BANQUE DU CAIRE OF EGYPT: A STATE-OWNED RETAIL BANK CASE STUDY

USAID AMAP FINANCIAL SERVICES KNOWLEDGE GENERATION—
STATE-OWNED RETAIL BANKS IN RURAL AND MICROFINANCE MARKETS

microREPORT #59

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ACRONYMS AND ABBREVIATIONS

ABA	Alexandria Business Association
ACSI	Amhara Credit and Savings Institution
AMAP	Accelerated Microenterprise Advancement Project
AsBA	Assuit Businessmen's Association
ATM	automated teller machine
BdC	Banque du Caire
BM	Banque Misr
CBE	Central Bank of Egypt
CDA	community development association
CGAP	Consultant Group to Assist the Poor
CGC	Credit Guarantee Company
DBACD	Dakahleya Businessmen's Association for Community Development
EGP	Egyptian pound
EM	*El Mohassil*
EQI	Environmental Quality International
EU	European Union
FSKG	Financial Service Knowledge Generation
G&A	general and administrative
GDP	gross domestic product
IFC	International Finance Corporation
IMF	International Monetary Fund
IT	information technology
KfW	Kreditanstalt für Wiederaufbau
MENA	Middle East and North Africa
MF	microfinance
MFD	Microfinance Department (BdC)
MFI	microfinance institution
MIS	management information system
MSMEs	micro, small, and medium-sized enterprises

NBD	National Bank for Development
NCBA	National Cooperative Business Association
NDP	National Democratic Party
NGO	nongovernmental organization
NPA	National Postal Authority
NPM	National Product Manager
PAR	portfolio at risk
PBDAC	Principal Bank for Development and Agricultural Credit
PEP	Private Enterprise Partnership
SBACD	Sharkeya Businessmen Association for Community Development
SEB	Small and Emerging Businesses Project
SFD	Social Fund for Development
SME	small and medium-sized enterprise
SOE	state-owned enterprise
UNDP	United Nations Development Programme
USAID	United States Agency for International Development
USD	U.S. dollar

EXECUTIVE SUMMARY

The purpose of this case study is to highlight how Banque du Caire (BdC), a large state-owned bank in Egypt, has been successful in implementing and expanding its microlending program. BdC was selected for this series of case studies on state-owned retail banks (SORBs) providing microfinance based on the organization of its microfinance operations as an internal unit and the resulting rapid growth and reported low portfolio at risk (PAR). Its achievements are of particular interest given that it has been active in microlending for only five years and it operates in a country with a population of 71 million, an estimated 20 percent of which live in poverty. This case study is timely given BdC's pending merger with a larger state-owned bank, Banque Misr. The authors' intent is to document the strategy and implementation that led to BdC's success and to consider the future of its microfinance activities in the new merged entity (also to be called Banque Misr).

ABOUT BDC

BdC was founded in the 1950s and was nationalized shortly thereafter under the socialist policies of Egypt's first president, Gamal Abdal Nasser. For decades, BdC collected deposits from the public and lent them to the government and state-owned enterprises. BdC began to work more closely with private enterprises after liberalization of the Egyptian economy and the financial sector accelerated in the 1990s. The bank performed poorly and suffered large-scale defaults and high profile losses in the late 1990s. Concluding that BdC could not be privatized in its condition, the Ministry of Finance hired a team with private sector experience in 2000 to reform the bank under the leadership of a new Chairman, Ahmed Mounir El Bardei. He took over an institution that was rife with nonperforming loans, overstaffed, and inefficient. His task was to turn BdC into a competitive retail bank.

Also during the 1990s, the Egyptian microfinance sector began to develop supported by USAID/Egypt, which assisted a core group of microfinance institutions (MFIs), including business associations, nongovernmental organizations (NGOs), and a commercial bank. More important for BdC was the U.S. Agency for International Development's (USAID's) close partnership with a local consulting firm, Environmental Quality International (EQI), which USAID/Egypt helped build into the primary technical service provider for microfinance activities in Egypt.

In 2001, Mr. El Bardei's introduction to microfinance came from a personal contact, the President of EQI, who convinced the new Chairman that microfinance might be part of the solution to restructuring BdC. With the support of EQI and USAID/Egypt, the Chairman won the agreement of BdC's new Board of Directors to pilot a microlending program that was based on EQI's work with successful MFIs in Egypt. The program appealed to the Board because it saw labor-intensive microlending as a means to use excess branch staff for a productive purpose.

EQI managed the rollout of a pilot project (10 BdC branches and US$1.3 million) in 2001, which succeeded without any problems or defaults. Encouraged by the early results, the Board approved a full-scale rollout of the microloan product line to most of its 120 branches throughout Egypt (see Table 1).

TABLE 1: SUMMARY STATISTICS—BDC MICROFINANCE

	Jun-02	Jun-03	Jun-04	Jun-05	Nov-05[a]
Microloans Outstanding	13,428	38,046	63,426	81,878	86,666
Branches with Microlending	48	96	97	105[b]	112[b]
Gross Loan Portfolio ('000 USD)	4,634	8,816	19,784	29,043	32,659
Portfolio at Risk 30 days (%)	0.4	0.6	0.4	1.0	1.2
Average outstanding loan size (USD)	90.9	83.9	306	341	376
Portfolio Yield (%)	N/A	N/A	25.9	27.5	27.8
ROA (%)	N/A	N/A	-0.2%	4.3%	6.0%

Source: BdC reports.
[a] Represents a five-month period. Relevant ratios have been annualized.
[b] Includes microfinance units, 1 in FY05 and 5 in FY06, respectively.

BdC has surpassed all other Egyptian MFIs in active loans and gross loan portfolio, many of which have been operating for over a decade. It also reports portfolio at risk as low as or lower than most other MFIs in Egypt. BdC has achieved a dominant position in the large markets of Egypt's primary cities, Cairo and Alexandria, and has forced other MFIs to seek different market niches or lower interest rates. As a result, the yield and loan sizes of competitors have declined in recent years

The profitability of BdC's microfinance operations is difficult to determine. BdC's Microfinance Department began tracking its profitability in fiscal year 2003 (July 2002 to June 2003). It applies a shadow rate, the Central Bank of Egypt bank discount rate, to its entire loan portfolio to approximate cost of funds. It can accurately allocate the personnel costs of Supervisors and Loan Officers dedicated to microfinance, as well as staff the Microfinance Department in headquarters. However, it is unable to attribute fully the costs associated with using the branch network and other branch staff. Microfinance staff now account for 8 to 10 percent of all branch staff, which suggests that such an allocation of branch overhead would be significant. The author's estimates (based on cost allocations) suggest that BdC was not profitable in fiscal year 2005 or the years prior to that, although it may well reach breakeven in the coming year. With the completion of its rollout of microlending in all branches in 2004, BdC client and portfolio growth rates are slowing considerably.

ENVIRONMENT

Egypt is the Arab world's most populous country, despite its territory being 95 percent uninhabitable desert. As a result, Egypt has some of the most densely populated areas in the world and half of its population is considered urban. Most rural Egyptians are reachable by roads or public transport, and mobile phone and internet networks allows for regular exchange of information. The legacy of socialist economic policies is evident in Egypt's economy and society—the government contributes 40 percent of GDP and 25 percent of employment. Government employment exceeds that of the formal private sector (5.3 million compared to 5.1 million), and only recently has the estimate of the informal labor force (6.9 million) exceeded the number of government employees. Two other factors permeate society and affect Egypt's stability, namely President Mubarak and the Islamic fundamentalism in the form of the Muslim Brotherhood. These two forces interplay with the tension between rich and poor, urban and rural, religious, and secular.

Egypt has a relatively developed financial sector that continues to be dominated by four state-owned banks, including BdC and Banque Misr. Furthermore, the Government of Egypt, directly or indirectly, owns shares in some of Egypt's 23 private commercial banks. The government has committed to divesting itself of shares in commercial banks, but not necessarily all state-owned

banks. It is selling the Bank of Alexandria. But, the merger of BdC with Banque Misr suggests that the government has no intention to privatize the merged Banque Misr in the medium-term.

Islamic banking principals, which are structured to observe the Islamic prohibition on charging usury or interest, are still the exception in Egypt; most banks, including the state-owned banks, follow Western practices. Bank lending in Egypt relies on collateral or guarantees. In Egypt there is a high percentage of "dead collateral," which refers to assets to which the owner does not have clear title. Of the 62 banks in Egypt, only 3 have entered the microfinance market, including BdC, Banque Misr, and the first bank to pioneer microfinance, the National Bank for Development (NBD).

Currently, there is no separate law for microfinance in Egypt. Several existing laws—including the NGO law, the small and medium-sized enterprise (SME) law, the Companies Law, and the Banking Law—affect microfinance providers. Under the existing laws, the types of institutions that can legally offer some or all microfinance services in Egypt are banks, business associations, and NGOs.

MICROENTERPRISE MARKET

A 2004 law defines microenterprises as those with fewer than five employees and with less than EGP 50,000 ($9,500) paid-in capital. It defines small enterprises as those with between 5 and 49 employees and paid-in capital between EGP 50,000 and 1 million. There is no consensus on the size of the market. The frequently cited USAID/Egypt estimate of 2 million microenterprises (60 percent of Egypt's private nonagriculture labor force) is countered by some MFIs that believe the actual market to be much larger than that, perhaps including up to 4 million persons or more. This includes rural households with activities other than crop harvesting as well as "underemployed" civil servants with additional microenterprise activities.

BdC's market is microenterprises and its loan product, designed by EQI through USAID funding, was for this target market. The product design and BdC's branch locations are more likely to attract urban traders and service providers than productive or manufacturing enterprises.

PRODUCT OFFERING

BdC has a single product, an individual loan that increases in amount and tenor (loan term) over seven standard cycles. This product is nearly identical to the individual loan product offered by every other major MFI in Egypt, all of whom received technical assistance from EQI. It is safe to say that BdC's product has broad acceptance in the market that offers few other formal options.

Although BdC is a licensed bank, capable of accepting deposits, it has neither made an effort to encourage its microenterprise clients to open accounts nor attempted to cross-sell any other bank products. This appears to be a potential opportunity, as BdC's microlending operations are located within BdC's retail branches and have become increasingly integrated into the branches' daily business.

ORGANIZATIONAL STRUCTURE

BdC has decentralized operations that provide significant authority to Branch Managers. In setting up the microfinance program, there was little choice but to respect this authority and work through the branch managers to rollout the product—they needed branch staff to become Supervisors and Loan Officers. The Microfinance Department was not fully staffed until USAID technical assistance ended in 2004. At present, the Microfinance Department's 15 Team Leaders (also known as Area or Regional Managers) function as trainers, monitors, and trouble-shooters for microfinance staff. They

have responsibility to oversee the microfinance operations but do not directly manage them. The Team Leaders' authority lies in the value of their assistance and their access to the ear of the Microfinance Department's senior management at BdC's headquarters.

The placement of microfinance activities in the branches has not been without challenges. Microlending has its own staff, procedures, MIS system, and approval process, which coexist with the traditional branch operation. In the beginning, Branch Managers were reluctant to relinquish newly trained staff to microfinance and occasionally assigned the worst staff to the product. Other problems included inserting additional staff or procedures in an otherwise unencumbered process. Over time, Branch Managers have been won over by the success of the program. The microfinance portfolio accounts for a small portion of a typical branch's lending activity (around 10 percent) and an even smaller portion of its assets (1-2 percent). However, it is frequently the second largest source of revenue for many branches.

