaign which described the goals and objectives of the nascent MFI. As there was no SME lending culture different marketing approaches were deployed to address the high level of skepticism. These approaches

included continuous broadcasts, scheduled events, and informational articles that promoted openness and transparency together with staff photographs and bios.

Also, SSEDF/SSBCS clients provided testimonials in print as well as by radio and talk radio. For example, in January 2001, the state run TV/Radio station broadcasted a series of programs called “Big Road to Small Business.” SSEDF borrowers were the highlight of this program. They were filmed at their business sites during working hours and shared with the audience the results of their participation with SSBCS: their group relations and cooperation, how they used their first loan, and shared their thoughts and opinions about the Island needing such a micro-lending institution. The number of potential borrowers calls and visits to SSEDF/SSBCS increased considerably as a result of these TV programs. Using a different program, “TV scroll line”, three 30 second commercials that profiled SSBCS borrowers also generated significant interest in March 2001.

As the Program matured, new and improved facilities were acquired in August 2001. The additional office space provided a larger and better-equipped group-lending “operational hall” as well as a separate credit room to accommodate loan applicants for individual loans. This was of great importance because when holding informational peer lending or training sessions, attendees could become familiar with our facilities and employees attracting more clients. Furthermore, this new office space improved the client’s banking experience by providing enhanced security and privacy, thus improving client comfort retention.

5.3.3. Staff performance

SSEDF/SSBCS loan officers proudly differentiated themselves from competitors because they offered the one-on-one customer service that commercial banks did not provide. This customer service included assistance completing forms, review of business plans, registration of collateral, assistance with financial planning and more.

To maximize efficiency, SSBCS management made the decision to combine the position of Branch Manager and Field Loan Officer (LO) under the responsibility of one staff member in each branch. Under their direction, all branch offices have reached an advanced level of operations. The manpower and activity profile of these branches include:

- A full-time branch manager
- Experienced onsite loan officers that fully implement the individual lending program
- Experienced onsite credit agents that carry out the peer-group lending program
- Loan reviews and disbursements are finalized at the branch level
- Full range of services, from oversight of all necessary loan documentation to credit monitoring

To maintain staff motivation, SSEDF/SSBCS developed and implemented an improved incentive system for loan officers that took effect in July, 2007. This new system provides more flexibility than the one developed at Program inception. The new incentive program is more equitable and more appropriately rewards loan officers for bigger and better quality portfolios. The major principles of the system are:

- Guaranteed competitive base salaries compared to the local market
- Incentive by portfolio size and number of borrowers
- Portfolio loan quality is required.

SSEDF staff were recognized by the banking industry in the Island and their performance and commitment to the Program has been the cornerstone of the performance of the Sakhalin Microcredit Program.

5.3.4. Adapting to the regulatory environment

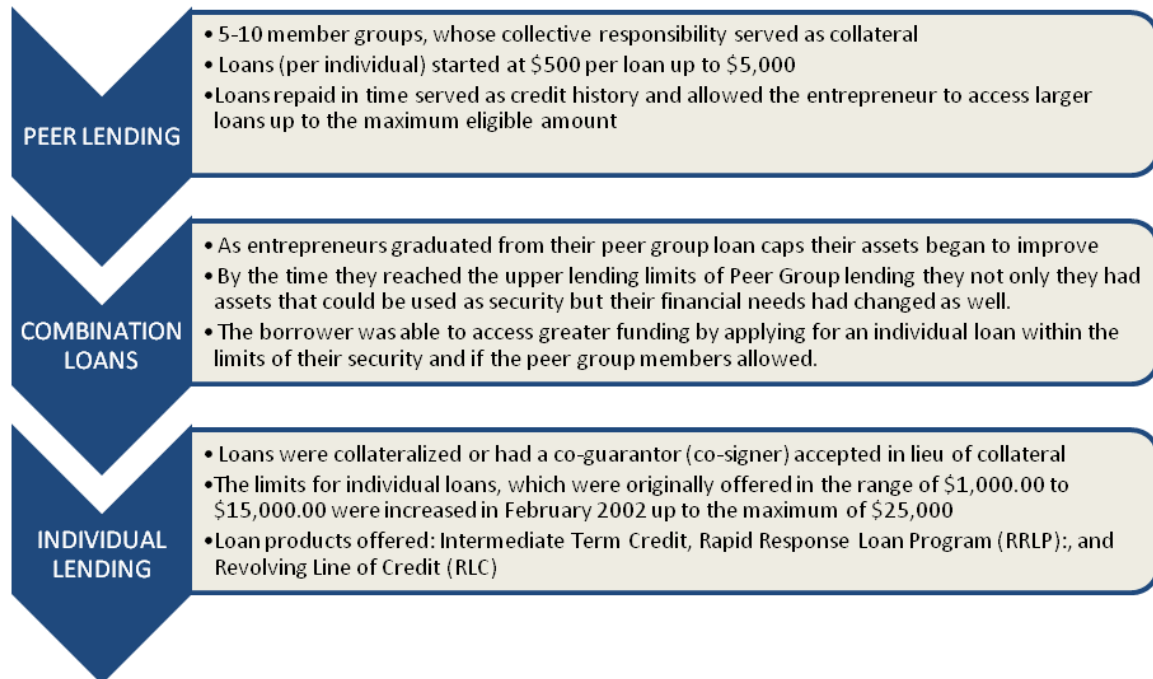
From inception the Program has remained tightly focused on meeting client needs while cognizant of the on-the ground realities. For example, the establishment of SSBCS in 2000 represented a change in the original concept of a non-commercial foundation organization to make loans to micro enterprises. While it was possible for the non-commercial Sakhalin Small Enterprise Development Foundation to make loans, Russian law did not allow non-commercial organizations to make retail loans. In order to do a significant number of retail loans, it was necessary to create SSBCS as a specialized consumer cooperative that could make individual retail loans. Through extensive training of the SSBCS Supervisory Board, senior management, and the SSEDF Board of Trustees, ACDI/VOCA brought the two established MFI organizations to a new higher level. At this higher level they operated independently and relied on the expertise of their Russian staff and Directors' in day-to-day activities as well as for strategic planning.

However by 2007 changes in MFI Russian regulation provided SSEDF the opportunity to streamline its operations. ACDI/VOCA's Program Director, Kenneth Smith, supported and provided technical advice and assistance to SSEDF in finalizing the merger of SSEDF and SSBCS. Significant time was devoted to assisting SSEDF in revising its current Charter, which now allows SSEDF to carry out retail lending directly to SMEs and, specifically, to have branch offices in Nogliki, Okha, and Yuzhno-Sakhalinsk. The merger has also helped the MFI simplify its loan processes, provide a range of loan packages, and secure earnings from non-financial activities. Furthermore, streamlining operations will help the MFI better confront the world economic crisis.

These changes came at an auspicious time as the market had outgrown the reach of SSBCS. Hence, at the end of 2008, SSBCS Board of Directors passed a resolution to merge assets and the loan portfolio of the SSBCS operations into the SSEDF which will continue as the emerging single retail lender. SSEDF has started direct retail lending, officially finalizing the merger before the end of the Sakhalin Microcredit Program.

5.3.5. Lending strategies

From 1999 to 2008 there has been a significant change in the lending environment on the island. SSEDF/SSBCS has continuously adapted to the needs of its clients. With peer lending, as the original model of the MFI, we cautiously moved into individual lending and into larger loans as clients built their collateral and the local economy strengthened.



As part of a new business strategy SSEDF and SSBCS began moving into loans with larger average amounts. Such loans passed through a rigorous approval system starting first at the loan committee level of SSBCS, then through the Executive Committee of the Board of Directors of SSBCS and final approval by the SSEDF Director. By August 2007, SSBCS was ready to approve its largest loan. This was a collateralized loan for 4.5 million rubles (approximately \$174,000 at the time) that was partly financed by SSEDF's line of credit with SakhWest Bank. This particular two-year term loan was for the purchase of a majority equity position in the largest cargo transport company in Sakhalin. This company, Stroymekhanizator, was a contractor of Sakhalin Energy since 1998. It also has subcontracts from Panalpina and SakhVneshTrans both of which are major contractors for both Sakhalin-1 and Sakhalin-2 projects. This two-year term loan was the first experience this client ever had with debt financing.

His application had previously been rejected by local banks. This was because local banks did not have experience with corporate finance. SSBCS filled this lending void by conducting extensive credit analysis and receiving written legal opinions that supported the loan and subsequent equity purchase.

5.3.6. Building relationships with local banks

Since the start of the Program, ACDI/VOCA and SSEDF had discussions with various commercial banks. The idea behind this was to have open collaboration so there could be improved services for SSBCS borrowers. From the beginning, the Program expressed an active interest in working with SSEDF in Sakhalin. With one of the most advanced branch office networks on Sakhalin, this partnership helped SSBCS with fund transfers and cash transactions. As a result of negotiations with the bank, the following agreements were reached:

- Reduced fees to open a bank account (75% reduction)
- Bank personnel in Tomary SakhWest Branch office assisted and trained SSBCS borrowers to correctly fill out their payment orders for making their loan repayments to SSBCS
- Fees for all SSBCS cash transactions were reduced
- Installation of the electronic payment system “Bank-Client” for all SSBCS borrowers (this service allowed SSBCS’ borrowers to make repayments at remote locations which are recorded that same day by SSBCS accounting department)

Partnering with SSBCS helped SakhWest Bank expand its clientele to SMEs in the central and northern parts of Sakhalin Island. Collaboration was truly amicable and fruitful throughout the life of the project. For example, SSBCS senior management was invited to key events held by SakhWest. This included taking part in ceremonies such as the opening of the SakhWest branch office in the district of Ulegorsk (a seaside town 300km northwest from Yuzhno-Sakhalinsk).

In July 2003, SSEDF applied for a revolving line of credit (RLOC) with SakhWest. After a number of working meetings with SSEDF, SakhWest offered a \$400,000 open-ended RLOC. Conditions of this loan negotiated with the Bank fit nicely with SSEDF/SSBCS lending operations. This line of credit allowed drawdowns and repayments consistent with SSEDF loan portfolio projections and financing requirements. In November 2003 SSEDF signed a related agreement with SakhWest Bank. This loan became the second commercial bank loan in the history of SSEDF/SSBCS. This was a clear market signal that the MFI had matured thereby securing stable operational performance. This loan offered more favorable terms as opposed to its first loan with Dolinsk Bank

SSBCS was the first Russian MFI in the RFE that received a commercial bank loan

The loan from Dolinsk bank, had several positive consequences:

- It showed that SSEDF is a credit worthy non-banking institution
- It opened the door for SSEDF/SSBCS to approach other banks
- Allowed SSBCS to improve its credit history and obtain borrowing experience with a commercial bank
- SSEDF, having a supervisory role over SSBCS through the GFA, learned how to monitor SSBCS’ credit quality
- Standing as a Guarantor for this SSBCS loan, SSEDF thereby achieved its other goal to draw loan capital from retail lending institutions
- It was able to attract private funds in addition to USAID’s program loan capital, thus ensuring continued access to credit for itself and for local entrepreneurs

in 2006. That loan did not provide a revolving line of credit and was for only \$200,000.

