Benchmarking Microfinance in Romania
2008 - 2009

A report from Eurom Consultancy & Studies for European Microfinance Network’s Microfinance Conference - London, UK 2010
Table of Contents

Overview of benchmarking and performance measurement ............................... 4
Purpose of benchmarking microfinance in Romania 2008 - 2009 ......................... 5
Romanian Microfinance Sector Segmentation ................................................. 6
   Institutional type: legal structure of the MFIs ........................................... 6
   MFIs mission, targeted market and service offered ...................................... 6
   MFI fund size and maturity ........................................................................ 7
I. Scale and Outreach indicators ...................................................................... 9
II. Profitability and Sustainability ................................................................... 9
III. Financial structure .................................................................................... 11
IV. Efficiency and Productivity ....................................................................... 12
V. Portfolio Quality .......................................................................................... 12
Crisis Impact as Perceived by the Romanian MFIs .......................................... 13
Conclusions ..................................................................................................... 14

Maria Doiciu
Senior Consultant on SMEs Development and Micro-finance

Diana Bialus
Consultant on Micro-finance

Edited by:

Andrei Ganci
Analyst, Eurom Consultancy & Studies

We would like to show our gratitude towards the representatives of Aurora IFN, Credit Unions National Union (UNCAR), Express Finance IFN, FAER IFN, Fair Credit House IFN, Good.bee IFN, LAM IFN, OMRO IFN, Patria Bank, ROMCOM IFN, for their contribution to the survey that made the creation of this report possible.
Benchmarking Microfinance in Romania 2008 - 2009

Overview of benchmarking and performance measurement

Microfinance activities in Romania started more than fifteen years ago when the first Microfinance Institution (MFI) launched its program for the financing of micro, small and medium-sized enterprises in Romania.

Within the last years (2003 - 2009), the sector evolved rapidly. It has become more efficient and productive in achieving its mission of providing support and services to the entrepreneurs that didn’t benefit from such support.

The regulatory framework is following the fast pace of changes experienced by the sector:

- The Credit Unions law no. 266 (2006) regulates the Credit Unions and their national apex structure: CUs National Union (UNCAR).
- The Non-Bank Financial Institutions law, no. 93/2009, adopted by the Romanian Parliament in May 2009 is the current legal framework for all financial activities developed by leasing, mortgage, consumer credit, and microfinance non-bank financial institutions. The National Bank of Romania is the supervisory authority of all Non-Bank Financial Institutions (NBFIs).
- Law 93/2009 is the main legal document setting forth the principles under which non-bank financial institutions should conduct their activity, as follows:
  - Defines the minimum capital requirements for non-bank financial institutions to develop micro-credit activities: EUR 200,000;
  - Establishes the specific environment for the organization and functioning of Non-Bank Financial Institutions: no interest caps, no deposits, transparency in setting costs, client protection etc.;
  - Defines the criteria based on which Non-Bank Financial Institutions should be monitored and supervised by the National Bank of Romania.
- The activity of the Microfinance Companies is recognized as part of Romanian financial sector, the legal framework that supports its development and 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, which licenses the MFIs and registers them based on the value of their portfolio into two registers: General Register for the MFIs with a portfolio lower than EUR 5 mil and the Special Register for the MFIs with a portfolio larger than EUR 5 mil.
- The regulatory framework and the reporting requirements for the large MFIs are closer to the regulatory framework of the banks. This procedure enables them to become more competitive, as credit unions and certain banks continue to down-scale and develop microfinance products, and to pursue the transformation into a microfinance bank (CAPA Finance transformation into Patria Bank).

Besides the first seventh Microfinance Institutions established with the support of international donors, around fifty new Microfinance Companies established under the new legal framework are registered and licensed with the National Bank of Romania.

Purpose of benchmarking microfinance in Romania 2008 - 2009

This document is the fourth 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 economic and financial crisis on the microfinance sector’s performance;
- To build the capacity of microfinance professionals in calculating and interpreting relevant performance indicators for their microfinance institution;
- To apply the European Microfinance Network’s microfinance benchmarking tool developed by the EMN Research Working Group to the Romanian MFIs in order to allow the comparison of the Romanian MF sector with the EU MF indicators.
- 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 – London, UK in June 2010.