CRITICAL SUCCESS FACTORS

BdC's accomplishments are considerable, which suggest a carefully thought-out plan by perceptive managers, qualified staff, and sound advisors. At the same time, a brief look at BdC's implementation reveals that it did not follow or even attempt many of the traditional steps suggested when testing and rolling out a new product line on such a large scale. It conducted no market survey and had no expertise or experience in this market. It had only five in-house staff to monitor the program, none of whom had worked in microfinance. Its strategy for rollout was driven by internal considerations, namely the location of its branches and need to absorb excess staff. Finally, it entered markets that were well served by experienced MFIs and offered the same product with identical terms and conditions and no marketing efforts.

Several critical factors explain BdC's success. BdC did benefit from several fortunate external conditions, not the least of which was a large underserved market and experienced technical advisors. At the same time, BdC management and EQI made a number of good decisions in adapting microfinance to BdC and, to some degree, adapting BdC to microfinance. Two features stand out in its success story. First, BdC succeeded in creating a proverbial microlending assembly line because the lending process is bureaucratic, rather than analytical. The process is simple and sequential, with interchangeable terms and conditions for almost all clients. Second, microfinance has the potential to become the "tail" that wags the dog by being its most successful and efficiently delivered product in an institution that is trying to become a better retail bank. The lessons learned from microfinance already are being applied elsewhere in the bank due in part to the promotion of the microfinance National Product Manager to the head of Retail Operations.

EXTERNAL FACTORS

Large Market. As noted throughout this case study, the market for microfinance in Egypt is immense. BdC did not need to look far for potential clients, even in the more competitive markets of Cairo and Alexandria.

Brand Recognition. Banks and bank staff (particularly Branch Managers) have retained a level of prestige in Egypt despite poor services and even worse financial performance. State-owned banks have not been allowed to fail and have a reputation for being safe, or at least safer than other options. Banks are also perceived as having a higher status and being more prestigious than NGOs or business associations in a society in which status and reputation are important. When given a choice of the same product and terms from either a bank or a non-bank, the experience of BdC in Alexandria and Cairo suggest that clients prefer a bank. In the case of Alexandria, one branch manager estimated that

40 to 50 percent of his clients came from other MFIs. In response, BdC's competitors have lowered their interest rates (below 16 percent flat) to try and stem the loss of clients and market share to BdC.

Technical Assistance. BdC benefited from EQI's decade of experience working with business associations and NGOs. BdC was able to receive (at no cost) a complete package of microlending technology, including a methodology, policies, procedures, training, monitoring, and an MIS system that could connect BdC's entire branch network. The EQI product designed for BdC was not unique. However, it was fully tested and known to work well in markets where BdC would be competing; BdC could use the speed of its service and recognition of its brand to differentiate itself. BdC relied on EQI for four years, after which time EQI adequately trained BdC staff to keep the lending machine running.

Liberalization of the Sector. BdC's willingness to pilot test microfinance was due to the liberalization of the banking sector and the shake-up of BdC by the government. After years of poor results in the state and corporate sectors, most of Egypt's banks have "discovered" retail banking, primarily for middle-class, salaried employees, as a potential profit center rather than a just a source of deposits. Consumer-friendly banking technology such as ATMs, smartcards, and phone and on-line banking are appearing throughout Egypt following improvements in communication systems.

INTERNAL FACTORS

Role of Champions. A number of influential people have championed microfinance at BdC since its inception. The Chairman understood the need to put the prestige of his office behind the program and did so not only by appointing a Board Member to oversee the pilot, but also by personally inviting Branch Mangers to participate. It was an invitation no Branch Manager could refuse; for many of them it was their first time meeting the Chairman of the bank, which is considered a significant honor. The Chairmen lent authority to the new young manager of the program by making him a Department Head and National Product Manager only months after he joined the bank. Throughout the rollout, the Chairman and the Board remained engaged and participated in annual meetings and other events related to microfinance.

Branch Network. USAID/Egypt's microfinance strategy was partially driven by the desire to open as many microfinance points of service (a branch, agency, or outlet) as possible. This target was included in its workplan with EQI. Only the state-owned banks and National Postal Authority have the outlets necessary for EQI to reach its target and a significant percentage of Egypt's low-income households. BdC's 120 branches were exactly what USAID/Egypt and EQI needed: most branches had access to lower-income areas, most had full financial services, and BdC had access to a large number of individual account holders, mostly government employees. The one drawback to working with BdC is that their branches are heavily concentrated in urban areas where other MFIs operate. Rather than avoid served markets, BdC decided to compete directly with MFIs using prestige and quick disbursement to its advantage. While this has worked well for BdC, it has not increased the depth of geographic outreach or opened new markets. These objectives more likely will be accomplished following the merger with Banque Misr, which has an additional 480 branches in Egypt.

Funding. Despite its poor asset quality and (probable) negative equity position, BdC is highly liquid. The deposit base of the average BdC branch is 5 to 10 times its loan portfolio. The additional cash, liquidity, and asset-liability management needed to operate the microfinance program is negligible. BdC was willing to commit funding to the project in terms of operational expenses (management, staff, and branches) as well as financing the portfolio. Comparatively, the amount of donor support was quite small: a rough estimate of USAID/Egypt's support from 2001 through 2004, in the form of

EQI technical assistance, is between $700,000 and $1 million.[1] This compares to the growth of a portfolio of more than $32 million over the same period.

Bureaucracy and Controls. Government ownership of BdC resulted in a large staff and bureaucracy. The excess staff was largely assigned to different control functions. However costly, the microfinance rollout benefited from a number of branch control functions overseen by staff that do not have a financial interest (that is, an incentive) in the microfinance programs. Tellers, a branch "internal auditor" (who functions as a controller), an MIS operator, and headquarters' roaming internal audit team all add oversight to the expanding microfinance program. One of the key challenges to introducing microlending on such a large scale is implementing adequate checks and balances. In BdC, many already existed and were strengthened by the new management team. In many ways, BdC's success is due to the fact that its microlending procedures are bureaucratic rather than analytical, and therefore easily monitored.

MIS. The El Mohassil system created by EQI was implemented during the pilot project and has functioned adequately for BdC since then. The system is not perfect and BdC does not utilize its functionality as much as it could. With respect to branch networking, the system was more advanced than BdC's own portfolio and management systems and has allowed BdC to monitor the microfinance portfolio on a daily basis. Headquarters has real-time access to all of its branches and inputs are verified daily against the banks branch accounting system (which includes all teller transactions).

REMAINING CHALLENGES

Profitability Measurement and Product Costing. It is currently impossible to measure the sustainability of BdC's microfinance program accurately. Not unlike other commercial banks involved in microfinance[2], cost information is gathered from different sources and cost allocation is done mostly through assumptions. There is no true allocation for the cost of using the branches to deliver the services. The new FlexCube system, the core banking system used at BdC and Banque Misr, may help determine the true cost of delivering microenterprise loans. This will be particularly important during a merger when managers compete for resources.

Product Development. BdC's notable shortcoming is the lack of product development. While several new products are being discussed, none have been designed or implemented. Even necessary changes to the existing product are seemingly difficult to implement. BdC has not taken advantage of its capacity to cross-sell products or automate transactions.

Merger. Banque Misr embarked on a microfinance pilot test of its own in 2005, with the same technical assistance package from EQI, although financed by the International Finance Corporation (IFC). The product has standard rates and terms, and most of the same procedures. However, Banque Misr does not suffer from the same level of excess staff capacity as BdC and has hired new staff for its pilot microfinance operations. The new (merged) Board and management appear to share BdC's commitment to microfinance as a product line and have expressed interest in introducing microlending in as many of Banque Misr's 480 branches as possible. However, it is still not clear who will run the department in the merged entity or how the merger will take place. The merger will create

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[1] Based on EQI estimates that the cost of their work with BdC was approximately $15,000 per month plus some additional costs up front.

[2] See the case studies on Hatton National Bank and Credife/Banco del Pinchincha for more information on the commercial bank downscaling.

significant redundancies in the large markets and some type of rationalization of the branch network and staff will be needed.

State Ownership. Banque Misr is likely to remain state-owned for some time. The merged bank should be in a stronger financial position than BdC was on its own. However, the track record of Egyptian state-owned banks is not good. There is some risk that the government will take a more active role in microfinance at Banque Misr, such as encouraging targeted lending as is done with the Social Fund for Development. There is also a risk that future asset quality problems or poor performance could negatively influence the microfinance program's access to the necessary staff or resources. While Banque Misr will undoubtedly be the major player in the microfinance market, microfinance will be a minor part of the bank's operations and therefore may be subject to neglect.

I. INTRODUCTION AND OVERVIEW

This case study is part of an overall research effort on SORBs in rural and microfinance markets being conducted under USAID's Accelerated Microenterprise Advancement Project (AMAP) Financial Service Knowledge Generation (FSKG) research agenda. This research segments SORBs into four distinct categories under its strategic framework as shown in Table 2. BdC was selected as a case study under the category of a SORB that has been reformed under continued government involvement.

TABLE 2: STRATEGIC FRAMEWORK FOR SORBS

SORB Category	SORB Subcategory	Existing FSKG Case Studies
Closure	No Alternatives Established	
	Alternatives Established	
Continued Government Involvement	Business as Usual	Land Bank of the Philippines
	Reform	Banco do Nordeste of Brazil **Banque du Caire of Egypt**
Creation of New SORB	General Development of Commercial Banks	
	Specialized Microfinance Institution	Amhara Credit and Savings Institution (ACSI) of Ethiopia
Privatization	Sold to Private Investor as Stand-Alone Bank	Khan Bank of Mongolia
	Acquired by Another Bank and Operations Merged	

While a common thread exists through all of these cases—state ownership—there are significant differences. For example, unlike the Land Bank of the Philippines, which is a specialized state-owned bank, or ACSI of Ethiopia, which was initially developed as an NGO, BdC is a long-standing SORB. Moreover, BdC has established a specialized unit for microlending integrated into its existing branch network. The case of BdC offers lessons for other SORBs, as well as private commercial banks.

This case study is structured to review the environment and context within which BdC's decision to enter the microfinance market took place and analyze the evolution and current state of BdC's microfinance operations. From this, the case study makes observations and documents lessons learned regarding BdC's experience.

II. ENVIRONMENT/CONTEXT

OVERVIEW OF EGYPT

GEOGRAPHY AND DEMOGRAPHICS

Egypt is the most populous country in the Arab world and the second most populous on the African continent with an estimated population of 71 million in January 2005. Most of Egypt's population lives in the Nile valley and delta (see map, Figure 1), which constitute about 4 percent of Egypt's total area. Forty-eight percent of Egypt's population lives in urban areas. Cairo, Alexandria, and other cities along the Suez Canal are some of the most densely populated areas in the world with approximately 1,540 persons per square kilometer. The estimated annual population growth rate in mid 2005 is 1.78 percent, which indicates a slight slowdown from preceding years.

FIGURE 1: MAP OF EGYPT

Source: USAID/Egypt

According to the most recent United Nations Development Programme (UNDP) Human Development Report on Egypt, released in February 2006, Egypt ranks 119th out of 173 countries in terms of poverty. The findings from Egypt's Poverty Reduction Strategy[3] suggest that poverty incidence in the country fell from 19.4 percent in 1995–1996 to 16.7 percent in 1999–2000. The distribution of poverty varies by region, with a higher concentration of the poor in Upper Egypt.[4] Poverty rates in rural areas reach up to 22 percent of the population and approximately 54 percent of all poor in Egypt live in the rural areas of Upper Egypt. The lowest concentration of poor is in the metropolitan regions (Cairo, Alexandria, Port Said, and Suez).