The open ended RLOC loan with SakhWest Bank came under the scrutiny of the Central Bank. The outcome of that review was that it was necessary to show an ending date on the note. We learned that, as a discount lending institution to SSBCS, SSEDF needed to ensure the availability of loan capital for SSBCS since it continued to grow faster than the donor funding allowed (especially in North Sakhalin). Thanks to this RLOC, SSBCS had no capital shortfall in its lending operations. In July 2005, SakhWest Bank approved another RLOC for one year.

In June 2006, SSEDF/SSBCS submitted a third application to SakhWest Bank for a one year RLOC for \$630,000. The loan request was approved thereby marking the fourth commercial loan received by SSEDF/SSBCS since its inception. This was followed soon after, in May 2007, with yet another RLOC from SakhWest Bank. This was a one year RLOC for RR30,000,000 (~ \$1,150,000) and was guaranteed by SSEDF and secured with a portion of the SSBCS loan portfolio.

SSEDF's need for credit continues to grow and in May 2007, SakhWest Bank approved the largest loan to SSEDF since their collaboration started: a RLOC for RR30,000,000 (approximately \$1,150,000), for one year. SSEDF stood as a guarantor for this loan and part of the SSBCS portfolio was taken as security for this revolving line of credit.

In 2007, this new loan represented another significant development in the impact the Sakhalin Microcredit Program had on commercial banking. In the past, commercial banks had encountered problems making loans to non bank credit institutions because the Central Bank did not consider the loan capital (and loans) sufficient security for a commercial loan. Finding a resolution and solution to this problem required research and ingenuity from the part of the SakhWest Bank credit and legal departments. The SakhWest Bank developed a special internal procedure, specifically to be able to take SSEDF guarantorship for this loan, and defended it against the skepticism of Central Bank auditors. SSEDF/SSBCS "collateral" in the form of operations (credit) and security (loan portfolio) were well outside the standard practices and experience of local banks.

The Program further developed ways to partner with SakhWest. With the continuous growth of the SME market, SSBCS encountered borrowers that were outgrowing their financing limits. Thus, a new gap was created between borrowers and commercial banks, and banks were not prepared to reach these expanding SMEs. The Sakhalin Microcredit Program researched additional ways to add value to its financial operations, along with improving its impact on SME development.

SSEDF proposed "participation" with SakhWest, where both lenders could reduce their financial risk and exposure by sharing the credit amounts that exceeded the financing limits of the originating finance institution. The idea was to combine funds from the two lending institutions to finance one borrower. In this scheme, the first Financial Institution (FI), which in this case was SSEDF, was selected as the *Agent* lender, working directly with the customer (helped with the borrower's loan application, loan analysis, loan

approval, monitoring, and if need, collection.) SSEDf did all the credit work on the loan and submitted it for the *Participating* bank (SakhWest) approval. The *Agent* FI had to also be capable of supporting a percentage of the overall credit to the borrower with the balance of loan funds provided by the *Participating* Bank. In June 2004, SSEDf closed the first participation loan with SakhWest in the amount of \$200,000, granted to one of SSBCS borrowers. SSBCS provided \$50,000, from its Revolving Line of Credit; and the bank's participation was of \$150,000.

SakhWest saw this opportunity as a way to pilot and develop future collaborations with other similar-size banks in the Russian Far East to share large loans. While participation loans with SSEDf were comparatively small for SakhWest, the first small participation loans with SSEDf allowed the bank to experiment with larger loans to SMEs while minimizing risk. With time, this allowed them to implement larger participation loans with other banks.

There were several positive outcomes from this approach. First, it helped commercial banks become familiar with a different and more progressive methodology of loan analysis while finding income generating opportunities for itself (while mitigating risk). Second, banks learnt a new approach to developing loan conditions based on that analysis and loan purpose. Third, and most important, it allowed expanding SMEs to access the necessary credit so that they could enter more profitable markets. For the Program, this was instrumental for its reputation, as it set a precedent that SSEDf could efficiently and profitably work with commercial banks.

SakhWest benefited equally from its relationship with SSEDf/SSBCS. As mentioned below, the Sakhalin Regional Microcredit Program actively provided training to SakhWest staff. Trainings were very well attended with key credit personnel representing the bank from branch offices throughout the island. Participants included SakhWest Bank branch managers and loan officers from the bank's branch offices from Kholmsk, Korsakov, Aniva, Nevelsk, Nogliki, and other towns including Nogliki and Okha. Together with SakhWest employees, SSBCS credit employees, including loan officers from Tomary and Korsakov Branch Offices and three credit employees from the Yuzhno Branch office, attended trainings.

In 2006, SakhWest again approached the Program with a request to provide credit training for new employees from numerous SakhWest bank branch offices to further improve the skills of the bank's existing credit personnel. In response to this request, and as a part of the project objective to promote the availability of SME financing, the Sakhalin Regional Microcredit Program held 40-hours of credit training from November 2 through November 10, 2006 in Yuzhno-Sakhalinsk. The training included three local banks, focusing on two major courses: Fundamentals of Credit, and SME Financial Analysis. This course was delivered by an experienced trainer who has over ten years of experience in the business, Mrs. Svetlana Zubritska (a Credit Consultant and Representative for Eastern Europe for OikoCredit a German financial organization; as well as Senior Loan officer for the Ukrainian Agriculture Financial Development Fund).

Twenty two employees from SakhWest Bank, SberBank, and Pacific VneshTorgBank successfully passed the final test and were granted certificates.

5.3.7. Broad based training

During the first two years of the Program, ACDI/VOCA subcontracted the Russian American Business Training Center (RABTC) to design and implement a Business Start-up Assistance Program (BSAP). SSEDf/SSBCS used this program to provide essential training and consulting to program clients and start-up entrepreneurs.

At the start of the Program, RABTC's training plan was approved by USAID with emphasis on business start-ups training and consulting on principles of business. These trainings reached out to people who wanted to start their own business but had no specific ideas, people who had specific new business idea, previously unsuccessful entrepreneurs who wanted to start again, and people who wanted to improve their business knowledge. RABTC selected candidates for the Business start up training seminars based on real intentions to start a business, as well as screening "negative" clients. This training was a proactive step to assure good loans and growth of good business.

Upon the request of the Project Director, RABTC also developed and provided different types of trainings and consultations for active clients of the Microcredit Program.

Participants including:

- Entrepreneurs who are Program clients and borrowers who want to have additional business training;
- Entrepreneurs who are Program clients and borrowers who need consulting on different aspects of business;
- Clients in general who want to improve their skills in specific aspects of business.

In addition, we initiated psychology seminars for the peer group lending borrowers. Realizing that "cooperation and communication" were fundamental business elements missing in our active clients, this training was designed specifically for peer-group clients. The objective of these seminars was to strengthen and develop confidence of the group members in each other, develop communication skills such as learning to listen, talking about their goals, learning ways to resolve problem situations and to build priorities.

We initiated the training seminar "Procedures for Concluding a Contract" specifically for active and start-up entrepreneurs to improve their knowledge and experience of juridical issues. This seminar introduced the participants to the main types of contracts and proceedings in concluding a contract. In addition, the various problems of labor relationships and arbitrating labor and economic disputes were touched upon during the seminar. Most of the entrepreneurs who passed this training considered it to be very useful in the context of improving their business qualifications.

Another example of training jointly developed is the seminar “Management of Human Resources.” This was initiated to help small business owners understand the value of human resources management and develop skills needed to manage possible conflicts and tension within and among teams and to cope with existing problems. Participants have been also introduced to the methods of personnel evaluation and human resources effective management. We consider the training especially important in the context of present-day labor market environment requiring employers to be skilled enough to keep good employees with the enterprise and make them work effectively in a team for the benefit of the company.

September 2002 marked the end of the formal training provided within the USAID-sponsored Training Program for Business Start-Ups. In Sakhalin, 24 training seminars for business start-ups were provided. In total, 454 entrepreneurs (including 269 women) were trained in ways that will help them enter the business market of Sakhalin. Including:

- In July 2000, Deputy Director Vitaly Vaganov, Department Managers and all Enterprise Agents, participated in credit training in Kazakhstan with the *Kazakhstan Community Loan Fund (KCLF)* group-lending program.
- A follow-up training seminar was held in August. Phil Brown, a short-term consultant with ACDI/VOCA, held the training onsite and reviewed the central aspects delved in the Kazakhstan program.
- In September 2000, the Senior Enterprise Agent from KCLF Micro-finance program in Kazakhstan was brought to Yuzhno-Sakhalinsk for further on the job training.
- In February 2001, SSEDf Deputy Director Vitaly Vaganov went to train on legal, tax and administration, in preparation for the initiation of the Cooperative registration.
- In March 2001, Endre Esztergomi, ACDI/VOCA Project Coordinator provided training for the SSEDf accounting department.¹
- April 2001, eight credit agents were selected for a standard 6 month training. By the end of the Program, all SSBCS staff had taken this training. It provided a theoretical and practical course in the Peer Group Lending Methodology. The trainees received detailed instructions and were able to practice such skills as customer management, marketing, different methods of group formation, loan monitoring, and public speaking. After trainees learned the theory and passed the Group Lending Program Presentation test, they went through on-the-job training to market the credit service to their potential customers.
- In May 2001, John Foy, management consultant for Winrock International, conducted the seminar “Marketing and Sales Work”.
- In May 2002 we launched a new “advanced” training program on credit service sales and management of people skills.
- In June 2002 the Project Director, Kenneth Smith, began training the SSBCS interim Supervisory Board to help them better carry out their responsibilities.

¹ By the end of the course every trainee was expected to build at least six peer-groups. If they succeed to do that in six months, they are considered to pass their training period, and become SSBCS Credit Agents.

- On the late autumn of 2002 through spring 2003 the Project Director provided Training for the Board of Directors and SSBCS management team in the business plan development.
- Additionally, the Program developed and provided the following training programs for *the graduates of Business start-ups trainings* and for SSBCS borrowers:

Basics of Rational Behavior	• 51 people (30 women)
Problems of Labor Legislation	• 27 people (18 women)
Marketing for Small Business	• 78 people (46 women)
Working online	• 189 people (125 women)
Accounting and Changes in Tax Legislation	• 104 people (85 women)
International Accounting Standards	• 45 people (40 women))
Introduction into basics of crediting	• 11 people (2 women)
Psychological seminars for SSEDF peer groups	• 38 people (20 women)
Procedure of concluding a contract	• 63 people (42 women)
Legal aspects of entrepreneurial activity	• 20 people (17 women)
Opportunities for small business in O&G	• 49 people (30 women)
Basic Business Course	• 6 people (2 women)
Practical Marketing	• 19 people (11 women)
Working online	• 189 people (125 women)
Human Resources Management	• 12 people (7 women)
Accounting for Informal Entrepreneurs	• 101 people (66 women)
Calculation and analysis of costs	• 9 people (9 women)

Other trainings were put together for the follow up projects funded by Exxon and Shell (see NSCP and NTCP sections). In general terms, SSEDF put together sessions that would help bridge the knowledge gap amidst entrepreneurs concerning future prospects of the expanding oil program. The seminars helped acquaint participants with service and supply demands of oil-processing companies, and subcontractors. We showed participants how and what to look for in opportunities for their business and how to cooperate with the oil companies. Furthermore, participants were coached on how to interact with these companies. The oil industry in Sakhalin continues to rapidly expand

and their search for local sub-contracts is ever widening. SSEDf saw extensive opportunities in this area because the Product Share Agreement for Sakhalin 2, the Russian share of work participation will be 70%. This is an area where to this day, more help can be provided.

