



CROATIAN CHALLENGES WITH MICROFINANCE

Modest development
with a lot of potential
Piotr Korynski



ACCESS TO FINANCE

Regional Comparison

Access to Finance: Croatia

- Banks are well developed and financial services are available, but many people and micro/small businesses are not adequately served:
 - Consumer loans are widely available
 - Payment services exist and are used but ...
 - Working capital loans and other types of finance for business investment are still difficult even for more established smaller businesses.

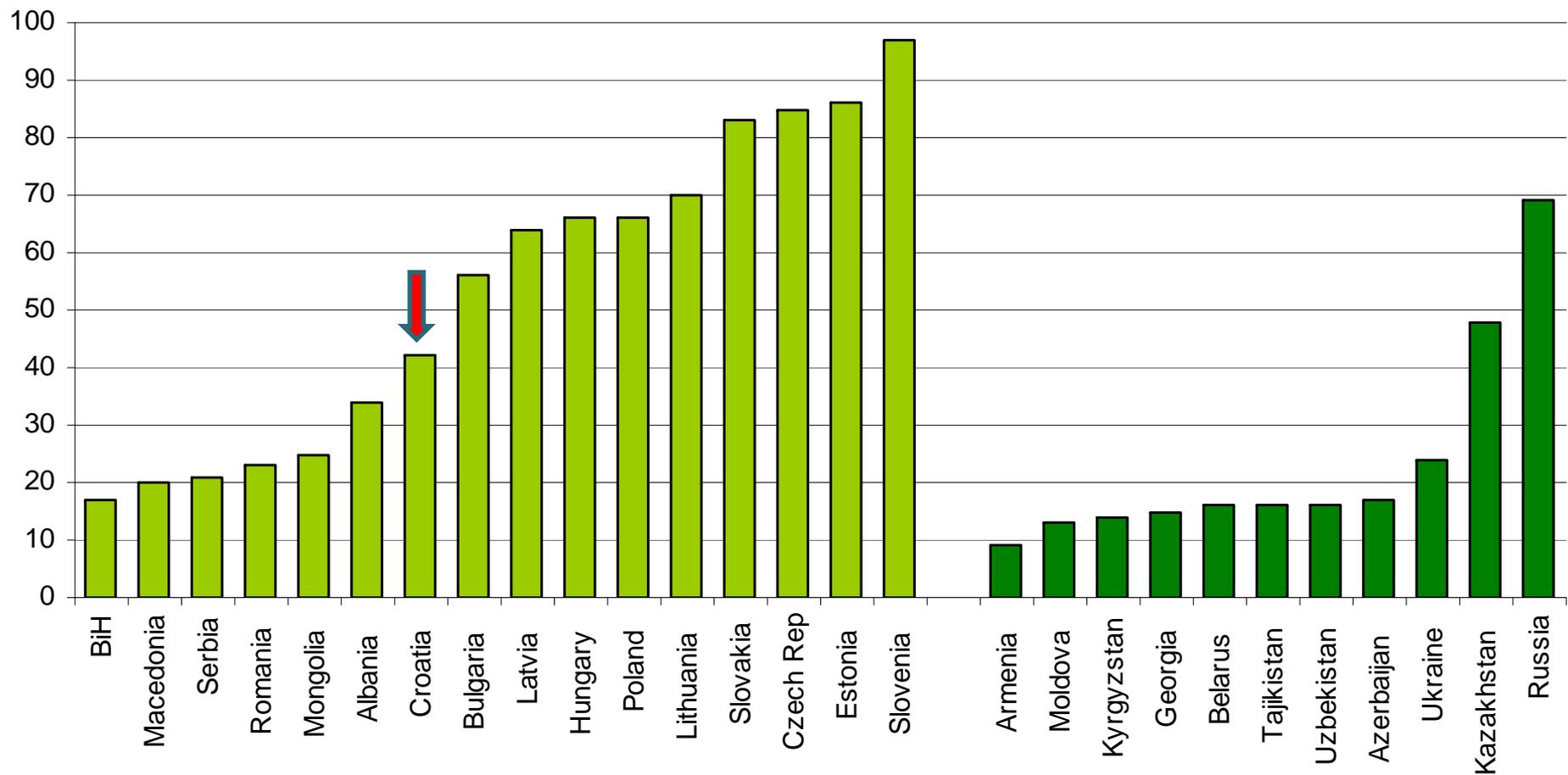
Composite Measure Access to Financial Services

