Eurom

Consultancy & Studies

Benchmarking Microfinance in Romania
2006 - 2007

A report from Eurom Consultancy and Studies SRL for European Microfinance Network's
Micro finance Conference – Nice, France 2008

Bucharest – Romania
www.eurom-consultancy.ro

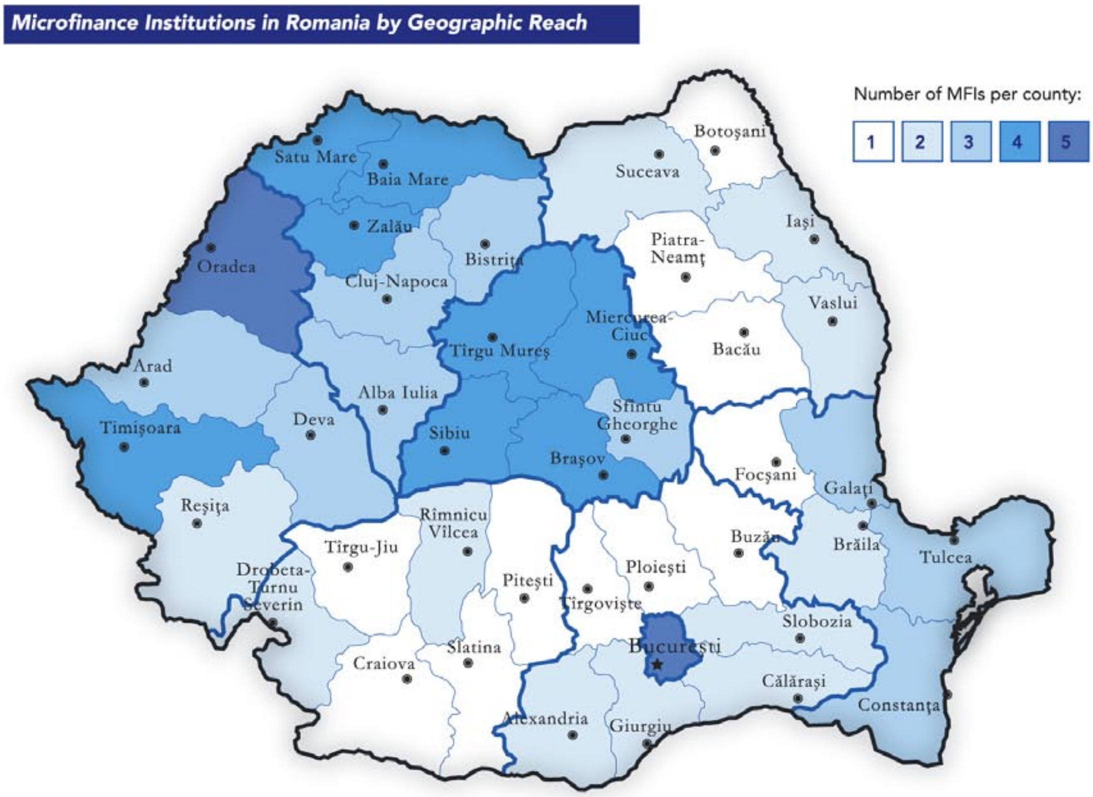

Table of contents

Benchmarking Microfinance in Romania
2006 - 2007

Microfinance activities in Romania started twelve years ago when the first International Microfinance Institution (MFI) launched its projects for financing of Small and Medium Enterprise Development in Romania.

Within the last years, 2003 - 2006, the sector evolved rapidly. It has become more efficient and productive in achieving its mission of providing support and services to the underserved entrepreneurs.

The regulatory framework is following the fast pace of change of the sector:

The Government Ordinance no. 40 (2000) provides for licensing of Non-Bank Credit Organizations (NBCO) to administer public funds.

The Microfinance Companies Law no.240 (2005), adopted by the Romanian Parliament in July 2005, creates an enabling environment for MFIs to grow and expand their portfolio of products and support services with micro loans of up to €25,000.

The Government Ordinance no. 28 (January 2006) regulates the non-banking financial institutions (NBFI).The National Bank of Romania is the supervisory authority of all Non-Bank Financial Institutions (NBFIs), which include Leasing Companies, Mortgage Companies, Credit Unions and Microfinance Institutions.

The activity of the Microfinance Companies is recognized as part of Romanian financial sector, the legal framework support its development and its commercialization. The regulatory framework is mostly liberal, for instance no limitation is set on geographical expansion or foreign investment.

The microfinance activity is regulated by the National Bank of Romania (Central Bank), which registers and licenses the MFIs. This procedure enables them to become more competitive, as credit unions and certain banks continue developing their microfinance activities.

Besides the first eight Microfinance Institutions established with the support of international donors, thirteen new Microfinance Companies established under the new legal framework are in process of registration and licensing with the National Bank of Romania.

The sector is undergoing a number of changes. UNDP supported MFI have closed and some other smaller MFIs might disappear as well. At the same time, the bigger ones need to adapt to the new constraints, attract funds and continue their mission of providing funds for the development of micro and small sized-enterprises.