Though the USAID-sponsored Training Program for Business Start-Ups ended six years ago, trainings were still held when deemed necessary. For example, on the last two weeks of August 2004 the Sakhalin Microcredit Program provided two advanced credit trainings to SakhWest Bank credit employees in Fundamentals of Credit, and SME Analysis. These continued at SakhWest request (see section 5.3.6). Furthermore, training opportunities continued to exist for SSBCS borrowers through *informal training*. Such training was delivered via lending peer groups. Entrepreneurs shared first-hand experience and provide support and advice to each other. This type of informal training proved to be the most efficient and beneficial training for our borrowers.

5.3.8. Sustainability: revenue diversification

Strategically ACDI/VOCA has also promoted diversification of SSEDf's revenue streams. In 2008 SSEDf finalized a contract with Exxon Neftegas Ltd to complete a Small Business Survey focused on mapping North Sakhalin SMEs. The Survey began on November 1, and was coordinated between SSEDf and ACDI/VOCA. It successfully produced a final report that recorded SMEs in the island, with specific information concerning their ability to tender to larger O&G contracts. The tools created will help ENL knowledgeably move forward localizing their procurement, as well as moving forward with a SME development strategy.

The accurate assessment of the scope and depth of the Small Business Development Plan required a classification of ENL's existing sectors and sub-sectors (services) contracts and upcoming procurement contracts which can be assigned in part to SME's. These sectors were classified as requiring either low development effort, medium development effort, or high development effort. This classification considered technological requirements, infrastructure and capability, as well as degree of investment required.

To correctly identify local SMEs that can appropriately service ENL, the SSEDf team developed "demand profiles," which detailed requirements for services from catering to minor engineering services. The following tasks were accomplished:

1. Classified existing contracts and upcoming procurements as requiring SMEs with either a low development effort, medium development effort, or high development effort.
2. Created 'demand profiles' (summaries of qualifications needed) for those opportunities requiring either low development effort or medium development effort.
3. Created an ENL Database of Sakhalin SME's, specifies the SMEs that can be developed, trained and financed during the SBDP Proposed Phase II.

This exercise has helped SSEDF and ACDI/VOCA define its future relationship as prime and contractor. ACDI/VOCA can leverage its resources for SSEDF to access larger consulting contracts with the O&G corporations, significantly increasing its revenue stream. A second non-financial source of income is discussed in section 8, under the Sakhalin Wild Natural Resources Program.

5.3.9. Management Information Systems (MIS)

An integral tool for sound financial control has been the development of our own software which meets the specific needs of our Program. In October, 2000, we purchased the basic MIS module. On the basis of this module, SSEDF/SSBCS developed its own database on various financial indicators as well as a customers' database. The software developed has a number of relevant distinctions from other software. It has two interfaces (English and Russian) and can easily add another language interface if necessary. The software was developed with the aim of working with distributed databases. This allowed it to run the centralized system in every branch office.

The basic module allows a user to enter not only general data on clients, but data concerning finance of the clients businesses (monthly income, debts and other). The basic module includes a common address classifier of the Russian Federation. It allows the user to check the client's data and to reduce the possibility of mistakes made in entering such data.

The data input and storage process that has been implemented by the MIS team can be divided into various stages and each of them subdivided into the following:

- Data input on credit groups, group and individual borrowers loan applications; development of loan applications and the transmission of applications for review and consideration (all these functions are implemented in the credit agent's interface)
- Review of electronic loan applications and data by loan officer and credit department; transferring loan applications for review by loan committee members; ability of management to review data on any borrower, group and loan (these functions the Credit Operations Manager's interface)
- Preparation, review and approval of all documents (loan agreements, repayment schedules etc.) necessary for customers to receive a loan. This is the loan processor's interface
- Money transactions such as loan disbursement, repayments; authentication of the customer; additional information about the customer; tracking of the customers repayment appointment and number of customers anticipated for repayment for a specific financial day. (This interface will be for the specific use of the Cashier.)
- Capital needs planning; reviewing all money transactions during the current day or during any other period; close of business each day with implementation of financial data. Once downloaded, this information cannot be changed without management participation. The Chief Accountant's interface has these functions
- Analysis of financial activity by company. This includes active loans, portfolio at risk, cumulative loans since the program started, percent of female participation and

many other preferred data tracking. This information is given in the form of a reporting database of the company. Access to reports can be restricted if required by management

A management interface was also developed; this allowed SSEDF/SSBCS management to work with any of the above referenced interfaces. Furthermore, the system was integrated with 1S accounting software, which was previously used only for bookkeeping and accounting. A new software module was developed that enabled us to streamline loan disbursements, repayments as well as obtaining cash funds from the bank. The successful installment of this module has saved us significant time and effort, eliminating manually projected loan fund receipts from the bank.

We have also considerably improved automatic interest calculation. For example, if the loan repayment schedule falls on a weekend or a holiday the program is able to automatically transfer this financial operation on to the nearest working day. The “Customer Database” was also updated and as a result it was easier to access customers’ information as well as make changes. The Program got the product registered for technical maintenance with “Interface” Computer Company. The MIS system was completed and integrated the last quarter of 2002.

Revisions to the system have been necessary throughout the life of the Program. In the fall of 2005 SSEDF performed a reviewed of the MIS system to:

- identify major weaknesses of the system
- develop a written concept of a new program that would be more efficient, automated, flexible, and could better adjust to changes in methodologies and portfolio size, to become more competitive in the lending market
- create and implement a new software to fulfill the above program changes and advances in operations

In September 2006 SSEDF finalized the development of the outline (technical description) for the new software program and by October it selected and contracted a local Russian programming firm to design the program. Having completed the new MIS software update in May 2007, by early June 2007 SSEDF/SSBCS transferred data from the old program into the new one and started new program implementation. SSEDF completed an overall update and review of its Informational Systems. Several new components and upgrades were also added to the 1C accounting program. In the final quarter of 2008, the informational technology department completed the following works and activity:

1. Replaced old Server with a new server
2. Installed new mail Server on Microsoft Exchange 2007 base
3. Installed new firewall Microsoft ISA 2006
4. Schedule references have been added in MIS which is a software program that reminds LOs of scheduled loan monitoring
5. The Loan officer incentive system calculation was also programmed

With these tasks completed, all SSBSC credit offices throughout Sakhalin have on-line access (“read only”) to their borrowers’ credit info and any transactions on their loans. With the IT backbone functioning, day to day operations are made more efficient.

5.4. Effects of the financial crisis

SSEDF/SSBCS have successfully become part of the economic landscape in Sakhalin Island. However, the effects of the world financial crisis cannot be dismissed. The impact of the current Financial Crisis continues to affect all aspects of business on Sakhalin Island. A clear example was SakhWest’s failure. Sensing this, SSEDF arranged a meeting in early 2008 with SakhWest’s CEO to determine their confidence and the feasibility of SSEDF/SSBCS continuing working with us. As a result of this meeting, SSEDF determined that the financial viability of SakhWest Bank had worsened to a point that the Bank’s failure was imminent. Indeed, SakhWest Bank lost its license to continue banking operations and make any transactions on accounts. SSBCS immediately closed its accounts with SakhWest Bank and directed a flow of loan repayments to different banks, which were selected based on a brief financial due diligence assessment undertaken by SSEDF. With this in mind, financial growth of SSEDF was impacted in three ways:

- Immediate loss of its revolving line of credit with SakhWest bank halted growth of the loan portfolio and limited the availability of credit funds (current borrower funds are maintaining the operations at a sustainable level)
- Due to the SakhWest banks insolvency, SSEDF was forced to make the decision to repay its loan to the bank immediately, using all cash assets on deposit with SakhWest bank plus immediate repayments for loans
- The balance of debt owed to SakhWest bank had to be paid upon the term maturity date of the Current loan agreement. This meant that SSEDF had to pay off the remaining balance of debt without having acquired other financing to replace the investment.

These issues have severely affected SSEDF/SSBCS maintain its prior level of operation. ACDIVOCA continues to provide technical assistance and advice and mentoring of SSEDF Board of Trustees regarding financial planning and actions to mitigate the impact of the financial crisis. ACDIVOCA assisted in researching and reorganizing SSEDF/SSBCS operations to streamline branch office operations and cut costs to maintain a positive sustainability operation.

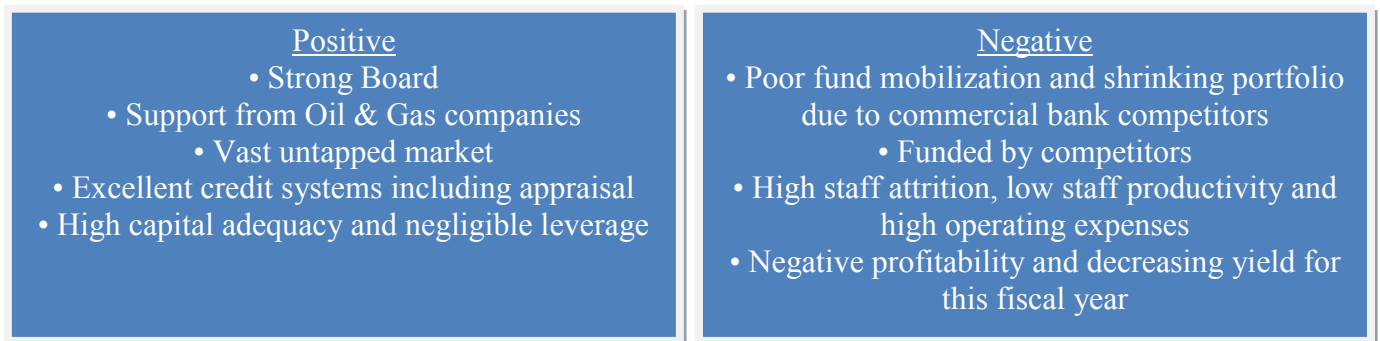
While throughout the life of the program collaborating with local commercial banks was the Program’s priority, the past year has emphasized the need to expand our efforts to search beyond local banks and develop relationships internationally. There is now, more so than before, a real need for Representatives of SSEDF to engage themselves with the international investment community. With that in mind, key employees attended the Russian Micro Financial Conference in St. Petersburg. During this conference SSEDF/SSBCS management met with International Lenders who are interested in providing either capital investment or Credit to SSEDF for lending to SMEs on Sakhalin.

5.5. MCRIL review of the SSEDf/SSBCS operations

From May 3 to 8, 2008, two M-CRIL analysts, Abhishek Fogla (Team Leader and Analyst) and Sachin Subhash (Analyst), visited SSEDf/SSBCS to conduct a rating review. They have looked into combined MFI operations, policies and procedures. M-CRIL representatives interviewed all departments, including credit, accounting and MIS. They also visited the SSEDf Director and the Project Director. Mr. Fogla and Subhash also interviewed SSEDf Board member Razhev, to discuss MFI governance and issues related to the current economic environment, as well as prospects of Sakhalin Oblast development. Having previously held a position within the Oblast Administration's Economy Committee, this SSEDf trustee provided reviewers with a valuable insight of information about the economy of the region.

M-CRIL met overall seven to eight SSBCS borrowers representing various types of businesses, credit products and loan sizes. Several field trips were made by the reviewers to business sites. Both analysts spent one day devoted to a site trip to the Kholmsk branch office. To better understand delinquent portfolio management by SSEDf/SSBCS, they interviewed Tatyana Valuiskikh, Kholmsk, Branch Manager, and visited three borrowers. They also spent time looking into detailed issues with problem loans of the Kholmsk Branch office.