	Percent with access
CEE/SEE	
Slovenia	97
Estonia	86
Czech Republic	85
Lithuania	70
Hungary	66
Poland	66
Latvia	64
Bulgaria	56
Croatia	42
Albania	34
Romania	23
Macedonia, FYR	20
Bosnia and Herzegovina	17

Note: The composite indicator measures the percentage of the adult population with access to an account with a financial intermediary. Data for Finance for All, The World Bank, 2008.

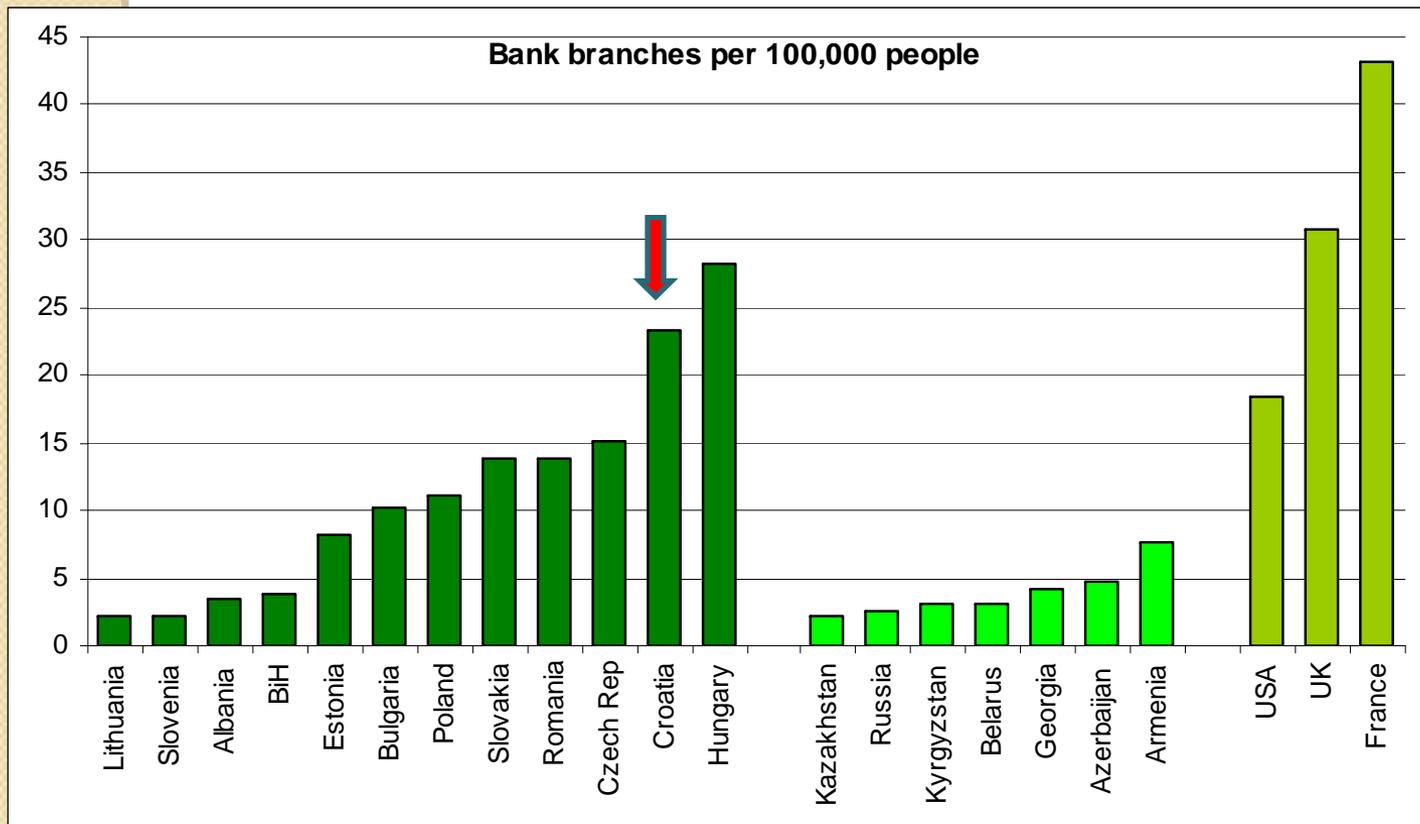
Use of Financial Services

Share of the population with an account in a financial intermediary



Access to Banking Services

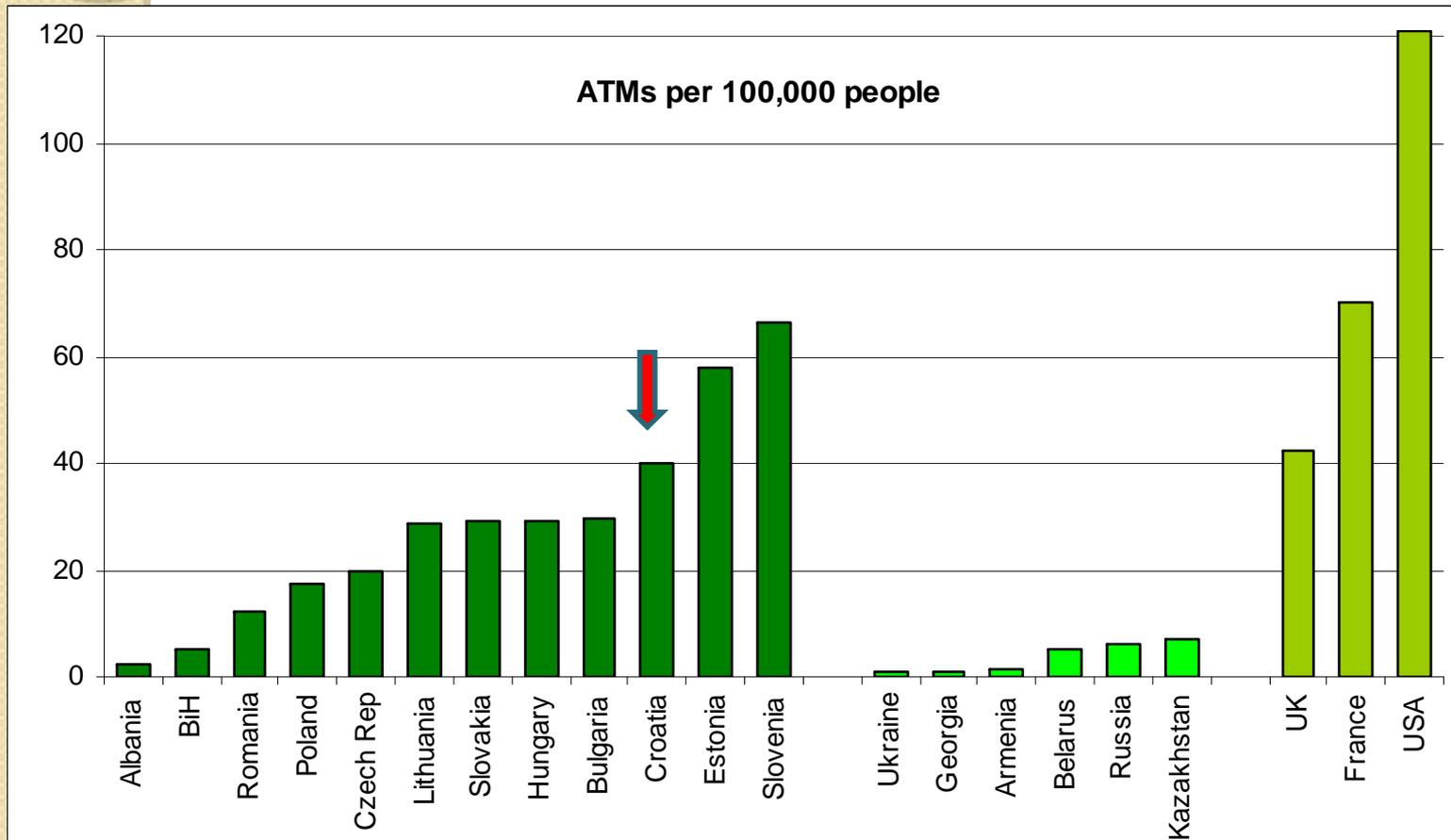
According to the World Bank study 'Finance for All' bank networks in the transition countries of CEE and NIS are still less developed compared to the West