Purpose of benchmarking microfinance in Romania

This document is the third[1] benchmarking report for the Romanian microfinance industry aiming to achieve several objectives:

- To determine the trends in the evolution of the Romanian microfinance sector and the influence of the new legal framework on the microfinance sector performance;
- To build the capacity of microfinance professionals in calculating and interpreting relevant performance indicators for their microfinance institution;
- To apply to the Romanian microfinance sector the microfinance benchmarking tool developed by the EU funded project ”From Exclusion to Inclusion through Microfinance: Learning from East to West and from West to East” ;[2]
- To promote the achievements of the Romanian microfinance sector in the lobbying efforts among bankers, investors in the sector and policy makers for continued support of the Romanian microfinance sector at the European Microfinance Network's annual Microfinance Conference – Nice, France in September 2008.

Overview of benchmarking and performance measurement

During the last decade, numerous microfinance institutions (MFIs) have emerged to offer diverse products to a multifaceted market. The microfinance sector, throughout Eastern and Western Europe has witnessed significant growth.

Thus, there is an increasing need to scrutinize how microfinance activities are affecting the geographic, social and economic areas in which they operate and how their efficiency, productivity and socio-economic impact can be measured and improved.

In order to highlight the diversity of political, economic and social conditions from one region to the next, the European Union designed the project ”From Exclusion to Inclusion through Microfinance: Learning from East to West and from West to East”. The main result of the project was a tool to measure sector performance and impact. It is vital to the health of the sector to possess the ability to evaluate its products, service delivery and impact. Practitioners across the sector must be able to understand and improve their own performance. Additionally, they must be able to measure their progress against that of their peers, as well as to demonstrate to stakeholders the viability and value of MFIs within a social and economic context.

---

[1] The first MF benchmarking report 2003 – 2004, was published by Economic Development and Strengthening Project – Micro Finance Component implemented by Shorebank Advisory Services
The second MF benchmarking report 2005 – 2006, was published by Technical assistance to develop the SMEs sector in Romania – access to finance component funded by EC and Romanian Government – Ministry of European Integration

[2] EC funded project implemented by the

MICROFINANCE CENTRE for Central and Eastern Europe and the New Independent States Microfinance Center for Central and Eastern Europe and the New Independent States,

EUROPEAN MICROFINANCE network European Microfinance Network and cdfa Community Development Finance Association

Romanian Micro Finance Sector's Segmentation

Microfinance institutions (MFIs) share a common purpose: to provide access to finance of less than €25,000. These loans or other financial products are in addition to other financial services to entrepreneurs that are unable to access the finance they need to develop and grow from external sources beyond capital generated within the business.

In Romania, there is a large geographical area to cover, with varying economic environments and differing stages of MFIs development and practices which leads to very diverse performance figures. There are a number of key factors bringing about this varying performance. As such, it is vital to understand these factors and how they affect performance in order to realistically measure the relative performance of individuals or groups' of MFIs.

The key factors that can influence MFI performance include a template of characteristics. These help in identifying and analysing particular peer groups, capturing both socio-economic data as well as more qualitative assessments of the operating environment for MFIs (see Figure 1.1 Segmentation Map)

The three key characteristics based on which the MFIs are grouped into different segments are:

Institutional type: legal structure of the MFIs
In Romania the new legal framework requires the registration and licensing of the MFI as Non-Bank Financial Institutions – Microfinance Companies. Centre for Economic Development (CDE), as microfinance foundation, is excepted as long as they are administrating exclusively public funds.

MFIs mission, targeted market and service offered
Due to increased competition, commercialization is the strategy of almost all medium and large MFIs. However there is a number of more targeted initiatives that may take a different, more focused path, e.g. the support for women entrepreneurs (Integra), farmers (LAM), former miners (CDE and Express Finance) etc.

One of the most significant factors affecting the performance of the Romanian MFIs is the market or type of customers they serve. This, in turn, is affected by the MFI's mission and orientation. These factors are strongly connected and influence the MFI size and their average loan size, both having a bearing on its financial and social performance.

Therefore, the Romanian MFIs were segmented in three categories: social oriented, social and commercial oriented and commercial oriented (see Figure 1.1 Segmentation Map)

MFI fund size and maturity
As global microfinance practice has developed, it has become clear that the age of an MFI is a crucial factor in understanding its relative performance.

In Romania, due to the new legal framework, which lowered the barriers of registration and licensing, thirteen new MFIs, some of them with significant resources, registered over the past two years. Therefore, the sector is divided into new and mature MFIs. These older MFIs have a fully developed lending methodology, internal mechanisms and controls, and are able to develop new ones when required.