Figure 3. Key results of the MCRIL Rating



Largely the problems faced by SSEDf arise from SakhWest Bank liquidity problems. Having a substantial amount of funds with the bank, and being unable to use or move these funds to another lending institution, the only reasonable option was to repay the SakWest Bank loan completely. Thus, SSEDf closed its accounts with the bank after having first paid the debt on its Revolving Line of Credit to a minimum amount.

As a contingency plan in anticipation of this action, SSEDf had started to retain fund repayments from borrowers, rather than roll these funds over into new loans. Eventually SakhWest Bank exercised its right as the lender and required SSEDf to repay its RLOC immediately. While SSEDf had planned for this contingency, the rapidity of the need to repay did not allow SSEDf reduce its loan portfolio adequately over time in a smooth and reasonable manner. The outcome was an immediate reduction of the loan portfolio

and without being to replace the Line of Credit, SSEDF/SSBCS was not able to reach its intended loan portfolio goal as was estimated for 2008.

With this in mind, MCRIL delivered its report in October 2008, six months after the start of the review in May. At the center of this issue was the disagreement of SSEDF management and the Project Director with MCRIL rating team that the review and subsequent rating was not balanced in its review of SSEDF collaboration with commercial banks and as well as the environment in which the SSEDF operates. In other words, SSEDF operations are not typical of the micro credit universe, working in an economic environment significantly impacted by the O&G sector. The final report provided a B rating for Credit operations while providing an A+ rating for future outlook opportunity.

5.6 Response to MCRIL rating and the financial crisis

The current financial crisis has especially hurt SMEs, which can no longer access previously available credit. Similar to events throughout the world, part of the contraction in credit has been overzealous financing, which resulted in poor repayment. The current restrictive lending position has in many ways taken SMEs back to the start of the Program, where they weren't able to access credit due to the over-rigorous requirements of banks. Unlike commercial banks, SSBCS/SSEDF continues to assist SMEs in all areas.

As mentioned in Section 5.4., due to the financial crisis and changing environments, SSEDF consciously took on the objective, before the closure of the Sakhalin Microcredit Program, to attract additional loan capital from foreign investors. SSEDF considered Symbiotics and Blue Orchard as strong potential lenders to SSEDF. Symbiotics and Blue Orchard reviewed the final report and the M-CRIL rating and were both very interested to continue negotiations. However, as the economic crisis continues to deepen in Russia, conversations remain on hold.

To continue the momentum even in difficult financial times, SSEDF proactively sent financial information to Developing World Markets and talked directly with Vice President Bogdan Tatarchevskiy. At his request SSEDF sent them electronic balance sheets, the MCRIL report, description of activity and credit products, and the 2009 budget. Discussions are ongoing and SSEDF remains confident for a favorable outcome.

6. How the credit Program was extended as the “North Sakhalin Microcredit Program” (NSCP)

In August 2002, ACDI/VOCA and SSEDf approached the Exxon-Mobil affiliate, Exxon Neftgas Limited (ENL), with a proposal to expand the Sakhalin Regional Credit Program to Nogliki and Okha. This would entail a \$500,000 loan capital donation. In return, SSEDf offered ENL a new approach to their corporate responsibility program: a result-oriented and self-sustaining Program that will give ENL recognition and build its positive image with the local community, demonstrating its on-going commitment.

ENL was interested in this proposal and we worked together to finalize all components in greater detail. Throughout the collaboration process, the donors changed from just ENL to the entire Sakhalin 1 Consortium. This by itself gave the North Sakhalin Program a different prospective and responsibility. The agreed project goal was to create two operationally sustainable North Sakhalin branch offices, in Nogliki and Okha, of the Sakhalin Small Business Credit Society (SSBCS). SSEDf would apply the same approach to SME financial services that had been successfully implemented through SSBCS, since 2000, in South Sakhalin.

This idea progressed from being just a proposal from SSEDf to ENL to a public-private partnership “truly in the spirit of the new Global Development Alliance business model announced by Secretary Powell and USAID Administrator Natsios” In this way the US Ambassador to Russia, Alexander Vershbow, praised the program during its official announcement at the US-Russia Commercial Energy Summit on September 22, 2003. Furthermore, he stated that the aim is “to help the local community capture more of the benefits of economic development from our investments in the oil and gas sector by working with USAID to give the best entrepreneurs in the northern Sakhalin districts a hand-up, not a hand-out”.

The NSCP achieved operational sustainability in 2006 relying on its credit operation for small businesses in the region. An essential component of this success was the significant demand for micro-credit from entrepreneurs representing various small and medium scale industry sectors. Another component was the training and consulting provided to clients and other start-up entrepreneurs through courses tailored, and prioritized, for different business groups. Taxation, for example, was an area where many clients needed assistance on. The NSCP also succeeded in reaching out to an often overlooked segment of the population in Northern Sakhalin, women. Women constitute more than 60 percent of our loan portfolio.

6.1. Building new strategies for NSCP

In 2003, SSEDf and ACDI/VOCA, through the technical direction of Project Director Kenneth Smith, established a small business community contribution program (North Sakhalin SME Credit Program) in the North Sakhalin towns of Nogliki and Okha. These Nivkh settlements had been hard hit by the perils of a resource economy, having a

comparatively high employment rate compared to rest of the Russia Far East. ACDI/VOCA and SSEDF designed a results oriented program that enabled local small and medium business entrepreneurs operating in these two targeted areas to access credit and fundamental business training.

A feasibility study of the microfinance market in the Northern towns of Nogliki and Okha revealed that financial institutions were not offering affordable and accessible small business financial services. Commercial banks in the two towns lacked ‘client-friendly’ lending mechanisms and were faced with restrictions against making non-collateralized loans. Furthermore, applications for credit usually involved a two-three month processing period. During this wait period, the applicant had to complete and correct legal documents required by the bank, usually without any assistance. The time spent during this interim period without any assurance of the loan being approved represented a high cost and time investment for entrepreneurs or micro and small business owners. These factors inhibited small business growth and the consequent ability of the SME sector to provide the goods and services needed by the oil and gas sector in the region.

Also, Nogliki loan applicants were unable to register their real estate or other assets to use it as collateral. Entrepreneurs had problems with registration because government officials lacked the experience and training to assist them through the process. In Nogliki there was only one Notary Office and one Registration Agent to process all legally required documentation. The one Registration Agent also oversaw all the requests and delivery of the necessary agreements from the State Registration Department. Thus, the local Notary Public Office and State Registration Department did not have time to work with entrepreneurs and thus, had not acquired the knowledge on how to process the paperwork themselves. Since entrepreneurs had collateral – though they couldn’t use it due to poor documentation – we knew we had to find a way to provide credit.

6.1.2. Meeting borrowers needs

The Nogliki office was opened, and actual lending operations began, in April 2004. To promote entrepreneurial growth we decided to provide a new kind of customer service through the Nogliki Branch office. Beginning November 1st, 2005, the Nogliki Branch office assisted credit applicants throughout the entire collateral registration process. For example, whenever real estate was requested as collateral the following services were provided to the applicant:

- The Nogliki Branch loan officer assisted the local entrepreneur in preparing all required documents and legal papers needed for registration
- Nogliki Branch office personnel monitored/coordinated the approval and registration process through all official departments
- The Nogliki Branch Office absorbed all the expenses of registering the customer

Based on our experience implementing the Sakhalin Regional Micro-Finance program and taking into consideration the different social and economic dynamics of these towns,

The NSCP offers entrepreneurs the unique opportunity to access loans in record time without additional difficulties. Thus, since its inception, the Nogliki Loan Officers priority has always been *customer service, disbursing approved loans within three weeks from the date of application.*

6.1.3. Credit activities

Although not scheduled to begin lending operations until much later, the demand in Northern Sakhalin was so high that selective group lending started in July 2005. Immediately following the official “Opening Ceremony” in October 2005, the Okha Branch Office started accepting applications for individual (collateralized) loans. In the first year of the program, 10 groups had been established in the NSCP Okha Branch Office. In the first year of the program, twenty individual loans had been approved and seventeen of them had been disbursed (average loan was \$ 8,000). This shows how quickly the team was able to start operations, building on the Sakhalin Microcredit experience.

PROGRAM APPROACH

The North Sakhalin SSBCS Branch Offices offered both Peer Group Lending (non-collateralized) and Individual (collateralized) lending to small medium entrepreneurs in the region.

- **Individual Lending:** Individual loans were collateralized or had a co-guarantor (co-signer) accepted in lieu of collateral. The average amount of individual loans was of \$10,000-\$15,000. Individual loans were disbursed for the period of one to two years. Size of loans available ranged between \$1,000 to \$50,000. Larger loans considered on a review basis depending on applicability to the intent of the program.
- **Peer-Group Lending:** Group loans (per each individual) will generally range from \$500 to \$5,000 per loan. Interest is accrued only on outstanding principle. This peer group methodology has successfully proven to ensure repayment of group loans (average delinquency ratio less than 1%). It has also proven to serve as a support group medium for entrepreneurs and informal training.

In addition to the above two basic credit products, NSCP made the following additional credit products available for the Northern entrepreneurs:

- **Combination Loans (peer group and individual loan combined).** Both programs (Sakhalin Microcredit and NSCP) focused on assisting customers graduate from their dependency in uncollateralized Peer Group Lending to independent collateralized borrowing. As entrepreneurs graduated from their peer group, we

could see that their immediate assets began to improve and change. By the time they reached the upper lending limits of Peer Group lending, they not only had assets that could be used as security but their financial needs changed as well. Using this method, the client was able to access more funding by applying for an individual loan - within the limits of their securities. As an added bonus, if the peer group members allowed, the entrepreneur was able to stay in his/her group and qualify for an uncollateralized loan within the group that will guarantee it. (Analysis of such loans received special attention from the individual loan officer, who considered the overall risk to the individual loan and the clients obligation as a group member).

- Intermediate Term Credit (derived from the standard individual collateralize lending product). This credit product was provided to clients for a period not to exceed two years - although three-year loans were considered on a case-by-case basis. The goal was to expand credit opportunities to customers by providing the missing long-term component to the existing commercial banks loan products. It was designed specifically to help entrepreneurs finance their capital expenditures without severely taking funds from their working capital. To implement this new credit program the SSBCS loan officer closely worked with clients to identify loan terms and repayment schedules most beneficial for their businesses and in line with the business cash flow. This loan program provides flexible options for repayment schedules depending on the financial capabilities of the client.
- Revolving Line of Credit (RLOC). This type of credit was designed to help entrepreneurs with very distinct operational business cycles, e.g., trading business. Under the RLOC the entrepreneur did not need to take a series of loans throughout the year or go through the lengthy application for a large loan. The RLOC allowed the client to make repayments and withdraw funds back, up to an agreed upon limit, without having to renew the loan over and over again. This meant that SSBCS personnel did not need to make new security documents and renewals of the note each time, saving time and resources and thus making operations more profitable.

NCSP SUCCESS STORY: Reaching Untapped Markets



Vladimir started his cargo transportation business thanks to SSEDF

Vladimir B. opened his transportation business in 1994 with one Russian truck, a ZIL-157 that his father gave him as a gift. Thanks to the increased need for local transportation due to the expansion of the Sakhalin I project, Vladimir was able to immediately begin delivering goods and merchandise for Nogliki entrepreneurs from Yuzhno. A good businessman, he saw many other potential opportunities, for example obtaining a cargo van to make deliveries for local traders from the Southern part of Sakhalin to the North. Vladimir needed credit but even though he had a strong business plan he was discouraged by the lengthy and burdensome loan application process of local banks.