[3] Developed by the Government of Egypt under the guidance of the World Bank.

[4] Upper Egypt refers to the southern part of the country, which is upstream on the Nile River, see Figure 1.

RECENT HISTORY AND THE POLITICAL ENVIRONMENT

Egypt's recent history began with the declaration of Egypt as a Republic, after a military coup led by Gamal Abdal Nasser toppled Egypt's monarchy in 1952. He adopted socialist principles and nationalized most private businesses, including financial institutions. Anwar Sadat, who became President in 1970, led a slow liberalization of Egypt's economy and secured a steady flow of foreign aid from the United States by signing the Camp David Peace Accords with Israel and the United States. Sadat's open door policy led to high economic growth, based mainly on trade, but also opened Egypt to cycles of inflation and devaluation. President Hosni Mubarak was elected President after Islamic extremists assassinated Sadat in 1981.

Mubarak's National Democratic Party (NDP) has dominated the People's Assembly and all major government institutions. In 2005, Mubarak was reported to have won 88.5 percent of Egypt's popular vote and was elected for another six-year term. The Egyptian constitution prohibits the establishment of parties based on religion, which led to the banning of the Muslim Brotherhood. However, in recent elections, members of the Muslim Brotherhood, running as unaffiliated individuals, unexpectedly won 88 seats in Egypt's legislative body, the People's Assembly, leaving the NDP with 72 percent of the seats.

Administratively, Egypt is divided into 26 governorates. Authority is exercised by and through Governors who are appointed by the central government, and by Mayors who are elected by popularly elected local councils. In February 2006, the President issued a decree calling off local elections that were due to be held in April 2006, due to fears that gains would be made by the Muslim Brotherhood.

ECONOMY

In 1991, Egypt faced accumulated economic crises: huge external debt, high inflation and high budget deficit. Egypt embarked on an economic reform program, including financial sector reform and privatization. The initial International Monetary Fund (IMF) and World Bank programs were completed in 1993 and Egypt went on to negotiate a subsequent program with the IMF that it did not fully implement. In November 1997, a group calling itself the Vanguards of Conquest attacked and killed 71 people, including 60 tourists, in a site near Luxor causing a precipitous drop in tourism, one of Egypt's main sources of foreign currency. By 1998, the economy was facing problems again, in part due to a more difficult external environment created by the Asian crisis of 1997–1998. This eventually led the Government of Egypt to abandon the Egyptian pound's peg to the U.S. dollar in May 2000, allowing for subsequent devaluations. Between 2000 and 2003, the pound had been devalued by 45 percent, severely undermining local purchasing power.[5]

Order began to return to the Egyptian economy in 2004, the same year in which President Mubarak appointed Ahmed Nazif as Prime Minister. Nazif has since appointed a team of economically liberal-minded cabinet ministers to key economic posts and begun implementing reforms. Inflation dropped to single digits in 2005.

Egypt's economy is dominated by services, such as tourism and the Suez Canal, which including public administration, account for about half of GDP (see Table 3). Even though only 3 percent of Egypt's total land area is arable, agriculture accounted for 13.9 percent of GDP in fiscal 2005 (year ending June 30, 2005) and 28 percent of total employment as of June 2001. Manufacturing,

[5] Economist Intelligence Unit, Country Profile of Egypt, 2005.

which is concentrated in Cairo and Nile Delta, accounted for 18.2 percent of GDP in 2005 and mining, which includes petroleum and natural gas, accounted for 14.8 percent of GDP.[6]

TABLE 3: EGYPTIAN ECONOMIC INDICATORS

(as of June 30)	1999/2000	2000/2001	2001/2002	2002/2003	2003/2004
GDP (EGP millions)	340,1	358,7	378,9	417,5	485,0
Private consumption (% of GDP)	75.9	75.3	73.6	72.9	71.3
Government consumption (% of GDP)	11.2	11.3	12.5	12.8	12.4
GDP per capita (EGP)	5,054	5,230	5,420	5,858	6,677
Unemployment rate (%)	9.0	9.2	9.0	9.9	9.9
Annual change in average consumer prices (%)	2.7	2.3	2.7	4.5	11.3
Total external debt (USD millions)	29,173	29,289	30,029	31,416	N/A
Net official development assistance (USD millions)	1,582	1,437	1,387	1,436	1,110

Source: Economist Intelligence Unit, Country Profile of Egypt, 2005

The Central Bank of Egypt (CBE) cites an unemployment rate of 9.9 percent, while unofficial sources estimate the effective unemployment rate to be significantly higher due to underemployment and reliance on the informal economy.[7] The labor force in Egypt has been growing at 2.7 percent per year and the government estimates the influx of 700,000 to 800,000 new job seekers a year, resulting in a widening gap between job creation and job seekers. For the fiscal year 2002/2003, official figures estimated that 38 percent of employment was in the informal sector, while 34 percent was in the government or state-owned enterprises.

FINANCIAL SECTOR

Under Nasser, the Egyptian financial sector underwent a wave of "Egyptianization" in the 1950s and nationalization in the 1960s. It was at this time that BdC acquired the Egyptian operations of two French banks and was later nationalized. Under Sadat, the financial sector began to be liberalized, a trend that has continued under Mubarak. Today, Egypt has a relatively well-developed financial industry for a poor emerging market country, despite its poverty and the dominance of its state-owned institutions in the sector. However, financing, to the extent available, is largely short-term, with limited opportunity for longer-term investment or non-bank financing.

Egypt's banking sector has suffered from low profitability in recent years primarily due to nonperforming loans, which is a major issue at state-owned banks, and is associated with the recession, limited expertise in credit risk management, and corruption. During 2002 and 2003, a number of highly publicized bad debt cases resulted in the arrest and eventual conviction of several bankers and businessmen on fraud and corruption charges.

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[6] Economist Intelligence Unit, Country Profile of Egypt, 2005.

[7] U.S. Department of State, *Economic Trends Report for Egypt*, September 2004.

As of late 2004, the CBE listed 55 banks in operation within Egypt's licensing framework; 38 banks were fully licensed local institutions. There are three state-owned specialized banks intended to bolster national development by providing industrial and agricultural credit. These include the Industrial Bank of Egypt, Principle Bank for Development and Agricultural Credit (PBDAC), and Egyptian Arab Land Bank.

Bank lending in Egypt is largely based on collateral or guarantees, which, among other factors, has restricted financing to micro, small, and medium-sized enterprises (MSMEs), despite high levels of bank liquidity. MSMEs have a high percentage of "dead collateral," which refers to assets to which the owner does not have clear title.

LEGAL AND REGULATORY FRAMEWORK

The CBE is the regulatory body for the banking sector. The CBE issued a moratorium on the issuance of new bank licenses in 1983 and is currently overseeing the reform and consolidation of the banking sector. The new Unified Banking Law of 2003 increased the minimum amount of required paid-in capital from EGP 50 million to 500 million (approximately $8.5 to 85 million), with foreign bank branch operations required to have local paid-in capital of no less than $50 million. The required increase in paid-in capital is expected to lead to consolidation in the sector.

Semi-formal financial service providers, such as business associations and NGOs are regulated and supervised by the Ministry of Insurance and Social Affairs. As such, these organizations are not allowed to mobilize deposits and are not subject to prudential regulations. Informal financial service providers, such as rotating savings and credit associations, operate beyond any regulatory framework.[8]

Currently, there is no separate law for microfinance in Egypt. Several existing laws—including the NGO law, the SME law, the Companies Law, and the Banking Law—affect microfinance providers. Under the existing laws, the types of institutions that can legally offer some or all microfinance services in Egypt are banks, business associations, and NGOs. Firms registered under the Companies Law are not allowed to engage in insurance, banking, savings, or investment of funds and there is no existing law for non-bank financial institutions. While business associations and NGOs are not given the full capacity to engage in all financial intermediation, they are not restricted from engaging in credit services. No other legal structure is allowed to engage in credit, deposit taking, insurance, or other form of financial intermediation.

MICROFINANCE SECTOR

According to the report *Microfinance in the Arab States "Building inclusive financial sectors,"*[9] Egypt has been the leading country in the Arab world in the area of microfinance, with the highest number of active microfinance borrowers and the largest outstanding loan portfolio. The engagement of a number of banks together with NGOs has contributed to the growth of microfinance in Egypt. However, the access of poor and low-income households to financial services remains lacking in terms of both service outreach and product diversity. The supply of microfinance products and services in Egypt is limited to conventional forms of micro lending (individual and solidarity group lending) and alternative credit and savings products remain largely untapped.

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[8] AVID, *Final Report of Mid-Term Evaluation of USAID/Egypt Small and Emerging Business Program*, 2004.

[9] Brandsma and Deena Burjorjee, 2004.

DEMAND—MICROENTERPRISES

There is no standard definition for an MSE accepted by MFIs and donors despite a 2004 Law defines micro-enterprises as those with fewer than five employees and with less than EGP 50,000 ($8,600) paid-in capital.[10] It defines small enterprises as those with between 5 to 49 employees and paid-in capital between EGP 50,000 and EGP 1 million ($8,600 and 173,000).

There is also no consensus on the size of the market. USAID/Egypt reports that small and micro enterprises make up 98 to 99 percent of nonagriculture private sector enterprises, and employ 2 million people (60 percent of Egypt's private nonagriculture labor force). However, MFIs visited during this study indicate they believe the market to be much larger than that, perhaps up to twice that when households and underemployed persons are included.

SUPPLY—MICROFINANCE PROVIDERS

In the past few years, banks in Egypt have become the dominant force in the microfinance market due to their branch networks, excess liquidity, and superior back office systems. However, to date, banks have been slow to exploit their ability to offer a wider range of financial products, such as micro-savings, insurance, and consumer loans.

Commercial Banks

Only three commercial banks in Egypt are currently active in microfinance. Table 4 indicates the year in which each bank initiated microfinance operations.

TABLE 4: COMMERICAL BANKS INVOLVED WITH MICROFINANCE

Commercial Bank	Year Microfinance Initiated	Number of Branches with Microfinance
National Development Bank (NBD)	1987	44[11]
Banque due Caire (BdC)	2001	112
Banque Misr	2004	10

These banks have targeted the upper end of the microenterprise market, leaving the lower end of the market to NGOs and community development associations (CDAs), which have both individual and group lending products.

Business Associations

Business associations, while registered as NGOs, are required to have a larger Board structure than a regular NGO, and many have received government permission to operate beyond their initial governorate. USAID supported the creation and development of business associations through grants for operating expenses and capitalization funds. Table 5 provides outreach statistics on the larger business associations. Until the entry of BdC, USAID' business association partners dominated the microfinance market. The bank's entry and successful expansion in the market is, in part, due to the inability of the business associations to match the extensive branch networks of the banks involved in microfinance.

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[10] USAID's definition of micro-enterprises, as defined by USAID/Washington, is firms with up to 10 employees. Ministries in Egypt, such as the Ministry of Agriculture or the Ministry of Industry, each use its own definition.

[11] Includes 33 branches with full microfinance operations and 11 branches with a microfinance window.

Nongovernmental Organizations and Other Informal Providers

There have been a wide variety of NGOs active in microfinance, including international NGOs (such as CARE and Catholic Relief Services), Egyptian NGOs, and CDAs. The international NGOs have taken the role of capacity building, while the Egyptian NGOs have been direct providers. There are thousands of NGOs registered in the country, many of which incorporate credit as part of their overall integrated community development programs. CDAs, which are primarily village-focused, are likely to have the greatest depth of outreach. NGOs rarely extend their services beyond the home governorate, which, together with the legal restrictions on their product range, often constrains growth.