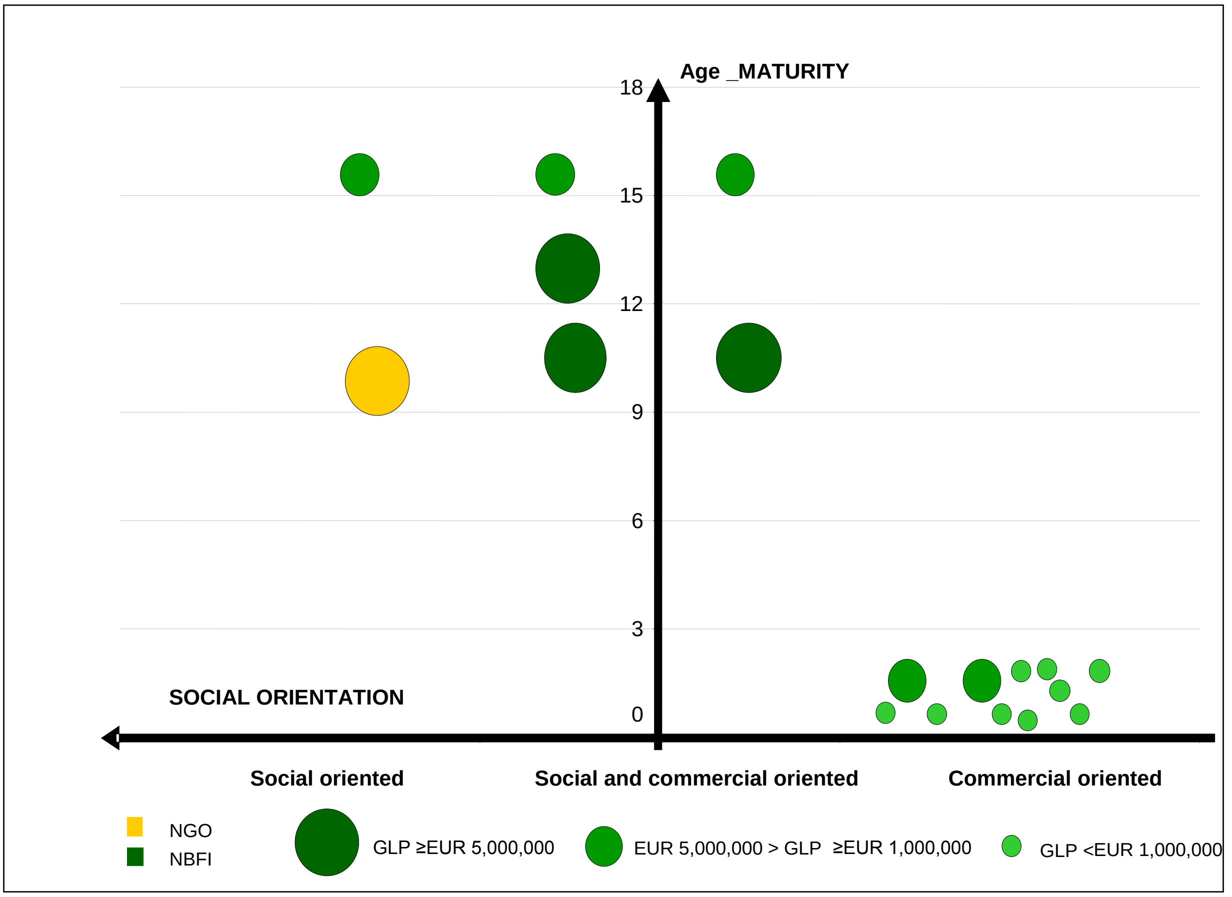

Figure 1. Segmentation map

The development of a core set of performance indicators across Eastern and Western European MFIs will enable both practitioners and stakeholders to compare and contrast performance across the continent. The performance framework comprises a "basket" of transparent and transferable indicators and principles.

The MFIs, included in this study, are those established more than six years ago initially with support from the international microfinance organizations. They are currently registered as Non-Bank Financial Institutions - Microfinance Companies: CAPA Finance, Express Finance (Former CHF International Romania), Opportunity Microfinance Romania (OMRO), ROMCOM, LAM, FAER and Centre for Economic Development (CDE) Foundation.

They are grouped into peer groups by size of their portfolio, allowing for comparisons with similar European microfinance institutions.

I. Scale and Outreach indicators

OUTREACH INDICATORS	All Romanian MFIs			Romanian Large			Romanian Medium		
	2005	**2006**	**2007**	**2005**	**2006**	**2007**	**2005**	**2006**	**2007**
Number of Active Borrowers	1,669	2,068	2,399	3,655	3,729	3,836	1,182	498	483
Gross Loan Portfolio (mil €)	3.93	5.92	8.48	9.22	10.55	13.03	2.54	1.60	2.41
% of Targeted Borrowers (micro and small enterprises)	n/a	n/a	80%	n/a	n/a	73%	n/a	n/a	90%
Number of Active loans	1,764	2,237	2,496	3,843	4,077	3,981	1,261	487	511
Average disbursed loan amount (€)	5,400	6,000	7,551	4,067	5,000	4,383	6,510	8,589	11,776
Average loan amount/GDP/capita (%)	148.72%	110.42%	134.38%	112.00%	92.02%	78.00%	179.30%	158.06%	209.57%
Drop-out ratio (%)	n/a	-6.18%	-20.00%	n/a	-7.22%	-17%	n/a	-6.00%	-23%

Table 1. Outreach indicators

The Romanian microfinance sector, as a whole, continues its growth in 2007, compared to 2005 and 2006. As it can be seen from the table above, the average gross loan portfolio has increased by around 44%, mainly due to the capacity of certain MFIs to attract funds for on-lending. This has determined an increase in the number of clients per MFI by 15% and an increase of the average loan amount.