About that same time his mother, also an entrepreneur, had attended one of NSCP's Informational Meetings in Nogliki. She suggested that he apply for a loan with NSCP. Following his mother's advice he became one of the very first individual member-borrowers of the SSBCS Nogliki Branch Office receiving his first loan in May 2004. This was a term loan for 18 months, in the amount of \$20,000 for the purchase of a small, seven ton cargo van. He expanded his truck fleet to two vehicles and, later, a trailer which he used to transport shelf operations waste materials, scrap-iron, various container loads, and construction materials for the local O&G industry. In addition to this he also found time to deliver goods for local entrepreneurs. Additionally, Vladimir hired his first permanent employee: a driver for the second truck. His profits for June through December 2004 increased 1.5 times over the previous comparable time period.

Watching for possibilities for growth Vladimir identified an increased need for large cargo transportation from the South to the North of the Island. He knew he would need a larger truck and thus met with Nogliki Branch Loan Officer, Olga Cheremina, to discuss the possibility of applying for another loan. Luckily, earlier in the year Sakhalin I Project had made their first donation of loan capital to the NSCP. This loan capital came with reduced interest and was, therefore, financially attainable for Vladimir.

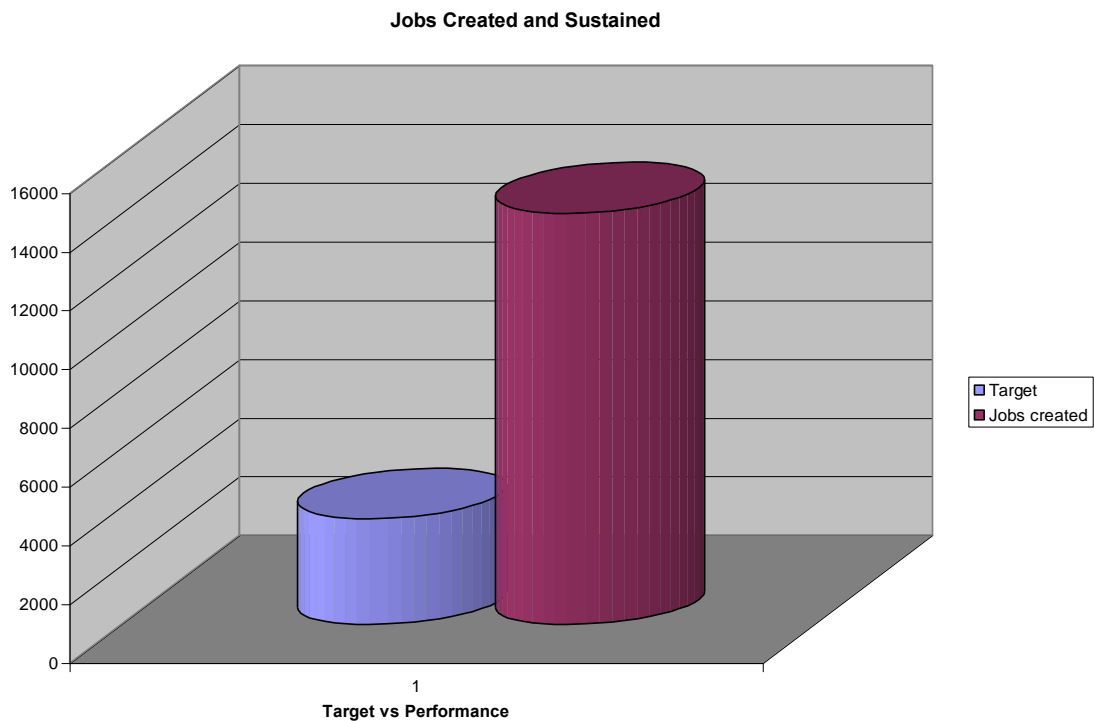
Since he had not paid off his first loan the Loan Officer took the application and analyzed Vladimir's business to see if it had capacity to buy another truck while still paying down his first loan. Olga's loan analysis showed that Vladimir's business was capable of repaying the loan; Olga's analysis showed Vladimir's profits could possibly grow as much as 40% if he bought the third truck. She recommended the borrower's application for a \$12,500 loan.

A closing footnote about this success story: After watching Vladimir's successful lending experience with the NSCP his mother, Valentina, entered NSCP Group lending program in October 2004.

6.1.4. Reaching out to indigenous enterprises

The NSCP made a special effort to track and maximize the participation of local indigenous entrepreneurs and rodovoye khozyaystvo (industry collectives). In December 2005, a rodovoye khozyaystvo from Moskal'vo (a village 30 minutes from Okha) entered one of the newly established groups in Okha Branch Office. This collective is involved in fishing and has four family members (two of which are nivkhs). Their first \$1,000 loan was approved in late December 2005 and disbursed in early January 2006.

Figure 4. Jobs Created and Sustained



While the North SSBCS Nogliki Branch Office still remains the *only* finance institution offering non-collateralized loans in town, the lending environment has changed significantly in the past year where bank credit became more accessible for SMEs. The program is the only lender making uncollateralized peer group loans available for small businesses.

6.2. NSCP Training

Training was key for capacity building at the start of the Sakhalin Microcredit Program and thus was adopted when extending the project to NSCP. Thanks to the enthusiasm of local business men and women, the North Sakhalin Credit Program SME training was always very popular. Most importantly, the trainings gave entrepreneurs and business owners a basic understanding of their legal rights and responsibilities and knowledge of

what to do (or should not do), to avoid conflicts and potential financial mistakes. The first formal business training sponsored by the North Sakhalin MicroCredit Program was held on “Financial and Strategic Business Development”. The training course combined basics of the subject and a lot of ‘hands-on’ consulting in business analysis and market positioning.

Just a couple of months after NSCP’s first training, in November 2004, NSCP organized its first informational exchange meeting for borrowers (and borrower guests) with the Sakhalin Energy (O&G company) site representatives. This gave entrepreneurs ‘first-hand’ information from the oil & gas companies on opportunities to procure services and goods. It also helped entrepreneurs learn about more immediate needs, the scale and time frames of one particular O&G construction site in North of Sakhalin area (Lun’skoye Bay). As in previous borrower meetings held by SSBCS, it became apparent that local entrepreneurs lacked solid information about the local oil and gas projects. Thus, the NSCP arranged the meeting to put borrowers in direct contact with O&G companies for questions/answers and create an informational dialogue on the interrelationship of oil and gas development and small business development and growth potential.

Having credit available does not necessarily translate into business opportunities. Thus NSCP training not only offered trainings in formal business planning and accounting but also offered trainings and discussions on how to recognize business opportunities and advantages. NSCP has helped entrepreneurs develop a sense of opportunity within their region, including procuring to O&G corporations.

Another important focus of the NSCP trainings was to educate entrepreneurs on the legal aspects of their business. Topics ranged from VAT and Single Imposed Tax issues to providing the most up to date changes in “individual entrepreneurs state legislation.” Most importantly though, SSBCS’s Nogliki office encouraged local business persons to register their assets. Thus, these trainings and group discussions helped clients formalize their assets, which translated into improving their collateral position with SSBCS, opening more opportunities for them to access credit. Trainings have also been held by government representatives, for example NSCP invited Nogliki Administration, Economy Department representative, Mrs. Balykh, to provide an update s on the administration’s program to support small businesses.

Training Outline

The Project Director developed an in-depth credit training for the loan officers. The training consists of two advanced courses. The first course *Fundamentals of Credit* is designed specifically for loan officers with middle-level experience in commercial banking. The second course is an advanced course titled “*Financial Analysis of Small Medium Enterprise*”. This advanced course takes the experienced loan officer farther into the detailed financial analysis of small and medium analysis based on IAS and GAAP standards. All SSEDF/SSBCS staff have undergone these training.

April 23, 2004	•Nogliky Office opened for business and held the first “Informational Meeting” for Nogliky entrepreneurs
March 23-25, 2005	• Legal Aspects of Entrepreneurial Activities
September 18, 2006	• Taxation for Small Enterprises (Okha)
October 10 th , 2006	• Taxation for Small Enterprises (Nogliki)
November 2004	•Informational Meeting with SEIC Representatives for NSCP Entrepreneurs
November 2004	• Specialized credit trainings in Fundamentals of Credit and SME Analysis
February 27, 2007	•Legality of SME Inspections by Monitoring Authorities (training for Okha Small Businesses)
June 28-29, 2007	• Insurance for Entrepreneurs (in Nogliki and Okha)

Case: Taxation for Small Enterprises Course

This eight hour course was developed and adjusted specifically for the local entrepreneurs of Okha. The course was taught by an experienced Okha local tax officer, Maria Kuzmina, who worked closely with SMEs in the area and with NSCP Okha.

The topic for this course was selected taking into consideration that in 2006 a new law came into effect prohibiting individual entrepreneurs (“physical entities”) from selling certain types of products. Entrepreneurs needed to register a different legal status (“legal entity”, i.e., limited liability company) to be allowed to sell these products. We saw that entrepreneurs did not have sufficient information to change their status in a timely and accurate manner. With the help of this training many of the local SMEs changed their legal status (which also entailed following new accounting requirements).

The “Taxation for Small Enterprises” course included not so much theory as practical exercises (for example, developing a simplified balance sheet format and tax statement for legal entities) and individual consultations for each trainee. Participant training feedback received was truly positive, “it is incredible that a one-day training can be so intense and educational, and provide with so much practical knowledge which can be immediately applied in businesses.”



Maria, trainer (upper left), encourages trainees to share their experience and problems.



Course was held at the Nogliki library

On October 10, 2006, NSCP held the same training but this time for Nogliki businesses. Seven trainees (SME business owners and their accountants) attended this training. NSCP invited a representative from the Nogliki Administration, Economy Department, Inna Balykh who used the opportunity to share with the entrepreneurs the administration’s program to support small businesses (through this government program, eligible businesses could receive partial reimbursement for the interest they paid on their loans).

These meetings also gave us the opportunity to discuss what other trainings might be helpful for local entrepreneurs. Furthermore, it encouraged our loan officers and staff who were able to mingle with borrowers and learn about their progress in a more personal setting. After the training was completed one entrepreneur, & NSCP client, N. Govorova, addressed the audience to say words of appreciation to NSCP for the seminar. She noted that the training and consulting provided by NSCP had always been very

timely and useful. In particular, she mentioned a previous training on “Transfer of the Status of Buildings” which helped her significantly in her business.

6.2.1 Networking component: accessing key markets

On October 15-16, 2005, the NSCP team from Yuzhno, the SSBCS Nogliki Branch Office Director, and USAID Moscow Mission representatives visited the construction camp of Exxon Neftegas Limited (ENL) (Sakhalin-1 project) located in Val village (Nogliki district). The purpose of this visit, in addition to seeing and learning about their camp operations, was to meet ENL contractors’ representatives and discuss the possibility for local entrepreneurs to provide supplies and services to the camp and its subcontractors. Nippon Steel, Euros AIOKA company’s representatives, and two local ENL Public Relations coordinators attended the meeting arranged by Yury Mikhailov, ENL PR manager from Yuzhno-Sakhalinsk. One significant idea that came from the meeting was the need for tire replacement services (the nearest shop was located in Nogliki, a two-hour ride from the camp) and spare parts for the large fleet of vehicles used by contractors and subcontractors of Sakhalin-1 project.