In addition, there are numerous informal sources of finance in Egypt, the most common being the *Gamiya*, or rotating savings and credit associations, and moneylenders—both of which primarily cater to the lower-income market segments.

SUPPORTING INSTITUTIONS

Donors

Microfinance in Egypt begins and, until recently, ended with donors. All MFIs and banks offering microfinance in Egypt are closely linked to a donor who has provided funding, but also the strategy, technical training, and products and services. USAID/Egypt is the largest and most influential. Since 1990, USAID/Egypt has been the largest financier of microfinance initiatives in Egypt, estimated to support more than 70 percent of all activities in this sector. USAID partner organizations currently operate more than 200 lending units nationwide, managing a consolidated outstanding loan portfolio of EGP 365 million (approximately $60 million) serving about 265,000 active borrowers, as of June 2004. Table 5 highlights the performance of USAID/Egypt's partners.

TABLE 5: PERFORMANCE OF USAID/EGYPT PARTNERS

Institution*	Active Clients as of June 2004	Outstanding Portfolio EGP	Outstanding Portfolio USD
ABA	39,917	52,497,503	$8,467,339.19
AsBA	49,432	48,834,300	$7,876,500.00
DBACD	26,752	30,808,235	$4,969,070.16
ESED	39,097	52,150,467	$8,411,365.65
SEDAP	5,078	6,862,083	$1,106,787.58
SBACD	15,585	19,054,168	$3,073,252.90
LEAD	3,474	1,820,414	$293,615.16
SPDA Fayoum	2,397	2,558,750	$412,701.61
SCDA Sohag	1,164	3,755,372	$605,705.16
Aswan	366	821,272	$132,463.23
BdC	63,426	118,341,519	$19,087,341.77
NBD	19,000	N/A	N/A
Total	265,688	337,504,083	$54,436,142.42

* ABA is the Alexandria Business Association; AsBA is the Assuit Businessmen's Association; DBACD is the Dakahleya Businessmen's Association for Community Development; SBACD is the Sharkeya Businessmen Association for Community Development.

Source: National Cooperative Business Association (NCBA)/EQI Quarterly Report April–June 2004 from AVID report

Social Fund for Development

In 2004, government legislation gave the Social Fund for Development (SFD) responsibility for coordinating financial and non-financial support to microenterprises and SMEs. Beyond its involvement in the multistakeholder process to develop a national strategy for microfinance, the SFD funds technical assistance for NGOs involved with microfinance; provides wholesale (subsidized) loans to CDAs, NGOs, and financial institutions for on-lending to microentrepreneurs; and has future plans to provide fee-based loan portfolio guarantees to commercial banks for microfinance, using a grant from KfW. The SFD has worked with the PBDAC, a state-owned specialized bank, to provide small loans to farmers using SFD funds. Little information is available on loan volume, but delinquency is believed to be high.

Technical Assistance Providers

There are a limited number of technical assistance and training providers for MFIs in Egypt. EQI is the largest of these providers and has been USAID's primary local implementing organization to date.

Environmental Quality International

EQI is an Egyptian consulting firm founded in 1981 as a limited partnership. It began with environmental consulting, but later entered the areas of governance and enterprise development. Over time, EQI's work in enterprise development has emerged as the central focus of much of its integrated development activities. EQI's approach in this sector is to present NGOs and banks with a "package" or toolkit that they can rollout for their microlending operations.[12]

EQI, previously in partnership with NCBA, has been USAID's primary microfinance technical assistance provider in Egypt. USAID/Egypt awarded more than $15 million in contracts to provide technical assistance from June 23, 1993 to January 31, 2005, most of which went to NCBA/EQI.[13] USAID recently awarded a microfinance technical assistance contact to Chemonics International, which has subcontracted EQI as the primary provider of technical assistance in the country.

Additional information on the banking and microfinance sector can be found in Annex D.

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[12] AVID, *Final Report of Mid-Term Evaluation of USAID/Egypt Small and Emerging Business Program*, 2004.

[13] This includes a contract for $1.5 million with ACDI/VOCA as well as three contracts with NCBA/EQI for $13,693,376.

III. INSTITUTION

OVERVIEW OF BANQUE DU CAIRE

HISTORY

BdC was established as a private company in 1952, the year of Egypt's revolution, at a time when foreign banks dominated the banking sector. However, the Suez Crisis of 1956 led to "Egyptianization" measures by the government in 1957. It was under this context that BdC acquired the Egyptian operations of two French banks, Comptoire Nationale d'Escompte de Paris and Credit Lyonnais. In 1960, Banque Misr and the National Bank of Egypt were nationalized, followed by BdC in 1961. Since that time, BdC has remained 100 percent owned by the Government of Egypt and operates under the auspices of the Ministry of Finance.

In 1964, the government established a system of sectoral specialization among state-owned commercial banks. BdC specialized in financing foreign trade, housing and public utilities, and information and tourism. In 1971, the Government of Egypt replaced it with a system of functional specialization, under which BdC was specialized in the services and construction sectors.[14] This gave BdC strong business ties with public sector institutions in the contracting, housing, tourism, insurance, healthcare, and transport sectors.[15] The liberalization of the banking sector in the 1990s prompted BdC to expand its client base to private sector clients, primarily larger corporations, and offer a broader range of products and services.

In 2000, BdC experienced major loan defaults in the private sector. BdC extended EGP 12 billion in unsecured loans to 37 businessmen from 1991 to 1999, many of whom defaulted or fled the country. After 2000, the Government of Egypt ceased discussion of privatization and decided to hire executives from private-sector banks to mange the reform efforts at state-owned banks. Ahmed Mounir El Bardai was appointed Chairman of BdC and brought in a team of 11 Executive Advisors.

In a surprise move, even to BdC's Chairman, the Government of Egypt announced in September 2005 its decision to merge BdC, the third largest state-owned bank in Egypt, with Banque Misr, the second largest. As the larger and financially stronger partner, Banque Misr is effectively acquiring BdC, creating Egypt's largest bank.

GOVERNANCE & MANAGEMENT STRUCTURE

Since 2000, BdC's Board has comprised seven directors, with largely private sector backgrounds, and been assisted by 11 Executive Advisors, all of whom were appointed by the Government of Egypt under its reform initiatives. The Board has been responsible for the bank's strategy and reviews and approves proposals for new products and new expenditures of more than EGP 50,000 (including expansion plans), giving them significant authority over bank activities. In 2000, the Government of Egypt gave the newly appointed Board and Chairman a specific mandate to devise and implement a strategy to upgrade and modernize BdC's operations. Beyond providing advice, the Executive also assumed senior management positions.

BdC was the first state-owned bank in Egypt to hire management from the private sector. BdC had to undertake fundamental reform to address the long-standing issues of poor asset quality, weak credit

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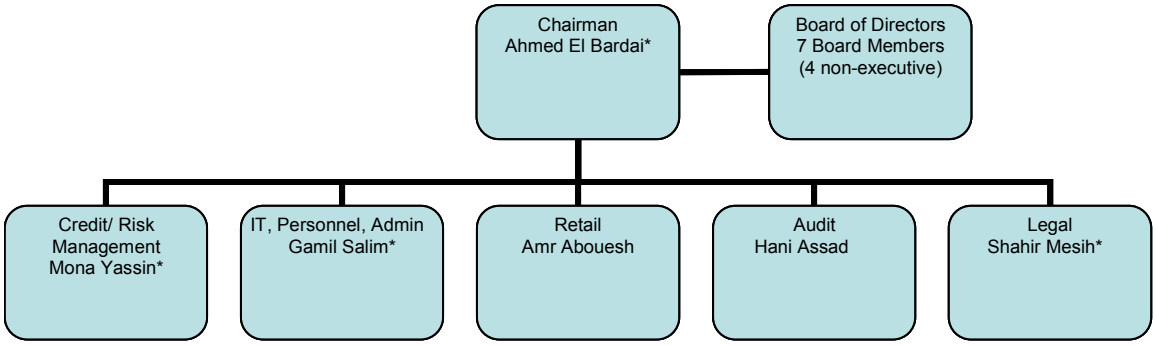
[14] See Mohieldin.

[15] Moody's Investor Services, November 2005, page 5.

culture, a low level of automation, bureaucratic procedures, and low caliber of staff. Under this new management, the bank reorganized itself, developed a strategy to expand its retail business, and implemented new systems, including the "FlexCube" core banking system.

While senior management is structured along functional lines as shown in Figure 2, the Board has divided the country into four geographical areas for strategic and work planning purposes. A senior regional management team has been appointed by the Board to oversee each of the areas. Each team is responsible for the implementation of the strategy formulated by the Board, as well as communication with regional branches and employees.[16]

FIGURE 2: BANQUE DU CAIRE ORGANIZATIONAL STRUCTURE (MARCH 2005)



*Executive Board Member

Source: BdC

After the merger was announced in 2005, a new eight-person Board for the merged entity (to be called Banque Misr) was formed. It includes only two former BdC directors, Mona Yassin and Sameer Hamza, as non-executive directors. The Government of Egypt has appointed ABN Amro to a three-year contract to assist with the restructuring of the merged bank.

BdC PERFORMANCE[17]

BdC has performed poorly in the past; its weaknesses have included a high level of non-performing loans, a bureaucratic nature, and overstaffing (see Table 6). As of June 30, 2004, non-performing loans were approximately 25 to 30 percent of gross loans, with loan loss reserves at EGP 5.0 billion, or 18 percent of gross loans. Loan loss provisions accounted for 88 percent of BdC's pre-provision profit in 2004 and it is expected that current unprovisioned non-performing loans represent 80-100 percent of shareholder's equity. According to Moody's, a significant part of non-performing loans are a result of the bank's past activities and former leadership. However, BdC has maintained a strong retail deposit funding base due to the perception that the government would not allow the bank fail. BdC's large branch network enables it to mobilize a good level of customer deposits, particularly from the household sector, which provide a stable source of funding.

[16] Moody's Investor Services, November 2005.

[17] See Moody's Investor Services, November 2005.

TABLE 6: BDC FINANCIAL PERFORMANCE INDICATORS					
EGP millions or % *(as of June 30)*	**2000**	**2001**	**2002**	**2003**	**2004**
Total Assets	33,824	36,276	37,657	43,960	45,263
Equity	1,334	1,379	1,479	2,433	2,984
Gross Loans	24,010	24,165	25,800	27,691	27,975
Net Loans	20,692	20,671	22,079	23,497	22,993
Customer Deposits	27,910	29,759	30,946	34,360	37,954
Net Income	146	100	61	53	55
Return on Average Assets (%)	0.44	0.29	0.17	0.13	0.12
Return on Equity[18] (%)	10.91	7.25	4.13	2.18	1.84
Cost to Income Ratio[19] (%)	40.3	51.56	58.07	47.74	47.84
Net Loans/ Customer Deposits (%)	74.14	69.46	71.34	68.38	60.58
Loan Loss Reserve/ Gross Loans (%)	13.82	14.46	14.42	15.15	17.81
Equity/ Total Assets (%)	3.94	3.80	3.93	5.53	6.59

Source: Moody's Investor Services, November 2005

BdC's loan portfolio has grown at a marginal rate of 3.9 percent per year over the past five years. This is partly due to market conditions and the bank's capital adequacy ratio as well as a decision by management to complete its internal reorganization and put the right systems and controls in place before expanding its portfolio. Public sector borrowers represent 20 to 25 percent of BdC's current loan portfolio, down from 70 percent in 1991. Management indicated that lending efforts are currently focused on microlending and extending credit to performing companies. The bank also intends to increase its exposure to the SME sector. BdC's substantial branch network is seen as a platform from which the bank can market new retail products and develop the bank's retail business.