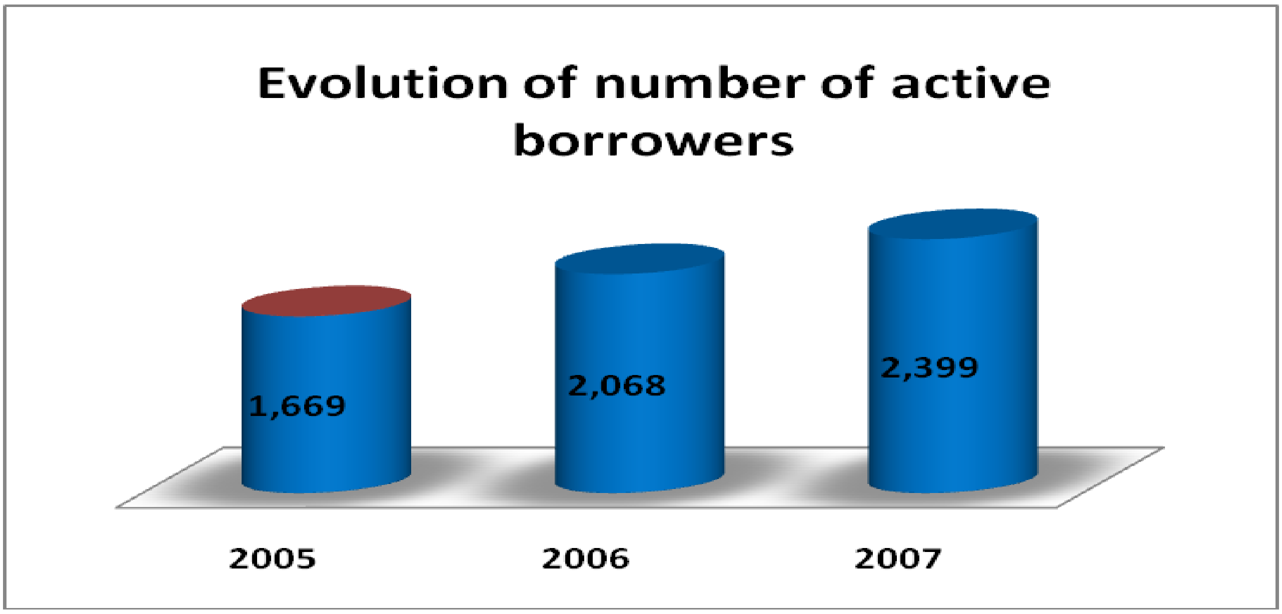

Figure 2. Number of active borrowers

As it can be seen from the chart above the average number of active clients per MFI has increased every year from 2005 to 2007. As the Romanian economy develops, more enterprises are set-up and they require financing to start and develop their activity.