On the second day, the team visited Chayvo Bay and Sakhalin-1 Offshore Processing Facilities. First, they met camp managers and contractors to discuss ENL’s needs and potential opportunities for entrepreneurs. The following conclusions were made:

- OPF runs short on certain food products and needs to buy locally. This is a problem since local entrepreneurs prefer cash payments and cannot take large orders from the camp. Therefore, the Procurement Department makes basic food orders in the mainland. It would be helpful if there were some way to devise a credit system for the stores allowing them to service a large customer such as the OPF.
- Spare parts are delivered from Yuzhno-Sakhalinsk as the assortment is very poor in the North of Sakhalin; if an SME did have a good enough assortments the camp would be willing to purchase orders there.
- Recruitment of unqualified short-term labor is a problem, and sub-contractors wish they could use a firm to hire needed personnel (instead of recruiting directly through word of mouth and direct newspaper advertisement as they currently forced to do);
- Possibility for an entrepreneur that sells souvenirs could be given space inside premises

The program provided a direct connection between SMEs and the O&G sector, with SSEDf bridging the information gap between both parties.

Nogliki Entrepreneurs Secure Transportation Contracts with O&G companies



This success story shows how three Nogliki entrepreneurs worked together, yet independently, to secure transportation contracts with Oil and Gas companies

The development of oil and gas projects on Sakhalin Island brought opportunities for local entrepreneurs to provide cargo transportation services. Many Nogliki entrepreneurs wanted to purchase a truck and get a contract with an oil and gas company to increase their income. However, most entrepreneurs faced a lack of equity capital to purchase trucks, needing at least eight trucks to make a profitable standing contract with an O&G company.

This success story shows how three Nogliki entrepreneurs worked together, yet independently, to secure transportation contracts in the Oil and Gas development. In September 2005 three entrepreneurs, Vladimir Bryuhanov, Alexander Oblapenko and Dmitry Larionov, visited the North Sakhalin Credit Program's Nogliki Branch Office. They were searching for loan capital to expand their transportation businesses. Vladimir Bryuhanov had been providing transportation services since 1994. With two trucks, he specialized in oversized equipment, containers, scrap metal, and construction materials from South to North Sakhalin for offshore operations. With the expanded development of the oil and gas projects, bulk cargo transportation services increased in demand and this entrepreneur needed a 20 ton capacity "Dump Truck", to compete. Vladimir was one of our regular borrowers and a good businessman but had not yet paid off his previous loan. Having analyzed his business, the SSBCS credit officer concluded that by purchasing this additional truck Vladimir would increase his overall profit by 182%. This was enough for the entrepreneur to pay the new loan for \$35,900 within a 15-month period. A second hurdle however, was that the security available for the loan was below the minimum standards acceptable for such a loan and risk was significant during the purchase period of the truck.

Dmitry Larionov started his business in 1999 carrying small goods from Yuzhno to Nogliki for local entrepreneurs using only his personal car. In 2003 he sold the car, added what liquid cash he had accumulated and bought a used tractor trailer. He started out driving the tractor-trailer himself but as it turned out, over time it became apparent that one truck was not enough. He couldn't participate in many tenders to advance his business and another truck with larger carrying capacity was necessary. Dmitry had very little funds as most of his liquid assets were working capital. He needed a \$28,125 loan. Like Alexander before him, he learned about SSBCS from Vladimir Bryuhanov as well. Alexander Oblapenko started his business in 2000 when he purchased his first truck, transporting grocery cargo for Nogliki entrepreneurs. With O&G activities in North Sakhalin, Alexander saw the potential business opportunity and using all his liquid cash assets he purchased a second and third truck for cargo transportation. In October 2005 an opportunity became available for this entrepreneur to collaborate with two other entrepreneurs to get a transportation contract with the O&G industry but to do it he needed to purchase an additional truck. His friend, Vladimir Bryuhanov, told him about the North Sakhalin Credit Program which provided financial support for entrepreneurs. Alexander joined with the two other entrepreneurs to apply for a \$31,250 loan to purchase the truck he needed. Forecasting an increase in his overall profits by 161%, the Nogliki credit officer advised Alexander that he would be eligible for a loan with repayments made over a 12 month period. Again, the problem was lack of collateral to adequately secure the new loan as he had very little equity.

Each of these entrepreneurs had applied to SSBCS individually but it was during the loan application process that it became evident to the loan officer that individually, each had enough capital repayment capacity but not enough collateral to cover the risk of the loans. Such a loan situation would not even be considered by any of the commercial banks yet SSBCS loan office brought the entrepreneurs together and continued to work and discuss with them possible solutions. Finally, after additional reviews, the SSBCS Credit Committee proposed to grant to the three individuals the loan they had requested, if each entrepreneur would act as security and guarantor for each other's loans and provide each person's own collateral for the loans of the other two members. This proposal was delivered to the applicants who were more than happy to hear the solution and readily agreed. The three loans with the North Sakhalin Credit program were rapidly concluded and the trucks purchased. With the three new trucks added to the eight trucks they had collectively, they now were able to make a profitable contract for cargo transportation. The three entrepreneurs collectively bid on and won an agreement with OOO Oren-Sakh.

6.3. Lessons learned: Building a Special Marketing Approach for the Northern Business Community

An essential part of developing the North Sakhalin Credit Program was to first earn the trust and respect of the local community; and to develop a sound reputation among the local SMEs. Besides providing credit, it was always critical for the Program to learn and implement a very “tailored marketing approach” for Nogliki and Okha communities. One of our first ‘lessons learned’ in the area was that the North Sakhalin business community (and entrepreneurs) is very different from all other parts of Sakhalin where we operated.

First of all, local businessmen and women were extremely cautious of all new people or ventures in the area. The Northern community is culturally and historically quite close and more conservative than South Sakhalin entrepreneurs. This was enhanced by the remnants of the centralized, public, and low risk business mentality that existed in the area during the times of the Former Soviet Union. Last, although of great importance, is the fact that the criminal structure had a strong hold in Nogliki directly affecting the settlement’s economy. Thus, the local business community had been forced to adjust to the situation in order to operate. For example, nearly all businesses in Nogliki paid a requisition fee to local criminals and the size of this requisition depends on the business size and profitability. Potential customers were hence concerned of local criminals knowing details about an entrepreneur’s business and revenue. Their desire for expansion and access to credit was trumped by the potential of having to pay greater “operating” fees.

This meant that receiving a loan from SSBCS could result in the entrepreneur having to pay ‘informal’ fees to operate. For this reason we ensured not only the confidentiality of the private business and financial information that we collected as part of our process but, as well, the fact that the entrepreneur was even our client. Our discretion in these areas earned us the trust and respect of our borrowers. Anything less would have deterred clients, hence we designed our marketing approaches to fit this particular aspect of the local environment.

The North Sakhalin management team put together a series of ‘tailored’ marketing meetings with the Nogliki/Okha branch office borrowers and potential customers. The first such successful meeting was held in September in Nogliki 2004. The meeting was experimental in nature and intended to get customer feedback on the impact of the previous four-month operations. We wanted to understand their vision of the SME business development in Nogliki, and start building trust and respect within the local business community. Word of mouth was our greatest advantage, for example the Okha Opening Ceremony received a lot of publicity and our message rapidly spread to the entrepreneurial community in the Okha region.

The first informational meeting held in the Okha Branch Office had more than 15 local entrepreneurs and guests attending. Evgenya Pak, Deputy Project Director, gave an overview of the program background and mission. Konstantin Chekhovskoy, SSBCS Director, made a presentation of the credit products that NSCP makes available for the

Northern entrepreneurs for business development. Having learned from the Sakhalin Microcredit Program the importance of media outreach, not only for attracting clients but to educate them and provide a level of confidence, NSCP started a solid media campaign in Okha and Nogliki:

- Updated NSCP brochures were published June 15, 2006. These were widely distributed across the Okha and Nogliki districts. Updated success stories leaflets were also published in June 2006.
- In August 2006, signs with the Program's name were placed in central locations on the side road close to the office in Nogliki and Okha. These signs helped to generate a significant amount of publicity.
- Widespread use of mass media such as articles in local newspapers (e.g. Okha's Navigator); press releases included information on the tranches received from the ENL-SSEDF agreement (On September 1, 2006 in Sovetsky Sakhalin newspaper and on August 28, 2006, on TIA-Ostrova news)
 - a) A 10-minute interview was produced for the local TV news. This included interviews with SSEDF & SSBCS management on site and with a current Okha group client; as well as covered an official opening ceremony of the NSCP Okha Office
 - b) In May 2006, a 30-second TV commercial was broadcasted on local television. The advertisement explained to the general public basic information on the Program, NSCP targeted clients, contact information and an invitation to come to the Okha SSBCS Office with loan applications
 - c) On August 24, 2006, ASTV news covered the US Ambassador's visit to the Sakhalin Regional Credit Program giving extensive exposure to NSCP in Nogliki and Okha. The news release also covered the 3rd tranche of funding which was presented to the NSCP by Vice President Al Short
 - d) Russia's leading private news agency Interfax published an article about the Northern Sakhalin Credit Program in August 2006

Another lesson learned from the Sakhalin Microcredit program applied to NSCP was to proactively reach out to the local government administration. At the start of the NSCP program the NSCP team met with the Okha Mayor, Mr. A. Khoroshavin, introducing him to the program and making him aware of the start of NSCP lending operations in Okha. This visit turned out to be very successful; the Mayor not only carefully listened to the presentation but also stayed longer with the team and asked detailed questions. The NSCP representatives received very encouraging and supportive feedback from Mr. Khoroshavin: a commitment to assist us, and his appreciation for contacting him prior to implementation. Again, in June 21, 2006, NSCP, represented by the Okha Office Branch Manager and the NSCP Regional Manager, met with Ludmila Burlakova, Deputy Head of Okha Administration. The NSCP representatives updated Ms Burlakova on the Okha Office progress and shared a brief view of future plans for expansion. In this manner, NSCP continued to be engaged with the local administration, ensuring that they were aware of progress, obtaining buy-in from outgoing and incoming officials.

Constant communications with our borrowers and the community also helped us gain more knowledge as to the business opportunity in the area, including the O&G projects. It became clear that local entrepreneurs did not have the experience or insight to map an opportunity and act upon it. With this information, NSCP decided that the first thing needed to do was to assist local entrepreneurs network and learn about the business environment that surrounds them. As explained above, trainings expanded to include networking sessions among entrepreneurs and other corporations such O&G companies. NSCP has always been aware that making credit available to entrepreneurs is not necessarily going to translate into business opportunities, and thus, we actively addressed the knowledge divide.