data as of 2003

Access to Banking Services

ATM networks are still underdeveloped





MICROFINANCE IN CROATIA

Big Picture View and Key Challenges

Microfinance: General Comments

- Croatia has been neither pro-active nor very supportive of microfinance
 - Over-reliance on banks for provision of financial services in the lower end market
 - Four types of microfinance activities
 - Legacy credit and savings cooperatives
 - New type Microfinance Institutions supported by foreign donors
 - Government special programs through banks
 - Bank initiated microcredit/SME loans

Credit and Savings Cooperatives

- Legacy institutions
- Most prevalent financial institution in Croatia (120+ in the heyday)
- Did not adopt to the new market conditions, many not transparent and violating the mission of a cooperative
- New law on credit unions eliminated most of them
- New credit union institutions operate on a much more restrictive basis making it difficult to operate on a sustainable basis

MFI's

- Organized as credit and savings per force as the only available legal form for a non-profit microfinance institution in Croatia
 - NOA
 - DEMOS
 - MikroPlus
- Never acted as true financial intermediaries, minimally taking deposits

MFIs – Harsh Treatment

- MFIs worked in difficult conditions and did not get a favorable treatment:
 - NOA forced to pay a sizeable **tax** on a foreign grant, which reduced the institution's capital base
 - MikroPlus lost in their efforts to adopt a more appropriate **legal** framework, and closed down
 - DEMOS refused to **transform** into a savings bank (after the introduction of the new credit union law), now in bankruptcy
- MFIs almost completely eliminated

Special Programs

- Numerous special programs, on and off, to stimulate lending to micro and small businesses through commercial banks
- Features:
 - **Cheap** credit @ below market rates (often 2-3%)
 - However credit **very expensive** in terms of non-price costs (mandatory pre-borrowing training, business plan, collateral requirements, lengthy procedures, etc.)
- Did not build capacity to lend and to adopt appropriate technologies and products for MSME

Questions ... I

- **Is there a need for microfinance in Croatia?**
 - Population: 4,500,000 or 1,115,000 households
 - 50% micro/small businesses = 562,500
 - 30% have access to financing, the remaining 20% = 112,000 micro/small businesses unserved
 - 25% will be approved for a loan = **28,125** MSMEs
- At the peak, MFIs had 3,900 clients or 14% of the market
- **Unserved market = 86%**

86% - ?

- Not all enterprises go without funding but ...
 - Lower capitalization of businesses
 - More expensive funding must be secured from somewhere else, therefore higher costs
 - Lower efficiency
 - Missed opportunities
 - Lower economic growth
- 28,125 clients ...
 - Enough clients for two microfinance institutions like Besa Fund

Unemployed/Underemployed

- Estimated 300,000 (?) unemployed
 - 5% can potentially become self-employed = **15,000**
 - Need start-up capital and additional funding for working capital
 - Package:
 - Training/counseling
 - Capital
 - An opportunity for collaboration between employment services and microfinance

Questions ...2

- **What capacity is needed to address the market demand and fill in the unserved segments?**
 - If isolated niches and segments: special programs and initiatives may be sufficient
 - If the need and demand is **widespread and deep**, a more systematic approach is warranted, requiring institution building and financial deepening

Questions ...3

- **What kind of microfinance is most appropriate for Croatia?**
 - Legal forms:
 - Credit unions
 - Non-banking financial institutions
 - Bank-based models
 - Special projects
 - Financing?
 - Policy/government role?