MICROFINANCE STRATEGY

The introduction of microfinance at BdC was championed by Chairman El Bardai, who developed the idea through personal contacts with Mounir Neamatallah, the President of EQI. USAID/Egypt had been seeking a bank partner for microfinance since its work with NBD over a decade before. Mr. Neamatallah's personal relationship with Mr. El Bardai provided EQI with the opportunity to enlist BdC in this effort.

This idea to introduce microfinance at BdC emerged in the context of the Chairman's mandate to improve efficiency and reduce losses. Microfinance was primarily viewed as means to absorb excess staff, but the Chairman also hoped it would provide a much-needed success story for BdC, diversify its portfolio, and contribute to the bank's new emphasis on retail business. This is clearly expressed by Amr Abouesh, who led BdC's microfinance efforts and is now the head of its Retail division. He has stated, "one of the reasons for the bank's losses was the poor quality of its loan portfolio and high concentration of risk on very few clients. The government also didn't want to fire the bank's redundant staff. In terms of risk distribution and as a labor-intensive product, microfinance presented

[18] Based on period end.

[19] Cost to Income Ratio = Total non-interest expense as a percentage of operating income.

itself as a very good product to pursue."[20] However, while absorption of excess staff was the initial driver of microfinance at BdC, perceptions of the product and the bank's strategy with respect to it evolved over time. Microfinance at BdC developed in phases, as outlined in Table 7.

TABLE 7: EVOLUTION OF MICROFINANCE AT BdC

Timeframe	Phase	
July 2001–Jan 2002	Piloting	• Board somewhat skeptical, but accepted the idea that was being championed by the Chairman • Primary objective was to employ excess staff in productive activities From a profitability standpoint, break-even would have been acceptable to the Board • Initial rollout of microfinance in Upper Egypt (southern Egypt) with help of USAID/Egypt-funded technical assistance
Jan 2002–Nov 2004	Growth within branch network	• Beyond employing excess staff, it appeared that microfinance could be profitable and a source of growth for the bank • Rollout of microfinance throughout branch network using existing employees • BdC begins to track microfinance profitability, using cost allocations, and to focus more on product profitability
Nov 2004–Sept 2005	Expansion beyond branch network	• BdC's existing branch network was reaching saturation, as most appropriate branches now had microfinance operations • Board approved the creation of 80 new specialized microfinance units in areas where BdC did not have existing branches • Six of the eighty units had been opened and staffed with newly-hired employees before the merger announcement
Sept 2005–present	Merger integration	• Expansion plans on hold due to merger, as it did not seem sensible to open new units until an integrated microfinance strategy was developed, given Banque Misr's 450 branch network • The new, merged Board has created a subcommittee to look into the integration of BdC and Banque Misr's microfinance activities and formulate a strategy

Source: BdC

To develop Board support for the microfinance initiative, the Chairman arranged for EQI and Bill Tucker of NCBA—the Chief of Party of the USAID/Egypt's Small and Emerging Business (SEB) Project—to give a Board presentation on the MSE market, microfinance, USAID/Egypt's SEB Project, and EQI's products and services. The Board approved an initial pilot of 10 branches and EGP 5 million ($1.3 million) and the allocation of existing staff to the program.

The pilot was successful insofar as BdC managed to maintain a PAR > 30 days[21] of less than 1 percent—as good, or better, than Egyptian business associations and NGOs. With the success of the pilot, BdC pursued a strategy of horizontal (geographical) expansion of its microfinance operations, which continued absorbing excess staff. Part of BdC's rationale was to build on momentum that had been created early on and to capture a material share of what it viewed to be a large and attractive microfinance market. USAID/Egypt and EQI encouraged this strategy, which matched their goal of significantly expanding the number of microfinance units (that is, branches) in the Egyptian market. Over the next three years, the bank introduced microfinance operations into 25 of Egypt's 26

[20] CGAP Highlight, June 2005.

[21] Measured as value of all loans outstanding with late payments over 30 days divided by total outstanding portfolio.

governorates and has penetrated approximately 40 percent of Egypt's mekas (equivalent to counties or local districts).

Geographical expansion of BdC's microfinance operations remained the primary goal even after most BdC branches had introduced the product by the end of 2004. Amr Abouesh, who was the microfinance National Product Manager at the time, developed a strategy to continue expansion through the creation of stand-alone specialized microlending units located in outlying areas near BdC branches. In 2005, the Board approved the creation of 80 units, which would include hiring new staff. The Central Bank approved the plan and five units had been created by the time of the merger announcement. Existing units have performed as well as or better than almost all other BdC branches.

Diversifying (vertical expansion) and/or differentiating its single microfinance product offering have not yet been made a priority by the bank, although this was envisaged as part of BdC's longer-term strategy. Savings accounts are offered by some branches as a means of facilitating payments and disbursements, but this has not been standardized throughout the bank and it has not been promoted or marketed by BdC's Microfinance Department.

The evolution of BdC's involvement in microfinance shares similarities with several other SORB cases. Similarities include:

- Involvement in microfinance took place after liberalization of the banking sector;
- A limited number of internal and external champions were relied upon to win support for introducing and expanding microfinance;
- Significant technical assistance was required;
- The size of the existing branch network was used as an advantage; and
- Bank had experienced poor overall performance in the past.

However, differences between BdC's experience and other SORB cases include:

- BdC had little understanding of the market and had almost no experience in working with micro or small entrepreneurs in the past;
- BdC's primary motivation was the utilization of excess staff, rather than to serve new markets;
- Microfinance is viewed as retail product line, not a mission; and
- BdC was prepared to take credit risk on an untested product, perhaps because its corporate loan portfolio was performing so poorly and other institutions (such as business associations) had success with the same product.

Another distinguishing factor is that the actual amount of donor support was quite small because BdC funded its microloan portfolio from its own resources. A rough estimate of USAID/Egypt's support from 2001 through 2004, in the form of EQI technical assistance, is between $700,000 and $1 million.[22] This compares to the growth of a portfolio of more than $32 million over the same period.

[22] Based on EQI estimates that the cost of their work with BdC was approximately $15,000 per month plus some additional costs up front.

Banque Misr's strategy differs from BdC. The bank has stated its intention to accompany its microenterprise clients up market, as they become SME clients. Despite this intention, Banque Misr does not currently have a small enterprise loan product, which would range from approximately EGP 10,000 to 100,000. Furthermore, Banque Misr does not have the same level of excess staff as BdC. Not surprisingly, Banque Misr's donor partner, the IFC, also influenced its strategy. Technical assistance to Banque Misr was funded by IFC's facility, Private Enterprise Partnership-Middle East and North Africa (PEP-MENA) (then North-Africa Enterprise Development), which has a mandate to increase access to finance to SMEs in Egypt. That being said, there are also similarities, as Banque Misr was advised by EQI, which introduced the same microloan product that BdC and many other microfinance providers in Egypt offer. Reliance on this product, however, is unlikely to be the best means of implementing its strategy.

MICROFINANCE ORGANIZATIONAL STRUCTURE

In its pilot phase, a new Executive Advisor in charge of the Information Technology (IT) Department, Gamil Salem, oversaw microfinance at BdC. Mr. Salem had worked for Citibank in IT and had some familiarity with micro and SME lending from his work with Citibank in Eastern Europe. He was also interested in the El Mohassil software developed by EQI. He worked with EQI to develop BdC's initial business plan for microfinance and to manage the pilot.

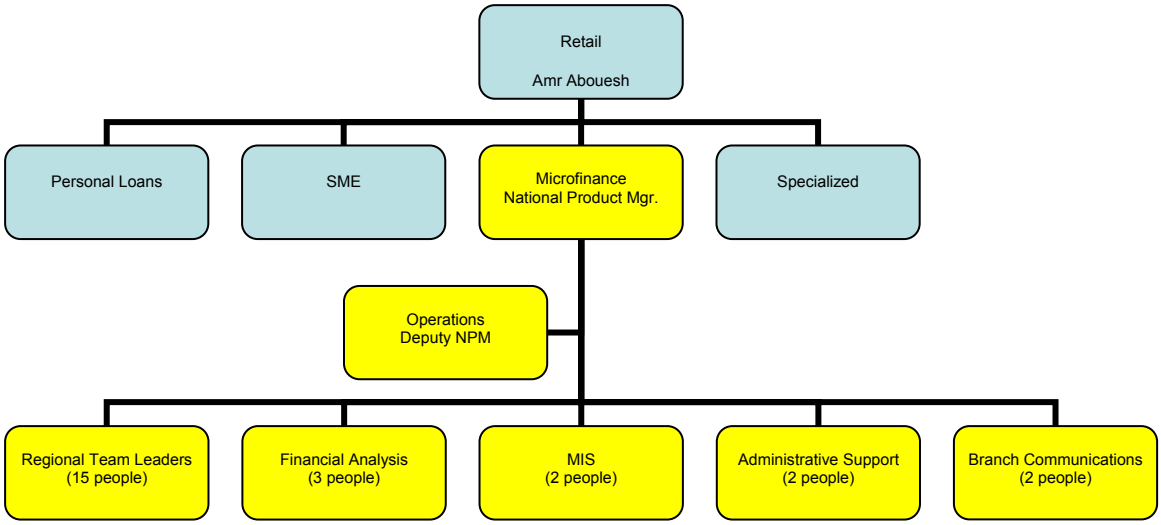
Amr Abouesh was hired to work with Mr. Salem and, in December 2001, took over as the microfinance manager. Mr. Abouesh, a relatively young official in the Ministry of Economy and Foreign Trade, had conducted a study on the microenterprise sector and was familiar with the existing MFIs. The Board approved the creation of the Microfinance Department at about the same time that Mr. Abouesh became the National Product Manager. In 2004, Mr. Abouesh was promoted to the Head of Retail within BdC and selected Mohamed Hafiz to serve as National Product Manager and Samir Nirouz to serve as Deputy National Product Manger. Both had previously been senior bankers at BdC and part of Mr. Abouesh's core microfinance team.

MICROFINANCE DEPARTMENT

Creating a department helped raise the profile of microfinance and integrate it into the bank. While the staff of the Microfinance Department was limited to five people until 2003, its elevation to the status of a department in 2001 (one of 24 departments at headquarters) raised its status and authority in the eyes of Branch Managers. Microfinance's profile was raised further during the first annual BdC conference of branches in 2002, during which Mr. Abouesh presented the microfinance product and spoke about its results.

The National Product Manager (NPM) and Deputy National Product Manager effectively work as a team, with the Deputy focused largely on operations and the NPM having greater responsibility for upward communication and interaction within the bank. Regional Team Leaders monitor the microfinance activities of several branches, the financial analysts are primarily responsible for reporting and control, the MIS team maintains El Mohassil (microfinance loan tracking system), and Branch Communications ensures communication and coordination between headquarters and branches, working through the Regional Team Leaders. Figure 3 illustrates the Microfinance Department structure in 2005.