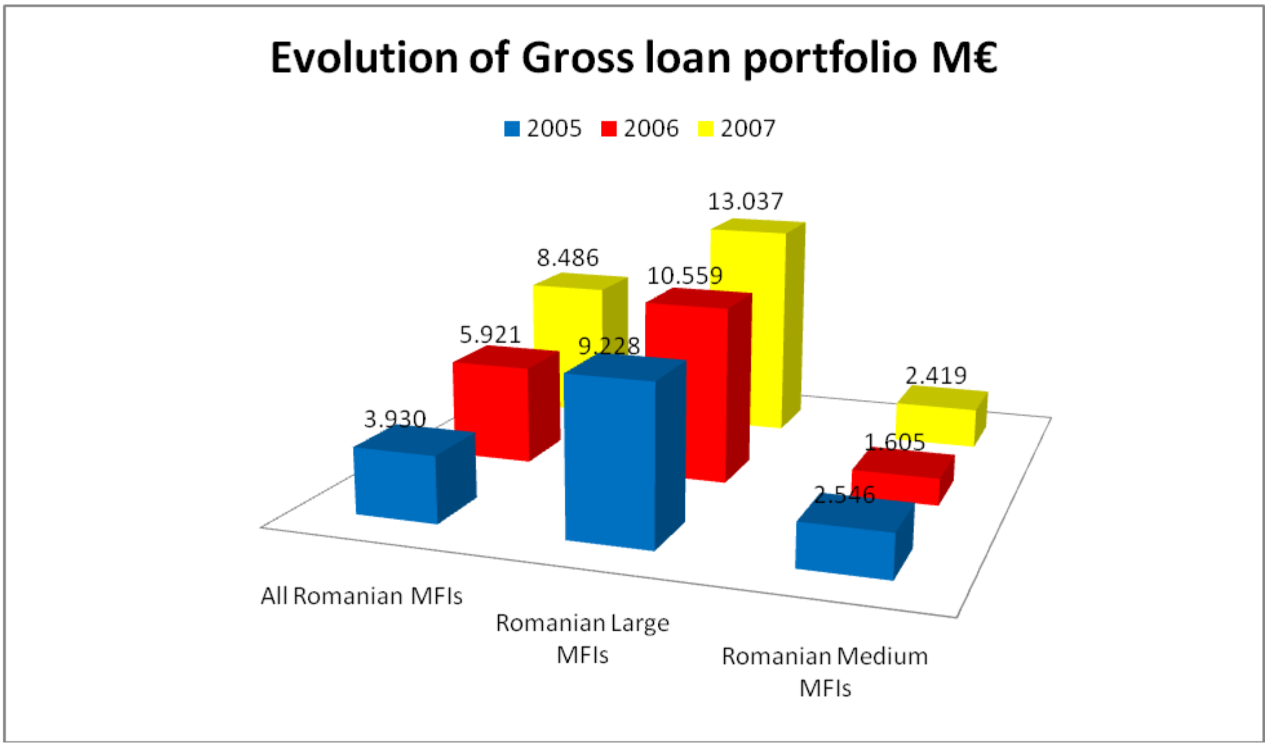

Figure 3. Gross Loan Portfolio Trend

At the same time, most of Romanian MFIs are becoming more competitive; they are able to increase their lending base and thus widen their portfolio of clients. The Figure 3 above shows an increase on the gross loan portfolio for Romanian MFIs between 2005, 2006 and 2007.

II. Profitability and Sustainability

PROFITABILITY AND SUSTAINABILITY INDICATORS	All Romanian MFIs			Romanian Large			Romanian Medium		
	2005	**2006**	**2007**	**2005**	**2006**	**2007**	**2005**	**2006**	**2007**
Operational Self-Sufficiency	120%	140%	120%	111%	154%	125%	124%	126%	114%
Portfolio Yield	17%	15%	14%	12%	15%	12%	16%	12%	14%
Financial Self-Sufficiency	118%	135%	114%	113%	150%	120%	122%	124%	107%

Table 2. Profitability and Sustainability Indicators

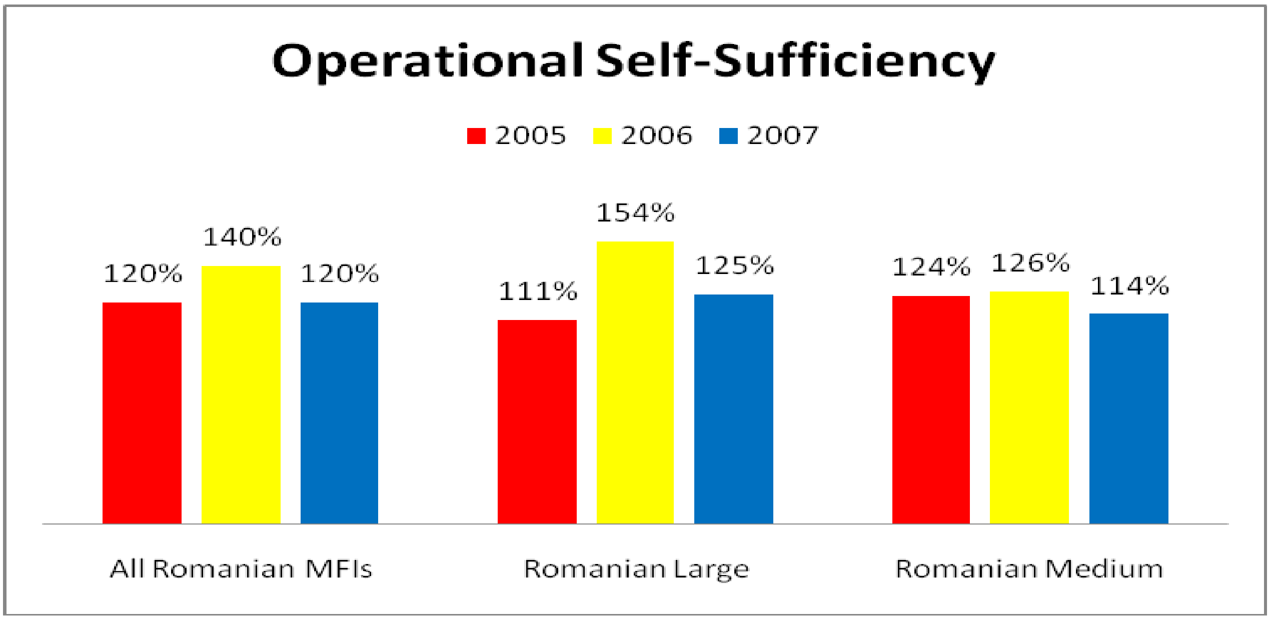

Figure 4. Operational Self-Sufficiency

Operational self sufficiency calculated above is defined as the point at which the MFI can meet the operational cost with the operational income. This is interest earned from the operational loan portfolio. In the table 3 above the average operational self-sufficiency for all Romanian MFIs, as well as for its two peer groups, is greater than 100. Thus, at present, the 7 Romanian MFIs analyzed, are self-sufficient, covering their administrative costs with client revenues.