This or Something Else?





Recommendations and Steps Forward

Capture the Benefits of Microfinance for Croatia

- Status
 - Modest but not very successful experience in microfinance in Croatia
 - Ambiguous approach of regulators and policy makers
 - Larger potential benefits from expanding access to finance
- Recommendation
 - Establish policy consensus and ground rules, including regulatory framework as necessary for advancing microfinance in Croatia
 - **'White Paper on Microfinance in Croatia'** for the Prime Minister developed by the Advisory Group will include all stakeholders: banks, credit unions, Central Bank, government ministries, business associations, etc.
 - CEPOR and HBOR can provide meritorious support for this work
- Outcome
 - Enabling policies established responsive the needs of the country and aligned with international best practice, which will serve as guidance for government policy for the sector in the future

Create more favorable conditions for credit unions

○ Status

- New credit unions are severely constrained in their ability to provide financial services on a sustainable basis
 - Lack of connection with the payment system
 - Limited territorial constraint
 - Inability to receive deposits from non-members and participate in economic development programs

○ Recommendation

- Amend the credit union law to eliminate the key constraints for sustainability and growth
- Adopt a proportional approach to regulation and supervision relative to the risk and scope of operations of credit unions
- Develop a study on the strategic development of credit unions and their contribution to economic growth and well being of citizens

○ Outcome

- Pro-growth policies and regulations for credit unions as viable financial institutions for low and medium income individuals and small businesses

Review options for non-banking credit institutions

- **Status**

- Non-banking financial institutions are not allowed to provide microcredit and small business finance
- NBFIs can be very effective and efficient in MSME market segment

- **Recommendation**

- Analyze legal options for credit granting NBFIs taking into account relevant experience of other countries

- **Outcome**

- Draft legislation prepared for introducing NBFIs

Develop an incentive system for banks to engage in microfinance

- **Status**

- Banks can play a significant role in MSME finance
- Lack of consistent policy providing positive incentives for banks to engage in MSME finance

- **Recommendation**

- Analyze effective incentive systems internationally and develop proposal for systems

- **Outcome**

- Incentive system for banks developed for banks to engage in micro and small business lending

Why Banks Engage in MF?

- Own Initiative

- Mission (social banks)
- Short/longer term profitability through cross selling
- Relations with local communities
- Corporate Social Responsibility

- External Incentives

- Agents for governments/EU/donors/agencies
 - KfW
 - EBRD
 - HBOR
- Special requirements
 - Community Reinvestment Act (CRA) – USA
 - Target lending (India)

Bank Involvement - Models

- Commercial banks
- Community Banks (USA)
- Specialized Microfinance Banks
- 'Downscaling' banks
- Social Banks
- Savings Banks
- Bank partnership models

Revise/Redesign Microcredit Programs

- Status
 - Many programs that focus on lowering monetary costs but expensive otherwise
- Recommendation
 - Focus microcredit support programs on developing appropriate lending technologies at the lending institutions and simplifying non-price conditions
 - Support for bank who can demonstrate ability to work with the segment according to the specification of HBOR
- Outcome
 - Easier access to credit by MSMEs

Assess financing constraints of micro- and small businesses

• Status

- Micro and small businesses still face severe limitations in receiving finance
- These include difficult access to working capital and investments, unfavorable conditions in trade credit, lack of risk capital for growth and business expansion

• Recommendation

- Systematically review actual use and access to financing, potential needs of the segment and gaps
- Analyze costs and benefits for economic growth and competitiveness

• Outcome

- Measures of access and use of finance by MSME developed as a basis for economic policy and market development

Monitor access to finance and improve use of financial services

- **Status**

- Despite well developed banking system, use of financial services lags behind countries of similar bank sector development
- Increased access has tangible benefits for individuals and small businesses

- **Recommendation**

- Conduct a national review of access to and use of financial services in Croatia, including geographic maps of access and review of pro-access policies

- **Outcome**

- Evidence for pro-active access policies collected for policy formulation

Summary