FIGURE 3: MICROFINANCE DEPARTMENT STRUCTURE IN 2005



Source: BdC

POINTS OF SERVICE

BdC's main competitive advantage is its branch network. In four years, BdC has managed to incorporate microlending into 107 of its branches (see Table 8).[23] It developed a plan to introduce microlending in other geographic locations through smaller units of 4 to 7 people. Five units were set up in 2005. Mr. Abouesh halted continued unit expansion due to the merger, as Banque Misr has 420 branches (of which only 10 currently offer microcredit), providing opportunity for future expansion within the merged bank's existing network.

TABLE 8: GROWTH RATES

	FY2002	FY2003	FY2004	FY2005	11/2006
Branches	48	96	97	105	107
Units	N/A	N/A	N/A	2	5
Branch Annual Growth	N/A	100%	1%	8%	7%*
Client Annual Growth	N/A	120%	107%	29%	14%*
Portfolio Annual Growth	N/A	146%	124%	41%	12%*

Source: BdC

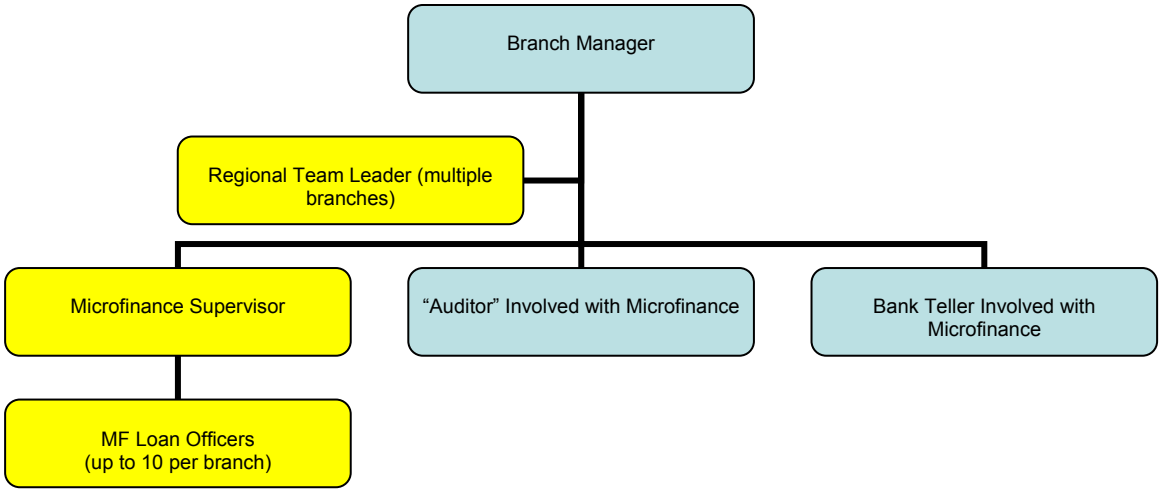
*Annualized for the five months of June–November 2006.

[23] BdC has 120 branches, but the remainder are not appropriate for microfinance (e.g. located in airport or hotel).

Branches

Given the strategic rationale behind the introduction of microfinance at BdC and absorption of excess labor, branches and existing branch staff were used as the primary points of service for BdC's microfinance product. BdC's branch network covers all areas of Egypt in the primary and secondary towns but does not extend into rural areas.[24] Officially, branches are classified as either A, B, or C, depending on their size and location. This classification also determines the Branch Managers' credit authority. Unofficially, Team Leaders roughly divide branches in five geographic regions: Upper Egypt, Lower Egypt, Cairo/Giza, Alexandria, and Suez/Sinai. Figure 4 presents an organizational chart of the branch structure. Neither the classification nor region factored into BdC's expansion strategy. To date, no effort has been made to determine which markets offered the greatest potential or which branch types or locations are most effective or profitable.[25]

FIGURE 4: BRANCH STRUCTURE OF MICROFINANCE



Source: BdC

All branches have the look and feel of a bank branch, including teller windows, ATM, foreign exchange bureau, desks for officers and administrative staff, as well as an office for the Branch Manager. In all but a few cases, microfinance staff is co-located in the branch and sit together. At present, approximately 9 percent (760 of approximately 8,000) branch staff is dedicated microfinance staff. If a single teller and the full-time equivalent of other staff involved in microfinance were to be included per branch, total microfinance staff would be probably closer to 10.5 percent of the 10,300 BdC employees.

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[24] A list of branches may be found on their website at www.bdc.com.eg.

[25] Anecdotally, staff tends to agree that Upper Egypt is often referred to as microfinance's best market whereas Alexandria is considered to be the most saturated.

Units

BdC also operates five specialized microfinance units. In 2004 the Microfinance Department proposed opening 80 specialized microfinance units in areas outside of BdC's existing branch areas, with a focus on Upper Egypt. These units would be small with 7 to 10 people, including a Manager, Supervisor, Loan Officers, and teller/administrative person. The Board approved this EGP 3 million ($520,000) plan in April 2004 and the central bank granted permission later that summer for the first 10 units to be opened.

Unlike microfinance in existing branches, the units were based on a clear financial plan with break-even targets, which was most likely driven by the intention to hire new staff. With an average start-up cost of EGP 75,000 (or $13,000 not including staff), BdC anticipated that it would take each Loan Officer serving 150 clients and up to 18 months to break-even (including covering start-up costs). As of December 2005, the units were serving a combined approximately 3,800 clients with a portfolio of EGP 6 million ($1 million). With an average of 90 clients each, the 42 Loan Officers are coming close to reaching their targets after only about six months. Team Leaders are convinced that the units will exceed expectations. BdC ceased to open new units after the announced merger with Banque Misr in 2005.

DECENTRALIZATION

Unlike the cases of ASCI or Khan Bank of Mongolia where decentralization was necessary due to geographic and technological barriers, BdC's branch network is reasonably well connected and accessible. Instead, decentralization at BdC was done to accommodate the existing bank hierarchy and institutional culture. BdC has a decentralized system that provides significant decision-making authority to Branch Managers who are responsible for managing all staff in his building. Culturally, this authority is equated with stature and importance, which would have made it very difficult for BdC to remove the Branch Manager from the process. Fortunately, the bank's culture is also bureaucratic, making it unlikely that Branch Managers would stray far from the approved policies and procedures.

This decentralization has brought the Branch Manager into the approval process (including meeting the borrower), to share in the microloan's success or failure. Over time, this has led Branch Managers to become champions of the product and the clientele within the branch. Furthermore, having a decentralized approval structure, and the availability of cash at branches, allows BdC to approve and disburse microloans more quickly than its non-bank MFI competitors, usually in two to three working days from the first client visit to loan disbursement.

MICROFINANCE OPERATIONS

PRODUCTS AND SERVICES

BdC has focused on offering a standardized credit product that was introduced by EQI, under USAID funding, and is available across the entire Egyptian microfinance market. BdC's individual loan product is virtually identical to that of all other providers, including ABA and Banque Misr. It is not uncommon for a SORB to focus on a single loan product in the initial phase of downscaling—BRI of Indonesia and Banco do Nordeste of Brazil did the same. However, the lack of innovation in BdC's product decisions may also be driven by internal considerations, such as the need to utilize excess staff (thus an initial focus on expansion), ample liquidity (thus little incentive to promote savings), and limited experience in retail lending (thus a lack of new product development). BdC's product offering has been supply-driven rather than client-focused. Its branch network holds potential for

innovation, such as cross-selling products, as well as for more efficient disbursement and payment transactions using automatic debit for loan payments, debit cards, money transfers, or ATMs.[26] Currently, clients are unable to make payments at BdC branches other than the one where its loan was originally disbursed.[27]

Credit

BdC offers a basic individual loan repaid in equal monthly installments of principal and interest (see Table 9). Clients must be involved in a commercial enterprise and may borrow for either working capital needs or fixed asset purchases. Furthermore, loans must be used for business purposes only.[28] Loans for agricultural production, consumption (including vehicle purchases), home improvements, and other "non-income generating" activities are not permitted.

TABLE 9: LOAN PRODUCT DESCRIPTION

Product name	Microloan
Type of client	Entrepreneur
Client eligibility requirements	The business must be in existence a minimum of one year. Service, manufacturing, or commercial activities are allowed. Business must be the primary source of family income.
Approval requirements	Loan Officer analysis, Supervisor approval, Branch Manager approval
Minimum *initial* amount per individual	None
Maximum *initial* amount per individual	EGP 3,000
Maximum amount per individual	EGP 15,000
Loan cycles (in EGP)	Up to 3,000 for the first loan Up to 4,500 for the second loan Up to 6,000 for the third loan Up to 7,500 for the fourth loan Up to 10,000 for the fifth loan Up to 12,500 for the sixth loan Up to 15,000 for the seventh loan
Minimum term	4 months
Maximum term	12 months for working capital loans 18 months for fixed-asset loans (after first cycle)
Repayment frequency	Monthly, equal payments of principal and interest
Grace period	Up to one month with special approval
Interest rate and fees	16 percent flat, EGP 5 penalty fee for late installments (average annual effective rate of more than 30 percent)
Collateral	Promissory notes for each individual installment check plus promissory note for the total loan amount. The spouse or immediate relative is the co-signer of the latter
Documentation	Photocopy of ID card, electricity receipt and registration of the business, if the firm is registered

Source: BdC

[26] Debit cards and ATMs could be used to allow clients to withdraw the proceeds of their loan at the time and place they choose or to withdraw over time.

[27] Real-time connections between most of BdC's branches have existed since early 2005. One branch indicated that clients could pay at other nearby branches but the branch would have to phone the originating branch and fax documentation. In any case, clients must come to the originating branch to retrieve their "checks" (promissory notes).

[28] The actual use of the loan is informally verified by Loan Officers within a week of the loan being disbursed. This usage is not formally tracked (through presentations of receipts), nor do Loan Officers indicate that punitive actions are taken if funds are used for other purposes.

Loan amounts begin at EGP 3,000 and increase in seven steps until reaching EGP 15,000, as indicated in Table 9.[29] Increases may be done for a lesser amount at the discretion of the Loan Officer and/or Supervisor. The tenor of working capital loans may range from 4 to 12 months and loans for fixed assets may be as long as 18 months.

BdC's average loan size has increased in nominal terms, as clients have progressed into higher cycles. However, as noted in Table 10, the average loan size has declined in U.S. dollar terms due to the nearly 50 percent decline in the Egyptian pound between 2000 and 2003. Furthermore, consumer prices rose between 2.7 percent and 11.3 percent in the same period, with no accompanying change in the programmed loan sizes, although BdC's average loan size is higher than many of its competitors.[30] The interest rate has also remained fixed at 16 percent flat per annum since 2001. Aside from adding a sixth and seventh step to the EQI model, BdC has made no modifications to its microloan product. BdC management is considering including credit insurance free of charge to clients, but has not done the analysis or designed the product.[31]

TABLE 10: LOAN SIZES

	FY2002	FY2003	FY2004	FY2005	FY2006
Average Outstanding Loan Size (in EGP)	1,640	1,745	1,890	2,064	2,186
Average Outstanding Loan Size (in USD)	382	324	306	341	376
Average Loan Disbursed	2,775	2,952	3,121	3,358	3,383
Average Loan Disbursed (in USD)	646	549	506	554	583

Source: BdC

Outside of microfinance, BdC also has a limited retail loan product offering, the most common of which appears to be salary-based loans to employees of state-owned enterprises (SOEs). These loans are for a period of up to five years and may not exceed 25 times the borrower's monthly income. The interest rate is 8 percent flat per year and payments are deducted directly from the borrower's wages. No collateral is required and the SOE agrees not to terminate employment without notification.