6.4. NSCP Impact on the Commercial Credit Market in North Sakhalin

A trend emerged were in the areas where the Sakhalin Regional Credit Program started lending, with time, it affected the local credit market to the benefit of entrepreneurs. Such perception was broad based and we began receiving complains that we were stealing customers from commercial banks. The Program thus started and continued conversations with local banks in this area. These resulted in banks taking seriously the lessons learned arising from this new competition. A clear example is that the Nogliki Branch of SakhWest Bank started their own new SME credit product in the autumn of 2005, offering:

- For loans up to \$10,000 no collateral was required and only two guarantors were needed to receive a loan
- SakhWest started marketing their SMEs loans as exceptionally expedient, promising to disburse loans no later than five working days

Other banks followed. In September 2005, the SSBCS Nogliki Branch Manager received a call from the local SberBank loan officer. The loan officer reported that their Regional Head office in Khabarovsk had asked her to research how NSCP implemented its financial service practices. Over multiple phone calls, the NSCP Branch manager explained how we do loan analysis, loan conditions and servicing of the borrower. The same way and for the same reason, in November Okha SakhWest Bank announced their new credit product for entrepreneurs up to \$8,000, which required no collateral and the borrower had up to one year to repay. Additionally, Nogliki SberBank began aggressively entering the market for consumer credits directly competing with NSCP.

Though the Sakhalin Microcredit Program and NSCP were successful transferring lessons learned and expanding the SME lending market, commercial banks aggressiveness triggered new issues. For example, loans up to \$1,500 were provided based on passport information and references on the applicant's monthly salary income. The main problem was that even though this product was marketed as a consumer product such loans were just used for business purposes and to minimize competition. This eventually hurt the lending environment as the competition created by NSCP success drove bank's credit policies to "push the envelope." Though beyond the control

of the program we still actively continue to promote sound lending practices and train commercial bank loan officers.

Overall competition was fruitful and in their try to be more competitive in the SME market, commercial banks significantly adjusted the expediency of their loan approval process. They also adapted to the local market, accepting guarantorship without any hard assets, relying on the borrower's reputation in the community. Also, they used a customer's credit history with SSBCS; in many cases banks made loans to an applicant based on the fact that they had been a successful customer of NSCP.

The most important benchmark of success for the program has not only been the creation of a sustainable MFI but such intangible contributions as improving the availability of credit for local businesses.

7. The Nogliki Tymovsk Credit Program (NTCP)

In June 2005, SSEDf received a Donation from Sakhalin Energy Investment Company Limited (SEIC) to expand its then current SME finance program to strategic areas of central and northern Sakhalin. The funds provided were to be used by SSEDf to finance loans in the Nogliki-Tymovsk Region through SSBCS under the Nogliki-Tymovsk Credit Program (NTCP). NTCP constituted an expansion of the Sakhalin Regional Microcredit Program that ACDI/VOCA had already successfully designed, piloted, and implemented through SSEDf/SSBCS in the South and strategic locations of North Sakhalin under NSCP. The Donation Agreement provided a loan capital donation of \$250,000 over two years. The first tranche of funds (\$100,000) was received by SSEDf in November 2005, the second tranche of \$100,000 was received in December 2005 and the last tranche of \$50,000 in January 2006.

With the experience gathered and our reputation backing our work, we moved swiftly into Tymosk and Nogliki. On October 13, 2005, the SSBCS team held an informational meeting for entrepreneurs at the Nekrasovka's village local library. About 8 to 9 local entrepreneurs including rodovoye khozyaistvo representatives, as well as the Deputy Head of Nekrasovka village Administration attended the meeting. This informational meeting included presentations of the overall program, results of operations in Nogliki and Okha, and various lending products designed to meet SMEs needs.

On October 12 another Power Point presentation was made in the building of the local Administration for both the Administration officials and approximately 25 local entrepreneurs. Lyudmila Burlakova, Vice-Mayor of Okha Administration (who supervises local SME development), opened the meeting by expressing her approval of the SSBCS Okha Branch Office to start lending to local small businesses.

By early fall, NTCP started its lending operations. At the beginning loans were analyzed and administered from the Nogliki Branch Office of the North Sakhalin Credit Program. In the beginning of June 2006 NTCP leased an office in Tymovsk downtown (in the building of the local trading center), and selected a full time loan officer to serve as a loan

officer of the NTCP credit office. SSBCS Tymovsk Contact Office concentrated its efforts on developing and promoting the Nogliki-Tymovsk Credit Program. As of June 29, 2006 it was officially registered with Tymovsk Tax Authorities.

NTCP most important legacy has been to promote an entrepreneurial culture that drives start-ups in the Nogliki and Tymovsk regions. NTCP does this by aligning the motivation of access to credit with targeted training and technical assistance. Local entrepreneurs and small businesses that could potentially provide goods and services to the SEIC Onshore Process Facility (OPF), or other facilities of SEIC, are identified, trained and developed. The goods and services that serve the needs of SEIC include, inter alia: minor facility maintenance, logistics support (diesel hauling, waste removal, transport, etc.), repair of appliances, office equipment, and vehicles, electrical repair, retail personnel services (commissary, cafés, hair-care, newspapers, magazines, etc), housekeeping, and food products (fresh produce, baked goods, berries, etc.)

7.1. Tymovsk Contact Office Official Opening Ceremony

The official “Opening Ceremony” for the Nogliki-Tymovsk Credit Program’s (NTCP) Tymovsk Office was held August 17, 2006. While the official opening was in early summer 2006, financing of Tymovsk entrepreneurs actually started as early as the summer of 2005 through the Nogliki Branch Office. This helped expedite NTCP startup of loans and to helped better promote the credit program and services to the local community. The contact office fully opened for business in May 2006 in downtown Tymovsk and collateralized lending was launched to meet the local credit demand.



Marianna and Marina cutting the ribbon

To ensure local community awareness of the Official opening, Tymovsk Loan Officer visited the Tymovsk Administration Vice-Mayor, local SakhWest Bank Branch Manager, local SEIC representative, local mass media representative, and, of course, the NTCP current borrowers and potential customers. The Project Deputy Director opened the ceremony by sharing with guests the background of the NTCP, its donors and SEIC’s contribution to SME development through NTCP. She emphasized that the major objective of the program was to provide accessible credit to Nogliki and Tymovsk small and medium business helping them to benefit from opportunities available through the O&G development in the area.

7.2. Credit activities

On the first year of the project, all loans went to entrepreneurs from the Tymovsk Region vicinity and settlements near Nogliki. NTCP borrowers represented a diversified area of operations from retail trade of automobile spare parts and accessories to production and sales of fur hats. The credit program financed these small businesses for support and expansion of existing operations (purchase of inventories/goods), purchase of capital assets for expansion (vehicles and trading equipment) and opening new business/or expanding existing ones.

At the beginning of the program, peer-group lending did not materialize in this region as originally anticipated mainly because:

- a) Borrowers had collateral
- b) We discovered that certain services were semi-monopolized, were owners' coerced employees to apply for loans yet appropriate the funds themselves

Program Management anticipated more interest in uncollateralized group lending based on SSEDF's preliminary research. However, once actual on-site visits and project start up began we realized that borrowers found of greater interest collateralized lending. Many entrepreneurs who thought did not have collateral did in fact have it. The problem was that most of it was not properly registered and therefore the entrepreneur had not been able to receive collateralized loans from commercial banks. As in the rest of the island, commercial banks had no processes set up to help applicants become eligible for a loan. These entrepreneurs had previously expressed themselves as needing uncollateralized loans, thinking they had no collateral to offer. NTCP assisted entrepreneurs register ownership of collateral. At first, the NSCP Officer took care of this process and then later on, an appropriate training was organized. This brought together borrowers as well as representatives from six state offices whose approval was required to fully register ownership rights.

A good example of this issue is the Nysh farmer, Valery. While working on this loan the NTCP loan officer determined that the borrower did have enough collateral (a few cows, agricultural equipment, and a tractor) but the problem was that the borrower had never legally drawn all these assets under his name. Registration requirements for the kind of property he owned were also very specific (for example, cows need to have a special registration certificate that included documentation on vaccinations, veterinary checks, etc.). The loan officer encouraged the borrower to register his assets and provided him with simple instructions about the registration process. Valery was then able to obtain his own credit.

Additionally, most of the small retail shops that in the previous projects were usual customers of the peer group lending program, turned out to be a network of outlets owned by 4 to 5 of Tymovsk larger businesses. These types of businesses forced their shop assistants to register as entrepreneurs and sell their merchandises as such. However, all the merchandise and micro outlets (counters on the market) did not belong to these "registered" entrepreneurs.

In addition to credit services, the NTCP loan officers provided customers the following personal assistance:

- We advised borrowers on how to present business registration applications to the local tax officers and advice on how to make the application process more expediently. This ensured further helped the local government by extending the tax payer base in Nogliki-Tymovsk
- We also assisted borrowers maintaining proper financial and accounting records. Several borrowers became eligible for individual loans after they started maintaining well documented evidence of their inventory as well as bank-transfers and non-cash transactions

7.3. Products tailored for Northern Sakhalin

To ensure the safety of loans we also encouraged entrepreneurs to insure equipment, buildings, and in some instances, carry life insurance. However, there was a lack of insurance providers in Nogliki and Tymovsk. The lack of competition between insurance companies (usually represented by only one company in the remote and rural areas in Nogliki and Tymovsk), increased insurance fees, making them unreasonably expensive. To facilitate access to insurance services for our borrowers, NTCP started collaborating and negotiating with a young and growing insurance company in Yuzhno. At the beginning of this partnership, on-site NTCP loan officers' assisted customers in filling out insurance forms, delivering the forms to the Yuzhno Insurance company office and getting the invoice for the borrower to pay. Besides obvious cost advantages, such assistance represented significant time savings for our customers.

In February 2005, an agent's contract was signed with this insurance firm, *Progress*. Under this contract, SSBCS authorized employees could also act as agents of the insurance company, helping North Sakhalin borrowers acquire more services. This arrangement works for the benefit of both NTCP and Progress but especially for the small business entrepreneur:

- NTCP can offer new services to its borrowers and add to its non-interest income, helping the continued financial sustainability of the MFI
- The insurance company had an opportunity to expand their business, covering remote areas normally not able to be serviced otherwise
- Use of SSBCS established offices and employees (outsourcing) made it a reasonable expense for the insurance company
- This new service improved the availability of insurance services for customers in remote areas (due to considerably lower prices by Progress), and provided them with a better choice

To make sure NTCP customers had a choice, NTCP officers are required to provide information on other insurance providers in the area and at no time can NTCP officers require the borrower to insure with any particular company.

8. Sakhalin Wild Natural Resources

The idea to search for non-financial sources of revenue came as a natural progression in the program's maturity. Thanks to the program's work financing several entrepreneurs who harvested wild natural resources in the North of the Island, we learned about harvesting and processing these resources. Through this experience, SSEDf/SSBCS became familiar with the industry gaps and as SSEDf researched the issues holding back this industry, we realized that we could be the first investor in a fruitful industry (which could provide increased income to SMEs in the poorest areas of the island). SSEDf launched a pilot program to demonstrate the feasibility of implementing a full-scale operation of the forestry project, creating a sustainable industry of sizeable proportions that had the potential to significantly impact Sakhalin economics, creating thousands of jobs, SME enterprises, and diversify the island's industrial landscape. Such opportunity envisioned extending employment in areas where indigenous groups had acquired experience and familiarity, providing them with immediate income.

8.1. Establishing a Competitive Berry Processing Company

In the spring of 2005, SSEDf and ACDI/VOCA approached SEIC with a proposal to finance the development of the wild natural products industry on Sakhalin Island (harvesting and processing berries, mushroom, ferns, and other wild plants. The proposal received significant interest from Sakhalin Energy but it had to compete with demands from the local government administration. The local government requested SEIC to donate funds for this project to the local budget instead – offering to take over the management of this project. This redirected the funds intended for SSEDf to the local government. However, since so much preliminary work had been completed, including recruitment, equipment acquisition, harvesting season preparations, and more, SSEDf moved forward and with its own and borrowed funds began harvesting operations on a small pilot plot. Harvesting started with fox berries in the regions of Tymosk and Nogliki, hiring for the most part the indigenous population.