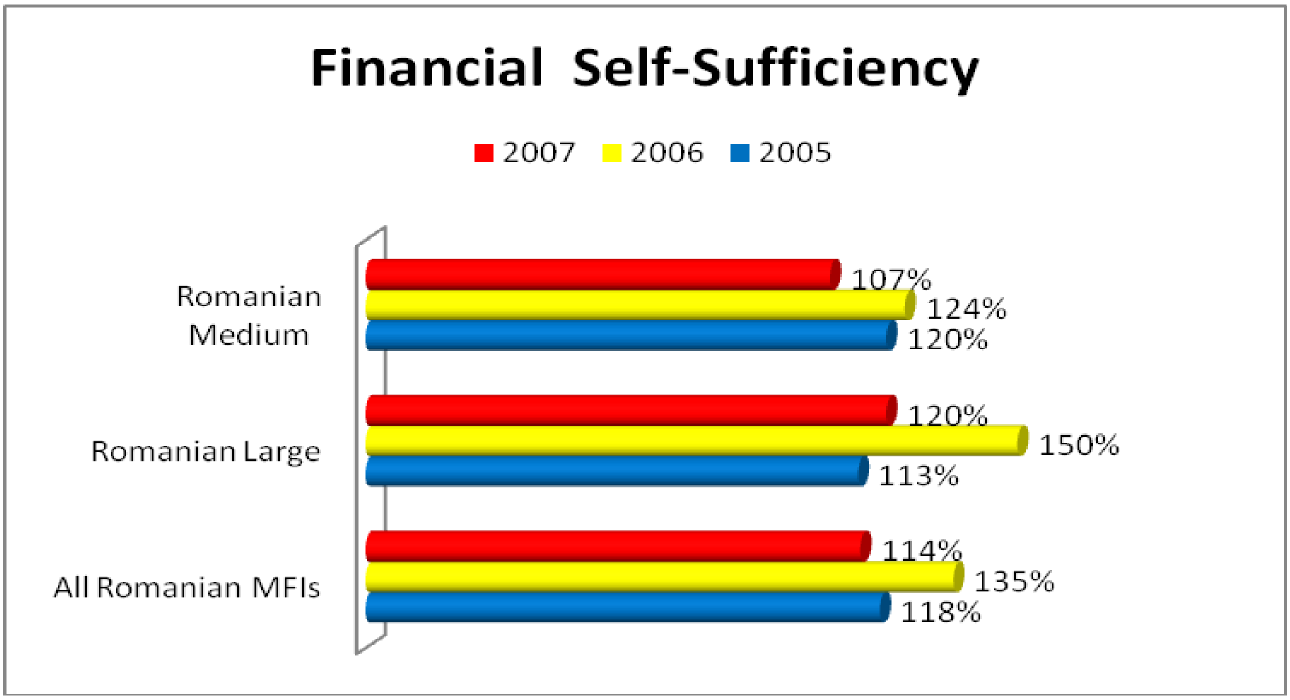

Figure 5. Financial Self-Sufficiency

An institution that is financial self-sufficient has enough revenue to pay for all administrative costs, loan losses, potential losses and funds costs. As is the case of operational self-sufficiency, all Romanian MFIs can be considered financially self-sustainable; revenues are greater than their costs.

Financial self-sufficiency translates into the ability of an MFI to operate at a certain level of profitability that allows it to provide quality services with no dependence on donor inputs. Being financially self-sustainable is essential for the Romanian MFIs as the donor funds are becoming less available. As such, they will need to continue shifting to a more commercial orientation, which will allow them to support their activity and further develop from these commercial funding sources.

III. Financial structure

FINANCIAL STRUCTURE INDICATORS	**All Romanian MFIs**		**Romanian Large**		**Romanian Medium**	
	2007	**2006**	**2007**	**2006**	**2007**	**2006**
Debt/ Equity Ratio	320%	293%	488%	539%	260%	236%
Commercial Funding Liabilities Ratio	60%	54%	59%	64%	61%	153%

Table 3. Financial Structure Indicators

One of the key challenges that Romanian MFIs have to face is the increase of their lending base in order to serve the high client demand for financing. The chart below offers a fair picture of the situation in the market. Large MFIs, that already have a significant capital base, are attractive to investors and/or lenders as they are seen as stable and mature institutions. That is why their debt to equity ratio is very high compared to medium and small MFIs. On the other hand, small MFIs need funds in order to grow and serve their clients, but their small size makes it difficult to attract new funds.

The high debt ratio of the Romanian microfinance sector requires equity or quasi-equity investment. For the large MFIs, equity investments are the basis upon which they transform into micro finance banks. It is a strategy that is worth following.