By learning more about the current scale and nature of Romanian microfinance institutions, including their performance and impact, as well as the influence of the financial crisis on the sector development, we are in a better position to identify and meet the needs of the sector and help them achieve the above mentioned objectives.

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.
The main result of the study is the measurement of the microfinance 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 the difficult social and economic context of 2009 and 2010.

For the purposes of this survey, we define microloans as loans of EUR 25,000 or less, to self-employed entrepreneurs or start-ups or for the further development of a microenterprise, that are intended to promote the borrowers’ levels of financial and social inclusion. Self-employed (SE), individual enterprise (IE) or Family enterprise (FE) are legal forms for registration for individual/family businesses. Microenterprises are business with nine or fewer employees, assets and annual turnover lower than EUR 2 mil.

**Romanian Microfinance Sector Segmentation**

Microfinance institutions (MFIs) share a common purpose: to provide access to finance of less than EUR 25,000. These loans or other financial products (except savings) are, in addition to other financial services, for 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 MFI development and practices, leading to very diverse performance figures. There are a number of key factors bringing 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 individual 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. 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. CAPA Finance initiated the transformation process into a microcredit bank.

**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 rural microenterprises and farmers (FAER and 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 the institution’s financial and social performance.

Therefore, the Romanian MFIs were segmented into three categories: social oriented, social and commercial oriented and commercial oriented (see Figure 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, over fifty new MFIs, some of them with significant resources, registered over the past two years. Therefore, the sector is divided into new and mature MFIs.

The older MFIs have a fully developed micro-lending methodology, internal mechanisms and controls, and are able to develop new ones when required. Provision of credits larger than EUR 25,000 requires a new know how to assess the credit worthiness of the borrowers and a different monitoring and controlling procedure.
The Romanian MFIs were segmented as follows:

- 11 MFIs including the Credit Unions apex structure took part in the survey. They are all registered as NBIs and one of them, CAPA Finance, is in the process of transformation to a Microcredit Bank: Patria Credit.
- 7 mature MFIs: Patria Credit, Express Finance, good.bee Romania, Opportunity Microcredit Romania, FAER, ROMCOM and LAM with more than 10 years of operations, operationally sustainable and historically more socially oriented, serving underserved entrepreneurs located in rural and peri-urban areas.
- 3 new MFIs with less than 5 years of operations: Aurora Credit, Fair Credit House and TOMIS, registered since the enforcement of the new legal framework for non-bank financial services, more commercial, serving mainly clients from urban and peri-urban areas.
- The Credit Unions apex structure UNCAR, with less than 10% of the portfolio related to micro-credits that funded Aurora in order to increase their operation in microfinance.

A core set of performance indicators, developed across Eastern and Western Europe was used in order to enable both practitioners and stakeholders to compare and contrast performance across the continent. The performance framework comprises a bundle of transparent and transferable indicators and principles.

The study includes eleven MFIs, most of them with more than sixteen years of activity: CAPA Finance (in transformation into a micro-credit bank), Express Finance (formerly CHF International Romania), Opportunity Microfinance Romania (OMRO), ROMCOM, LAM, FAER, good.bee Romania (formerly Centre for Economic Development (CDE) Foundation), Aurora, FAIR Credit House and UNCAR.

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

The performance indicators were calculated based on the data collected through a survey shared early this year with the participating MFIs. Additional data that was not available from the survey results was taken from the “Benchmarking MF in Romania 2006 - 2007” brochure and Mix Market website. A color scheme has been used in order to indicate the source of the data as follows:

### 1. Benchmarking MFI in Romania 2006-2007

**Table 1. Scale and Outreach Indicators**

<table>
<thead>
<tr>
<th></th>
<th>All</th>
<th>Large</th>
<th>Medium &amp; Small</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number active borrowers</td>
<td>2,399</td>
<td>2,220</td>
<td>1685</td>
</tr>
<tr>
<td>Gross loan portfolio</td>
<td>8,480</td>
<td>7,468</td>
<td>5,660</td>
</tr>
<tr>
<td>% targeted clients</td>
<td>80%</td>
<td>n.a.</td>
<td>84%</td>
</tr>
<tr>
<td>Number active loans</td>
<td>2,496</td>
<td>1,599</td>
<td>402</td>
</tr>
<tr>
<td>Average disbursed loan amount</td>
<td>7,551</td>
<td>n.a.</td>
<td>7,681</td>
</tr>
</tbody>
</table>