BdC management had obtained Board approval to introduce an SME loan product that would target sole proprietorships and partnerships with annual turnover of EGP 400,000 to 20 million ($70,000 to 3.5 million), with loans ranging from EGP 100,000 to 5 million ($17,000 to 865,000). The introduction of this product was postponed due to the merger with Banque Misr. However, even if/when implemented, there would still be a gap between BdC's current microloan product (maximum EGP 15,000 or $2,600) and the new product (minimum of EGP 100,000 or $17,000). There is no strategy to graduate clients from the Microfinance Department to other units at the branch or bank.

[29] The maximum in the EQI design is EGP 10,000. The increase for the sixth and seventh cycles was made recently. The branch visited in Qena indicated they had not implemented the larger loan sizes because loans greater than EGP 10,000 were too risky.

[30] ABA and DBACD have moved down market into group lending, bringing their average loan sizes down to less than $200.

[31] The basic credit insurance would provide payment of the outstanding balance of the client's loan in the case of death or disability. The attraction of this to clients is that it releases the guarantor, frequently a close relative, from liability.

Non-credit

BdC has not actively pursued savings with its microcredit clients, despite BdC's advantage of being a licensed deposit-taking institution. Savings accounts could facilitate the automation of loan disbursements and repayments. However, BdC does not require or encourage its microloan clients to open accounts or track how many have been opened. The number is believed to be small, around 10 to 20 percent.[32]

BdC management is aware of a single branch known to encourage clients to open a free savings account and have loan payments made through direct debit.[33] There was insufficient space at the branch for microfinance, so microfinance staff are located in a separate building without easy access to tellers. The branch estimates that nearly 90 percent of its microloan clients have opened savings accounts, primarily for the convenience and to earn some interest (the current rate paid on savings accounts is 8 percent). The branch does not track separately the value of savings balances of these clients, but its success in encouraging clients to open accounts suggests that BdC is missing an opportunity to promote this product to microentrepreneurs.

POLICIES AND PROCEDURES

Credit

BdC's credit procedures are based on EQI's standard design, which was geared towards business associations and NGOs. According to BdC and EQI, the standard processes and terms were largely unchanged, with modifications primarily related to approval, disbursement, collection, and control, in order to better fit within the existing structure and hierarchy of the bank.

The process for obtaining a loan is simple. Loan Officers promote the loan product by "cold calling" on prospective clients at their place of business.[34] To be eligible, clients must have a business that has been in existence a minimum of one year and is involved in service, manufacturing, or commercial activities (such as nonagricultural); the family income must be derived primarily from this business. After giving a brief explanation of the microloan product, terms, and conditions, the Loan Officer presents the interested businessperson with the one-page loan application (with name, address, date of birth, ID number, and type of business) and collects a copy of the prospective client's national identification card and proof of residence (for example, photocopies of an electricity bill). The Supervisor then visits the applicant's business, often in less than 24 hours, to verify and visually assesses the applicant's business. The Supervisor either approves or rejects the application immediately. If approved, the client is requested to come to the bank branch (usually the next day) to sign a loan agreement and receive the loan.

At this stage, microlending enters the existing branch hierarchy. Rather than utilizing the branch's credit committee, microloans have a streamlined approval process. The branch "internal auditor," who functions as a controller, reviews documents, after which the Branch Manager reviews the agreement and gives final approval. The average turnaround time on loans is two to three days in urban areas, but may be longer if clients are from outlying regions. The client will meet with the

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[32] Based on conversations with Team Leaders and three Branch Managers.

[33] Khlousy Branch in Cairo. However, Carlson (2000) notes that as of 2003, three branches were piloting savings.

[34] Originally, Loan Officers were limited to working in the area defined by BdC as the branch's territory. Interviews indicate that this restriction is largely ignored and Loan Officers seek out qualified clients in any area, even if it is served by another BdC branch.

Branch Manager just before a branch teller disburses the loan. All payments are made in the branch to a bank teller.

Branch Managers are ultimately responsible for loan approval. Again, approval is usually given if all documentation has been completed correctly. In the early stages of implementation, some Branch Managers tried to conform microfinance policies to existing commercial lending policies by requiring additional documentation and reviews. To counter this trend, BdC's Microfinance Department created and distributed a detailed operational manual that clearly outlined procedures for microfinance. This guidance mitigated Branch Managers' tendency to add additional bureaucratic steps.

While the Microfinance Department has been effective in standardizing and streamlining procedures, it has not been responsive to suggested changes and feedback. For example, clients that prepay loans are unable to take out another loan until after the original contractual maturity date of the prepaid loan.[35] There appears to be widespread support at the branch level to change this policy, which would require Board approval, but the Microfinance Department has not taken up the cause or acted as a conduit for turning feedback into improvements.

BdC's bureaucratic culture has, however, assisted the successful rollout of microfinance across BdC's branch network. This is due to the fact that microlending at BdC is more of a bureaucratic process than an analytical one. Very little analysis is done of the client's business and there is no credit score. BdC's credit policy is largely based on the principle that most microenterprises are bankable, if the Loan Officer and Supervisor determine that the applicant is of good character and borrowing for an allowable income-generating enterprise.[36]

Liquidity/Asset-Liability Management

BdC branches primarily capture deposits, which are used for large-scale corporate lending and investments made through other parts of the bank. Very little lending takes place at the branch level. Loan assets typically account for only 10 percent of a branch's total deposits. In smaller "C" branches, salary-based loans to employees of SOEs and collateralized personal loans comprise more than 50 percent of the branch's loan portfolio, with microfinance accounting for an additional 10 to 25 percent. In larger "A" branches, corporate loans are more prominent.

The Microfinance Department has no need for its own liquidity and cash management policies as all disbursements and collections are part of overall branch operations and asset/liability management is also managed centrally. Microfinance is small in terms of the bank's loan portfolio and negligible in terms of cash and liquidity management.

Interest rate management has not been dynamic for microfinance or other retail products. The cost of funds for all products is set by the bank's Investment Department on a monthly basis and has remained close to 10 percent over the past three years, despite significant fluctuations in inflation. This reflects the Bank of Egypt's discount rate to banks, which was set at 11 percent (on the average gross loan portfolio) in 2001 and was reduced to 10 percent in 2003. Lending rates for microfinance have remained at 16 percent flat and loan sizes have not been adjusted to match declines in the real

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[35] The current policy permits prepayment of loans (with full interest), but does not allow client's to access repeat loans until the contractual term of the loan is completed. EQI incorporated this policy to avoid clients progressing through steps (and loan amounts) too quickly. This has been problematic for clients seeking cash for peak seasons and holidays. BdC has plans to change this policy such that clients in later cycles (3-7) can prepay and secure repeat loans more quickly. The time it has taken to amend this policy is indicative of rigidity of the methodology and the product-driven (rather than client driven) approach of BdC.

[36] See Carlson (2004) for a more detailed explanation.

value (purchasing power parity) of the Egyptian pound.[37] This leaves BdC a comfortable spread of 20 percent.

MARKETING, PRODUCT DEVELOPMENT, AND PLANNING

No one in the Microfinance Department is dedicated to marketing or product development. Product promotion is done through the Loan Officers and their contact with clients. BdC does not conduct market research, survey new areas, or formally monitor client satisfaction with the product. Similarly, BdC has not brought in external product development expertise or developed internal expertise.

The Board has divided the country into four geographic regions for strategic and work planning purposes. Under this structure, all national product managers, including microfinance, provide each Regional Head with projections for their product within that region. To produce projections for microfinance, the National Product Manager and Deputy Product Manager liaise with Branch Managers to gather branch-level estimates as an input into the overall planning process. Analysis is done at a branch level, taking into consideration the branch's location, the number of Loan Officers, the historical growth of the microfinance portfolio at the branch, the rate of loan renewals, and the dropout rate. Then, branch projections and targets receive feedback from Regional Team Leaders and are negotiated with Branch Managers.

CONTROLS AND AUDIT

Monitoring and Oversight

Dedicated microfinance staff, other branch staff, the Microfinance Department, and BdC internal audit personnel are involved with the monitoring and oversight of microfinance. The function of each group is shown in Table 11.

TABLE 11: CONTROL FUNCTIONS

Location	Title	Planning	Approval Authority	Monitors	Controls/ Audits	Receives Incentive
Branch	Loan Officer	N	Y	Y	N	Y
Branch	Supervisor	Y	Y	Y	Y	Y
Branch	Branch "auditor"	N	N	N	Y	N
Branch	MIS	N	N	N	Y	N
Branch	Branch Manager	Y	Y	Y	Y	Y
MFD	Team Leader	Y	N	Y	N	N
MFD	Finance Officers	Y	N	Y	N	N
MFD	MIS Officer	N	N	Y	Y/N	N
Audit	Internal Auditor	N	N	N	Y	N

Y = Yes (participates or has some responsibility), N = No (participation or responsibility)

[37] This is also true for civil servant loans, which have a rate of 8 percent and have not been adjusted in recent years.

The primary controls with respect to microlending are at the branch. These include:

- Client verification by the Loan Officer, Supervisor, Branch Manager (usually), and the Teller;
- Loan approval by Loan Officer Supervisor and Branch Manager;
- Verification of document by branch "auditor" and Branch Manager;
- Handling of cash exclusively by tellers; and
- Reconciliation of El Mohassil to FlexCube by the branch MIS person.

Regional Team Leaders are required to spend a minimum of one week in each branch per year. Reportedly, they spend more than half of their time in branches. Currently, their primary duties are monitoring each branch's procedures, assisting Supervisors and Loan Officers with collection, and visiting a sample of each branch's clients.

The role of branch "auditor" is a result of the decentralization. Auditors do not have authority over microfinance or implementation and they do not participate in the incentive system.

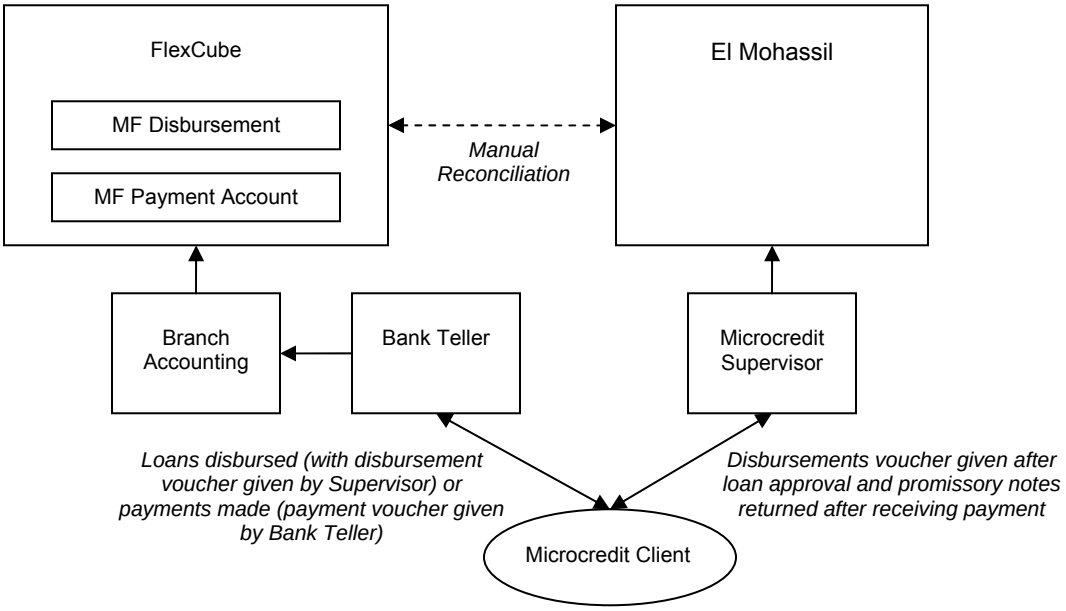
The Microfinance Department financial analysts are responsible for reporting and control. Despite the wealth of information contained in the El Mohassil system, financial reporting (as opposed to portfolio reporting) remains a manual process (discussed below in the sections on MIS and Reporting). One officer is responsible for gathering information from different systems and departments to create financial reports for microfinance. Two officers primarily monitor incoming reports from area managers and Branch Managers. These reports are reviewed for "red flags" and to calculate incentives.