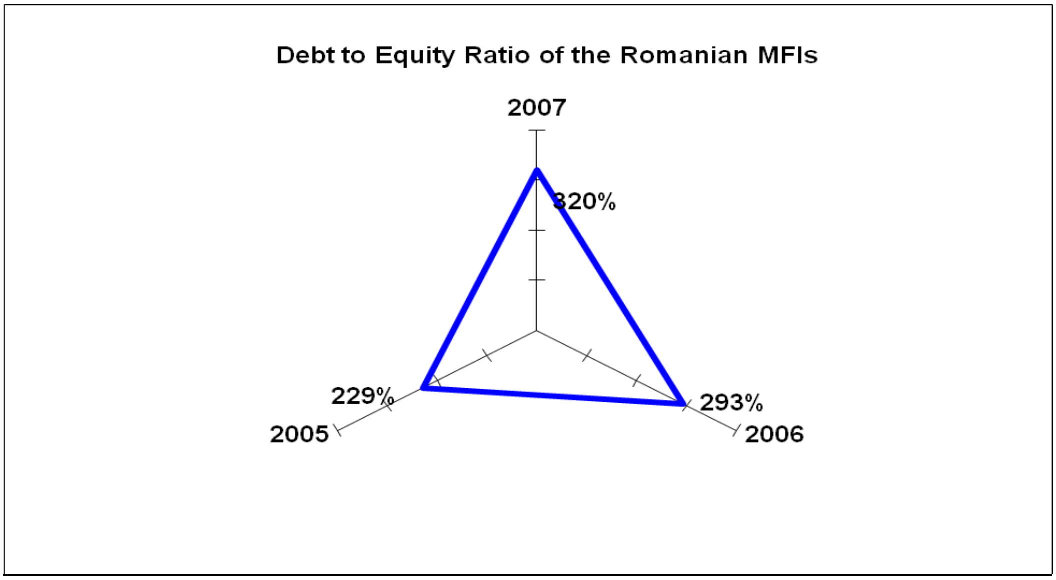

Figure 6. Debt to Equity Ratio

VI. Efficiency and Productivity

EFFICIENCY AND PRODUCTIVITY INDICATORS	All Romanian MFIs		Romanian Large		Romanian Medium	
	2007	**2006**	**2007**	**2006**	**2007**	**2006**
Cost per Borrower	558	386	444	397	711	337
Rapidity of service	4	6	3	5	5	5
Staff productivity	133	140	137	136	128	203

Table 4. Efficiency and Productivity Indicators

In terms of efficiency and productivity, Romanian MFIs are focused on reducing their costs and thereby maximizing their profits. As it can be seen from the chart above, in 2007, the average staff productivity per MFI was 133 loans/loan officers, a high number for individual lending methodology. High staff productivity was registered by the medium-sized MFIs that are maintaining the current base of clients focusing their attention on diversifying the range of financial products offered.

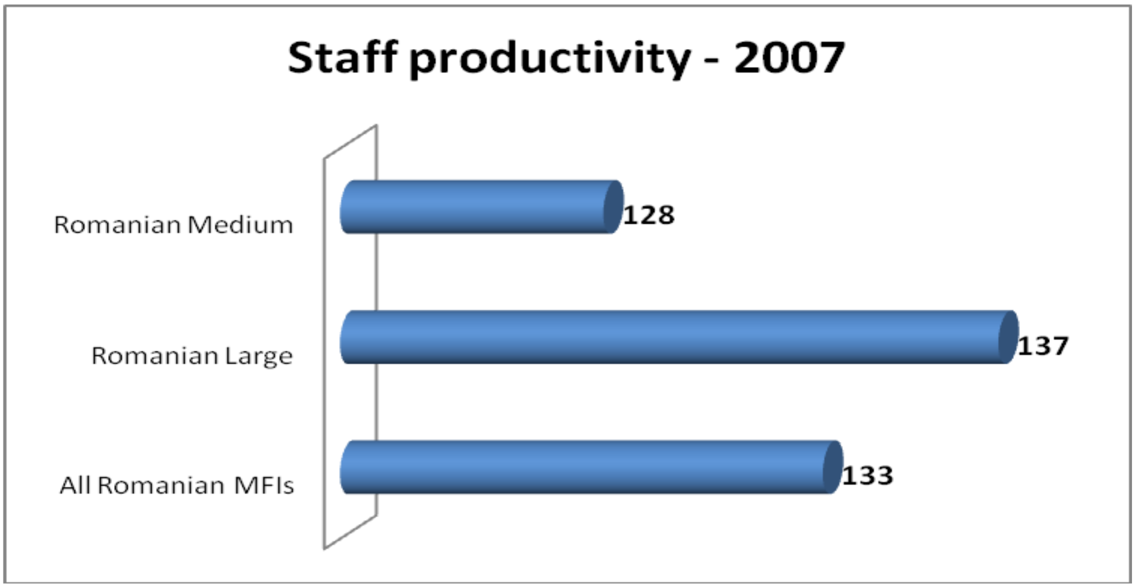

Figure 7. Staff productivity 2006

V. Portfolio Quality

PORTFOLIO QUALITY INDICATORS	All Romanian MFIs		Romanian Large		Romanian Medium	
	2007	**2006**	**2007**	**2006**	**2007**	**2006**
Portfolio at Risk (> 90 days)	1,70%	1,01%	1,44%	0,55%	2,0%	1,39%
Write-off ratio	0,4%	0,17%	0.65%	0,14%	0,08%	0,16%