To take over this project, SSEDf created a for profit subsidiary, the Sakhalin Wild Natural Resources (SWNR). SWNR was registered on June 16, 2005. Certificates for SWNR to produce berry drinks were received (based on GOST state standards) the next year. At the beginning, only a limited number of stores were willing to display the juice and frozen berries. We discovered through market assessments that stores preferred dealing only with large wholesalers who could supply all orders. The five large wholesale companies on Sakhalin were disinterested in collaborating with a local partner like SWNR. The reasons were that at the time SWNR did not have proven stability in production and thus no guarantee of stable supplies. A second reason was that we had no proven product quality and marketability. Lastly, it was clear that large wholesalers simply did not want a new company to enter their market and “use” their customers. Though a small operation with only two employees and immense challenges ahead, SWNR was able to sell juice and frozen berries to small stores in its first year of operation, covering payroll from its profits.

By the last quarter of 2007, SWNR successfully expanded retail sales of the frozen berries. The number of regular customers (mostly represented by local cafeterias, restaurants and kindergartens) doubled. They liked the opportunity to purchase berries by small lots (20-60 kg) and as needed all year round (plus have the product delivered - as part of SWNR's service). SWNR insured certification of these berries through the Oblast Center of Standardization. Ten tons of purchased berry successfully passed sanitary tests, and these tests proved the excellent quality of the berries. SWNR continues looking for suppliers to purchase more berries.

Though we had an encouraging start partnering with Svetoch, in 2008 the owner of this plant decided to close it due to the financial crisis. Under local law, the building is the entity that is granted the license to process and bottle juice. SSEDf did not have enough funds to get its own building, registration and full machinery so establishing a new partnership was necessary. There were three processing plants that broadly fitted the scope needed (it is important that before SWNR there were no juice processors or capacity in Sakhalin). We were able to find a new plant in Nevak (thirty miles south of Yuzhno) that met SWNR's needs. After a couple of months of negotiation, in May 2008 we had a timeline to transfer all our equipment and start operations again. The plant bottled water from a local natural spring and is technically superior to our previous facility. Currently, SWNR is in the process of acquiring new certificates for production so that it can work with its new partner, Aqua Standard Production. This validation process is under the purview of a scientist hired by SWNR.

Our current partner will sell SWNR's juice together with the distribution of their bottled water, helping us extend our market reach, while helping him diversified products. Together with the facility upgrade we also developed a new logo and bottle that will be more marketable. Also, thanks to USAID's donation, SWNR was able to purchase a new berry presser which will extend the life of the juice.



8.2. SWNR Trade Mark Registration

In the fall of 2006, SWNR started developing the SWNR trademark. Management made the decision that investing in an attractive brand for SWNR would be very helpful in marketing the forestry production of SSEDF's subsidiary. While working on the brand with the design firm, SWNR requested the following idea to be communicated to potential customers:

SWNR production is natural, local and healthy.

In November 2006 the design of the SWNR trade mark was completed. The brand included the ritual image used by local indigenous people, a small twig that symbolizes health and good luck. In December 2006, the registration package was submitted to the Federal Patent Bureau in Moscow.



Today, the trade name (Nay Nay) is registered in the name of SWNR. Also SWNR is a member of Automatic Identification Association (bar-codes) and a number of SWNR products have registered bar-codes (frozen packaged berry, drinks made of berry juice).

8.3. Farmer to Farmer Volunteer helps SWNR upgrade

Since the start of the bottling operations, we were looking for methods to improve beverage production, including new recipes and processing. Our goal was to utilize the resources to their maximum so that any leftover fruit could, for example, be used to develop a new product, such as jams and syrups. SWNR faced major challenges finding appropriate equipment mainly due to the comparatively small scale of its operations. It was hard to find machinery for small scale production at a reasonable price that would allow the factory to ensure the quality of the product. Furthermore, SWNR needed to find a proper processing filter without which SWNR could not obtain production certificates necessary to start sales.

The USAID funded Farmer-to-Farmer Program (FtoF) program offered a viable opportunity. The program helps agriculture related businesses in various areas from improved farming methods, cattle breeding, production processing technologies to sales and marketing. Experienced agribusiness professionals volunteer to offer on-site individual consultations. A well-known professional from the United States who specializes in berry and fruit processing, Jim Valentine, was invited to Sakhalin through FtoF in March 2007. During his ten day visit to Sakhalin the consultant provided a very timely hands-on professional advisory to SWNR. Of great significance was that neither SSEDF nor SWNR could afford such necessary help vital to the success of the operation. The FtoF Program covered all expenses, such as cost of the consultant services, travel, lodging, visa, and others.

With his report at hand, SWNR continued to work on improving berry drinks recipes conducting a series of experiments and public taste testings, with higher juice percentage in the drink, various berry mixes, sugar and natural sweetener, and mors (a type of fruit/berry drink with pulp) to select the best recipes. SWNR developed recipes to make and produce the following products:

- frozen packaged berry** (fox berry, blackberry, cranberry, red berry, magnolia vine);
- drinks made of berry juice** (fox berry, blackberry, cranberry, red berry, magnolia vine);
- frozen packaged garlic**

In 2008, SWNR was able to purchase the necessary berry processing equipment that met all necessary qualifications, improving the pressing of the berry and extending the shelf life of the juice. The equipment arrived at the close of the calendar year, ready for its installation in the new facility in Nevak. And along with new drinks developed, SWNR has successfully developed a secondary base of sales offering frozen berries in bulk and packaged with a small but consistent customer base.

8.4. New equipment will ensure SWNR product quality

At the end of 2008, SWNR completed placing orders for equipment to improve its line of drinks together with its processing facility partner Aqua Standard of Aniva. The purchases included

- Mixing tanks
- Syrup boiling tank
- Filter and press

In November 2008 the first one of this equipment, a mixing tank, was purchased and delivered to Sakhalin. It has already been installed in the processing facility line of “Aqua Standard”. These mixing tanks will allow a more uniform mix of drink ingredients and will allow the mix to cool before bottling. It will improve the quality of the drinks and reduce production time because the process of mixing and chilling are done simultaneously.

By early December 2008, the purchased syrup boiling tank was also delivered to the facility in Sakhalin. This equipment allows the processing facility to produce sugar syrup to be used in the production of drinks. This is a major change in SWNR’s processing history. In the past, the ingredient Stevia was used as a sweetener for drinks. It is believed the sugar syrup will enhance the drinks process (and taste) significantly.

The press-filter was delivered to Sakhalin in early 2009. With this, Aqua Standard applied for the “Production Certificate” that will include all drinks to be produced by SWNR. SWNR also concluded an agreement with a leading scientist to develop new recipes for the SWNR drinks line. The scientist currently works for one of the major

drinks companies in the Russian Far East. He will develop recipes for SWNR, and assist in helping certify the recipes in SWNR's name. He has also agreed to provide onsite training to SWNR's specialist to improve drink production in the premises of Aqua Standard. Finally, he will also assist in future purchases of additional ingredients to improve the flavor of the drinks.

In late November 2008, SWNR, along with the new partner Aqua Standard, started to research improved systems to glue labels, and purchased a thermo labeling equipment to use on the SWNR bottles. This type of labeling was selected to attract customers, since a more professionally packaged bottle can stand out on store shelves among similar drinks.

In the meantime, SWNR continues with its sales of frozen berry and in at the end of 2008 sold 6,710 kg of frozen berries to restaurants and cafes in Yuzhno Sakhalinsk. This is not SWNR primary sale but it continues to keep the SWNR operations in touch with SME businesses that use natural products as well as produce profits.

The Sakhalin Regional Microcredit Program has been and continues to be a success. It is truly an example of what can be accomplished thanks to innovative and practical ideas centered on the development of SMEs in the Sakhalin.

9. Lessons Learned

ACDI/VOCA programs in Russia have focused on business development and strengthening business support institutions, the development of credit cooperatives and agribusiness management. Thanks to these projects, including the Sakhalin microcredit Program, ACDI/VOCA has identified lessons specific to the Russian context:

- The banking system remains unstable. Since 1992, periodic financial crises have disrupted the normal functioning of banking services and financial markets, undermining public confidence in banking institutions. In many ways, little has changed in the region's formal lending regulation that allows for a more stable system.
- New micro and small businesses in Russia continue to face a maze of legal, tax and market hurdles to be successful. The inclusion of reliable business support services to assist entrepreneurs to follow local loans and manage credit provided to them is essential to business success.
- While systems of collateral are important security for lenders, enforcing collateral agreements is difficult and expensive. Mechanisms are needed that encourage loan compliance and offer mutual benefits to the micro finance institution, the loan officer, and the client from loan performance.
- Citizens have collateral and adequate purchasing power, greater efforts are needed to formalize collateral and encourage entrepreneurs in developing basic services.

10. Lasting Impact

The program demonstrated that small business loans are profitable and are good businesses. Banks adopted lessons learned and continuously approached SSEDf for leadership and instruction to develop their own business portfolio. SSEDf was the start of commercial banks becoming more familiar with a progressive methodology of loan analysis, reaching out to SMEs while mitigating its risks. Commercial banks typically used as a benchmark \$20,000 for their loan ceilings for small businesses, thanks to the program, this was reduced to \$2,000 by 2003. Furthermore, trying to be more competitive in the SME market, banks significantly adjusted the expediency of their loan approval process, improving efficiency overall. Today, bank credits for small business owners are more competitive and available.

Furthermore, SSEDf support of the legal lending market gave choices to entrepreneurs and business owners. This meant better terms as well as participation in the formal economy. The project enabled small business owners to establish a positive credit history, with many clients graduating to commercial bank loans. Thanks to the program, they have a choice on financial service providers.



14,000+ new jobs



2,154 Sakhalin small business entrepreneurs received 9,522 loans worth \$29,638,722



Reduced commercial banks loan ceiling benchmark from \$20,000 to \$2,000 by 2003

Selected achievements include:

- Stronger local economy: provided a SME lending business model which the commercial banking sector copied, thereby increasing access to credit
- Commercial banks designed competitive SME lending products
- Benchmark loans for SME lending decreased from \$20,000 to \$1,000
- Broadened 'white' banking services thereby decreasing blackmarket lending activity
- SSEDf is now a direct competitor to larger banks, giving Sakhalin residents choices and strengthening the local formal economy
- Thanks to SSEDf, its clients learnt how to register their collateral, improving their access to capital
- Bank processes became less bureaucratic
- With an SSEDf credit and collateral history established, many of our previously unbankable clients have graduated to commercial lending
- Thanks to the Sakhalin Wild Natural Resources (SWNR) the natural juice industry has

flourished, expanding the job market as well as helping diversity the local economy

- Today, SWNR serves as another financial element of SSEDF “non-interest’ income that adds to the sustainability and growth of the Program
- SSEDF had a direct impact helping Sakhalin residents access the Oil and Gas market in the Island, improving the local economy

It is ACDI/VOCA’s honor to see these outstanding market changes and know that the presence of the Sakhalin Microcredit Program made such system-wide contributions, improving the overall availability of credit for local businesses.