I. Scale and Outreach indicators

In 2009, compared to previous two years, the Romanian Microfinance sector experienced a significant contraction in terms of number of borrowers and loans as a direct result of the economic and financial crisis. As the first reaction to the changes in the economic environment most of the MFIs became more risk adverse and restrained the credit activity, while focusing on the recovery of non-performing loan. At the same time, when the first shock of the liquidity crisis passed, as the microfinance organizations were planning to restart lending, the market demand significantly dropped as the business owners perceive the future as too uncertain to launch new investments in their activity.

In terms of number of active loans, the figures at the end of 2009 also show an important drop compared to previous year. For the large MFIs the drop is approximately 30% showing the high impact the crisis had on these institutions compared to medium and small MFIs for which the decrease was about 40%. An important aspect to note is the average disbursed loan amount which increased in 2009, compared to 2007 for large MFIs. An explanation may be that these MFIs, which were historically more socially oriented, in their effort to reduce operating costs in response to the crisis, preferred to focus on larger loans for which they could do a more thorough analysis.

The gross loan portfolio also decreased for all types of microfinance institutions as most of them reduced lending and tried to consolidate their portfolios. At the same time, the financing available for MFIs reduced.

II. Profitability and Sustainability

The profitability and sustainability indicators have also been affected by the liquidity crisis which reached its peak in 2008. At the end of 2008, the Romanian MFIs, as a whole, were self-sufficient from an operational point of view. The crisis however determined a decrease in the interest earned from the operational portfolio, in particular for the large MFIs. At the end of last year, most medium and small MFIs were operationally self-sufficient.

1 The MFIs did not report on the average disbursed loan amount for 2008.
Table 2. Profitability and Sustainability Indicators

<table>
<thead>
<tr>
<th></th>
<th>All 2007</th>
<th>Large 2007</th>
<th>Medium &amp; Small 2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operational self-sufficiency</td>
<td>120%</td>
<td>125%</td>
<td>n.a.</td>
</tr>
<tr>
<td>ROE</td>
<td>0.65%</td>
<td>-3.21%</td>
<td>-4.36%</td>
</tr>
<tr>
<td>ROA</td>
<td>-1.4%</td>
<td>-0.22%</td>
<td>0.45%</td>
</tr>
</tbody>
</table>

Figure 4. Return on Assets

If we look at the main profitability indicators, that is Return on Equity and Return on Assets, we see that most impacted were the large MFIs who had a less focused approach in terms of the target segment and which, in a growing environment, took a higher risk by lending either to business sectors that they did not know enough or by creating concentrations in the portfolio (such as excessive lending to the construction or transportation businesses) which later led to significant increases in the portfolio at risk and determined a decrease in the return as well. It is important to notice that the small MFIs, after a slight drop in profitability in 2008, they experienced an important growth over the last year as they were able to maintain a healthy portfolio and extend new loans.

If previous initiatives to benchmark the Romanian microfinance sector have shown that one of the key challenges that Romanian MFIs had to face was the increase of their lending base in order to serve the high client demand for financing. In 2008 the level on indebtedness of the Romanian MFIs continued to grow, in particular for the large MFIs whose leverage had reached almost 7 times the value of their capital. In 2009, the decrease in the value of financing available for the MFIs as well the decreased demand for microloans determined a drop in the debt to equity ratio which reached lower levels than those in 2007.

As it can be seen from Figure 6 below, in 2008 the level on indebtedness of the Romanian MFIs continued to grow, in particular for the large MFIs whose leverage had reached...
Most of the performance indicators analyzed in the previous sections demonstrate a significant impact of the economic and financial crisis on the Romanian MFIs. The two charts below aim at showing the internal perception of the MFIs on the impact of the crisis on their operations, but also on their clients.