Table 5. Portfolio Quality Indicators

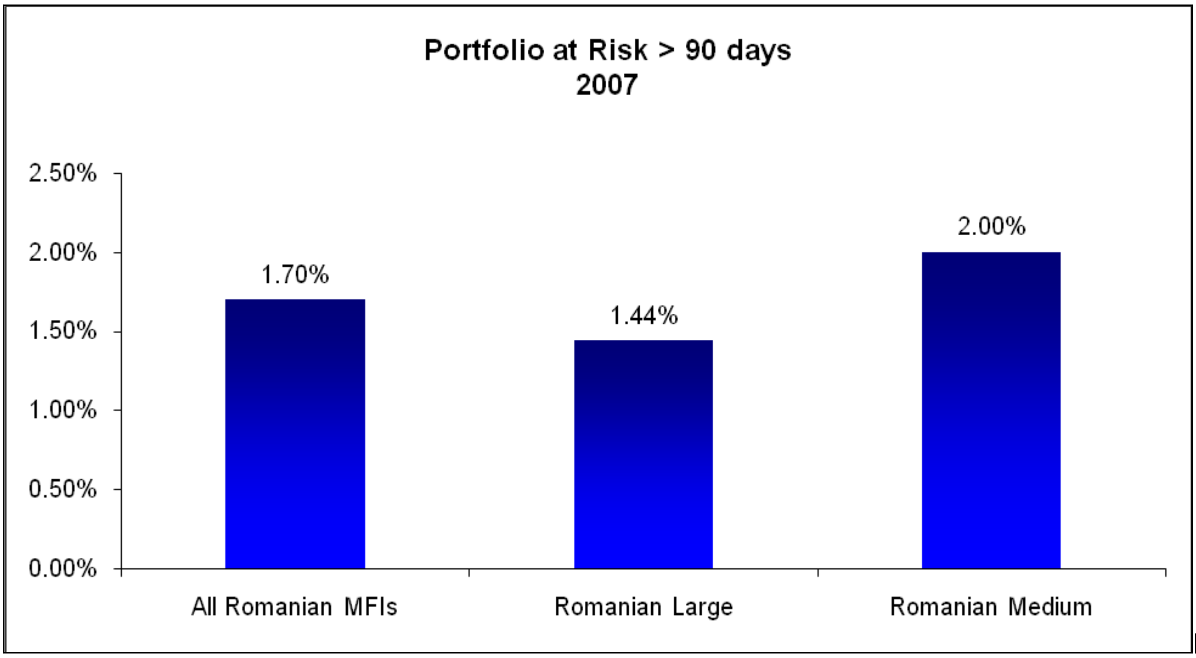

Figure 8. Portfolio at Risk > 90 days, 2007

The Romanian MFIs also pay special attention to the quality of their portfolios. In 2007, the average write-off ratio at sector level was 0.4%, a very small number of loans written-off.

In terms of portfolio at risk, it can be seen from the figure 8 above, that the highest value of the PAR > 90 days, was registered by the medium MFIs. That is due to the social orientation of these institutions that sometimes face more problems in the repayment of loans that the large MFIs do.

Conclusions

What differentiates the microfinance sector from the banking sector is the social orientation of the microfinance institutions as well as the development and inclusion approach of microfinance organizations' lending activities.

The micro-entrepreneurs and start-up enterprises are not classically bankable, even if their need for financial services is not sophisticated. However, for traditional commercial banks the cost involved by the underwriting of loans for these types of enterprises is too high. Therefore, the banks, even the so called SMEs banks, are targeting small and medium enterprises with a good credit history, considered less risky than the start–ups and micro-enterprises.

Due to the new legal framework in Romania, the microfinance sector is divided into distinct segments. The first is a mature one, efficient, operationally and financially self–sufficient and attractive to investors in the sector. The second is composed of a large number of new MFIs, registered or in process of registration. They are immature and need specialized technical assistance and training in order to successfully integrate into the sector, and thereby, contribute to its achievements.

It seems that the commercialization strategy pursued by most of the MFIs in 2004 is beginning to pay off. The development of the sector measured in terms of geographical outreach, increased efficiency, productivity and profitability, are good indicators that the strategy adopted by these MFIs is working. However, faced with the need to be more and more profitable, a large number of MFIs are struggling to maintain their social orientation.

Additionally, after Romania's accession to the European Union, the sector is facing new challenges. There is an increased demand for financial services from the MSE sector. This is demonstrated through the estimated unmet demand for 2007 which is projected at over €700 million. Given the MFIs fragile capital base, finding sources of equity and quasi equity investments, in order to stabilize the mature large and medium MFIs, was the main priority of 2007. Several new investors were providing financial resources and existing funders converted the loans into equity.

The supervision of the National Bank of Romania increased the operational costs and forced the MFIs to invest in new and more sophisticated Management Information Systems and to train their staff in reporting. As a consequence, at the end of 2007 the first Romania MFI handled over the license and stopped the crediting activity.

The achievement of the triple bottom line, through a continuous improvement of the quality of services provided to targeted clients, social responsibility towards the staff, clients, community and environment is the challenge that makes the Romanian microfinance sector become European.

Maria Doiciu – Senior Consultant on SMEs Development and Micro-finance

Diana Bialus – Consultant on Micro-finance