As it can be seen from Figure 9, all the MFIs that participated in the survey believe that the new economic setting caused a decrease in the number of loans approved, which can be explained in two ways. Firstly, there is an internal reason, which also noted as the second most important effect of the economic downturn, the increase in the delinquency and which let many MFIs to restraining their activity and becoming more risk adverse, thus approving a small number of loans. Secondly, the current economic situation made many microentrepreneurs less willing to take a loan and develop their activity which again reduced the number of new loan applications for the MFIs.

Table 5 provides a fair image of the impact of the crisis on the Romanian MFIs. The level of delinquency has constantly increased for large MFIs over the past two years. The medium and small MFIs recorded a slight drop in the PAR > 30 days in 2008, but at the end of 2009 their delinquency over 30 days reached 12%.

Nevertheless, it must be mentioned that the PAR > 30 days may not provide an image as accurate as the PAR > 90 days. In many cases the microentrepreneurs, in particular those in rural areas tend to pay with a delay of several days each month, depending on the day in which they cash their receivables. This argument is also supported by the low levels of write-off ratio.

In terms of impact on MFI clients, the most important effect is the decrease in liquidity, which influenced the microentrepreneurs in various ways. Those that had a loan were faced with problems in keeping the loan repayment schedule which, as mentioned above, caused a significant increase in the level of delinquency for most MFIs. The microentrepreneurs that did not have a loan before, but which were now confronted with liquidity problems, wanted...
to access a loan, however the lending conditions had become stricter.

Finally, the businesses who managed to maintain a healthy financial standing became more prudent and limited their investments and thus were less interested in accessing a microloan. In addition to the more prudent approach of MFI, also most banks considerably reduced the financing of micro-businesses and SMEs. Thus in order to avoid a blockage in the operation of the micro and SME sector, it is important that MFIs build their internal capacity in order to be able to correctly identify and assess businesses with potential and which can sustain their activity even in the current challenging and uncertain economic setting.

The Romanian microfinance sector is much more integrated in the country’s financial system and therefore affected by the crisis directly through limited and more expensive access to financial resources and indirectly through the decreasing number of clients.

There are clients-farmers in rural areas that are relatively isolated from the economic and financial cycles, but they are proportionally less than in other regions. Also, as it has already been highlighted, microfinance in Romania has a high proportion of clients in urban and peri-urban regions.

Even if there are some few cases of MFIs which offer exclusively credits to the rural population (this is the case of FAER and LAM in Romania), generally MFI clients in Romania and Eastern Europe are more linked to the mainstream systems, and thus impacted by the crisis especially in terms of access to financial resources and liquidity, than completely isolated microfinance clients of Asia or Africa.

The commercialization strategy pursued by most of the MFIs in 2004 lead the development of the sector measured in terms of geographical outreach, increased efficiency, productivity and profitability, but in the same time increased the debt/to equity ratio and their dependency on external financial resources. However, faced with the need to be more and more profitable, the large MFIs are developing new financial products targeting the small companies, exceeding the value of the micro-credit (EUR 25,000), struggling to train the personnel and redesign the application appraisal system and the monitoring procedures.

MFIs with a medium portfolio (up to EUR 5 mil) were less affected by the crisis due to their moderate growth and consistent outreach strategy, as well as good control of the costs and a lower debt to equity ratio.

Good relationship with the clients and communities (rural) they invest in and adequate appraisal and monitoring procedures are elements that contribute to lower the impact of the crisis. MFIs with large portfolios (up to EUR 20 mil) were more affected by the crisis mainly due to their ambitious geographical growth and change in the targeted beneficiaries, without proper testing of the new financial products and proper training of personnel.

Various cooping strategies are tested; the most successful ones are related to the reconsideration of the growth strategies, development of real partnership with investors / lenders and improved relationship with the clients and communities / associations, as well as the introduction of new risk management techniques such as early warning systems for delinquency, cost control and the exchange rate risk mitigation.

The current financial and economic crisis increased the number of challenges that the Romanian MFIs have to face. In their efforts to achieve a triple bottom line through continuous improvement of the quality of the services provided to targeted clients, social responsibility towards the staff, clients, community and environment, the MFIs have to surpass many difficulties. Nonetheless, this is part of the process that makes the Romanian microfinance sector become European.