MIS

As part of the USAID/Egypt-funded technical assistance received from EQI, the *El Mohassil* (EM) system was implemented at BdC microfinance branches as microfinance was rolled-out at BdC, beginning in 2001. The EM system was developed by EQI as part of its previous USAID/Egypt-funded technical assistance to other MFIs in Egypt. It is a loan tracking system and does not include an accounting module. A notable attribute of the EM system is that it can be networked across branches, allowing BdC to screen out bad clients and applicants with existing loans from BdC. In this respect, the EM system was ahead of other BdC branch systems.

In FY2003, BdC began to implement FlexCube as its new core banking system. FlexCube is now available and networked across branches and serves as the accounting system. Unfortunately, EM is not integrated or interfaced with FlexCube, so BdC's microfinance operations operate on a standalone basis. However, given that microcredit disbursements and payments are made through the branch, they must be reconciled with FlexCube at the branch level. Senior management has expressed an interest in having microfinance integrated into other bank operations so that "real" accounts can be opened for microfinance clients. For the time being, clients have a "microfinance account." Figure 5 depicts how system entries are made at the branch level.

FIGURE 5: MICROFINANCE SYSTEMS AT BRANCH LEVEL



Source: BdC

As a loan tracking system, EM has two modules—one for the headquarters and another for the branch. Branch data is replicated to headquarters, which has access to all branch data. At the branch level, the first step in the process is to create and submit a client profile—which contains information such as name, national ID number, gender, and type of business—after required information and documentation has been gathered and verified by the Loan Officer, Supervisor, and "Auditor," per microcredit procedures. After being submitted, client profiles are then "approved" (or rather acknowledged, as it is done mechanically) by the microfinance MIS group at headquarters.

After the client profile is created and approved, a loan contract can be generated for the client. The Supervisor enters loan information[38] and a disbursement is recorded in the EM system. A disbursement voucher is given to the client so he or she can receive the actual cash disbursement from the Bank Teller at the branch. Subsequently, clients first go to the Bank Teller to make payments using payment slips provided by the Supervisor and receive payment vouchers that are then given to the Supervisor, who returns the client's promissory note for that payment and enters the payment into the EM system. Microcredit disbursements and payments are reconciled between the EM and FlexCube systems at the branch level.

The EM system has the flexibility to manage multiple products, although it is currently only being used for one product at BdC. Within a product, the system allows for loan amounts and terms to vary within pre-defined ranges. However, it is not possible to vary the interest rate or the interest rate method (that is, flat or declining balance) between loans within a product, although these factors can

[38] In two branches visited, the Loan Officers had access to the EM system and input loan information directly.

be changed between products. Furthermore, the system does not easily support partial payments (possible, but complicated) and does not support penalty fees, which must be calculated and tracked manually by branches.

Reporting

The EM system has a number of pre-defined reports, including productivity, portfolio quality (portfolio at risk), and aging of arrears reports. However, reports take a long time to generate and are hard coded within the system. Only EQI, which owns the EM system (source code), can modify the system or create new reports. BdC would need to pay EQI to create new reports, as this service is not included in the licensing fees that EQI has charged to BdC after USAID/Egypt-funded technical assistance to BdC ended. Otherwise, to look at information differently from pre-established reports, data must be exported outside of the EM system and reports generated in other software.

Beyond portfolio monitoring reports from the EM system, microfinance management also receives a monthly income statement for the microcredit department, which is created using information from sources such as the EM system, FlexCube, and BdC's personnel department.

HUMAN RESOURCES

Management

Initially, the emergence of Amr Abouesh as the manager of BdC's microfinance product created an issue, due to his youth and newcomer status.[39] To mitigate this, Mr. Abouesh selected two senior bankers from BdC, Mohamed M. Hafiz and Samir abd All Nirouz, with combined experience in IT and branch operations, as his core team in early 2002. Branch managers and employees respected their seniority and experience and both new managers shared Mr. Abouesh's vision for microfinance and the BdC's commitment to reduce bureaucracy. In 2002, Mr. Abouesh was made an Executive Advisor and, in 2004, promoted to run retail banking.

The Microfinance Department operated the microfinance rollout with only five staff members in headquarters through 2003 by relying heavily on the involvement of EQI in training and monitoring. EQI trained 15 new Regional Team Leaders to carry on the product rollout and monitoring by the end of 2004. The Regional Team Leaders oversee a portfolio of branches within a given geographical area and liaise with Supervisors and Branch Managers to troubleshoot issues that may arise. Regional Team Leaders report directly to the Deputy National Product Manager (Mr. Al Nirouz) at headquarters. The Microfinance Department's role is to train and monitor the microfinance staff in branches and to report on microfinance activities to senior management and the Board. However, the Microfinance Department also functions as part of the internal control system.

[39] As an anecdote about the importance of status, Mr. Abouesh shared a story that a rumor started that he was related to the wife of President Mubarak, which explained his position in the bank. He did little to dissuade rumor mongering as the prestige factor of being related to Mrs. Mubarak won him respect.

Staffing

The initial driver of introducing microfinance at BdC was the absorption of excess staff. As of the end of 2005, 792 BdC employees out of approximately 10,300 were dedicated to microfinance.[40] Nearly all of these employees had been employed at other (various) positions at the bank, with most having been recommended by the Branch Manger to join BdC's microfinance operations, although BdC relied on the EQI training to help screen Loan Officer candidates.

During the rollout, Branch Managers were asked to put forward names of staff members for the microfinance Loan Officer and Supervisor positions. The only criterion for Loan Officers was that they must live in the local community and be able to interact with clients. Supervisor candidates should have a good reputation, long tenure, and strong relations with other staff members. Credit analysis skills were not a significant advantage, as most microfinance staff were drawn from noncredit positions. The most common transition was for "Information Officers," who were responsible for gathering client data at branches, to become Loan Officers. This trend appears to be largely due to their experience in dealing with and visiting clients.

There have been some advantages of using internal staff, other than absorbing excess capacity. Microfinance staff are well versed in bank procedures, familiar with bank systems, and keenly interested in preserving their position in the bank. At times, the Microfinance Department also found that bureaucratic tendencies worked in their favor by providing a natural level of control that is not inherent in NGOs. Staff tends to be loyal to BdC out of self-interest. Many microfinance staff have more than 10 years of employment, earn above market wages, and receive significant benefits. While BdC staff are unlikely to be fired for poor performance, they may be forced to relocate. This threat became greater with the announcement of the merger with Banque Misr. Several Loan Officers expressed relief that they are now "productive" employees and are unlikely to be forced to move.

Training

Microfinance staff receive introductory training. Initially, the introductory training was provided by EQI which had previously provided similar training sessions to numerous NGOs, but now the Regional Team Leaders deliver it. Introductory training is largely theoretical and is followed by several weeks of on-the-job training.

Incentive System

An incentive system designed by EQI through USAID-funded technical assistance is detailed below (Table 12). These incentives are incremental to existing bonuses currently received by BdC employees. The system was designed to motivate Loans Officers, Supervisors, and Branch Mangers to originate large numbers of loans, while maintaining the quality of the loan portfolio. Microfinance staff and Branch Managers seem, generally, to be pleased with the incentive system. Most loan officers are earning a higher level of compensation than they would have with their previous positions within the bank.

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[40] The initial microfinance business plan prepared for BdC by EQI projected that BdC would implement microfinance utilize over 1,000 employees by March 2003. This projected pace of microfinance expansion/ employment was unrealistic and may have been partially attributed to the targets that EQI had been given by USAID/Egypt, which focused on expanding the number of microlending "units" in the country.

TABLE 12: MICROCREDIT INCENTIVE SYSTEM	
Loan Officer	• Loan officers do not receive incentives during the first six months they are in the position • After six months, loan officers will earn incentives if they have at least 30 borrowers in their portfolio. If qualified, the monthly incentive for each loan officer will be calculated by multiplying the total number of loans disbursed by that loan officer during the current month, with the appropriate monetary incentive per loan originated based on the loan officer's current PAR: — PAR of less than 1.5% EGP 20 — PAR of 1.5% to less than 2.5% EGP 15 — PAR of 2.5% to less than 3.5% EGP 10 — PAR of 3.5% or over EGP 0
Supervisor	• Supervisors earn incentives for loans originated by loan officers, based on the same criteria established for loan officer incentives. Supervisor incentives are as follows: — PAR of less than 1.5% EGP 3 — PAR of 1.5% to less than 2.5% EGP 2 — PAR of 2.5% to less than 3.5% EGP 1 — PAR of 3.5% or over EGP 0
Branch Manager	• EGP 50 per month per loan officer • On average, each loan officer must have at least 30 borrowers in his portfolio for the Branch Manager to receive his monthly bonus. For example, if there are five field specialists, there must be at least 150 micro-borrowers in the branch • If the end-of-month PAR for the branch exceeds 3.5%, the Branch Manager does not receive his monthly bonus

Source: BdC Microcredit Business Plan, June 2001

FOSTERING CULTURAL CHANGE

BdC's Executive Advisors have found changing the bureaucratic culture of the bank a challenge. Bureaucracy and territoriality are endemic to any large financial institution and are particularly pronounced in state-owned banks. In the case of BdC, all employees are unionized civil servants who face little risk of dismissal, which limits the effect of sanctions for poor performance. [41] To gain acceptance of microfinance within the bank, the Chairman and his Executive Advisors had to deploy a mixture of authority, status and prestige, and incentives. Remarkably, microfinance at BdC has become the proverbial tail wagging the dog—while microfinance is a very small part of the BdC's business, it has led cultural change at BdC's branches.

In contrast to Khan Bank or BRI in Indonesia, prior to being named credit officers in branches BdC staff had little client or community contact. Many did not develop the interpersonal skills and temperament necessary for microlending. Management understood that microfinance would be "uncomfortable" for most Branch Managers and Loan Officers, as they were largely accustomed to desk jobs. Although the bank's culture would inhibit any direct protest, throughout the rollout many Branch Managers expressed their skepticism by quietly selecting their lowest performing employees rather than turning over more qualified staff to the pilot.[42] Even after Loan Officers were selected and trained, some Branch Managers continued to require them to do their previous work in addition to microfinance.

[41] The new staff hired for BdC's five microfinance units are contractors rather than government employees.

[42] Team leaders commented on a few Branch Managers even nominated persons with handicaps that were obviously incapable of the work.

Consequently, the bank's Chairman got involved in initial meetings regarding microfinance to lend prestige to the pilot project and get "buy-in" from Branch Managers. For many Branch Managers, it was their first encounter with the bank's senior management. Additionally, the Branch Managers of the 10 branches in Upper Egypt selected for the pilot phase were personally asked by the Chairman to participate in the project. As one Branch Manager commented, "It was an honor to be asked by my Chairman." An introductory meeting with Branch Managers with senior management (and on occasion, Board members) was incorporated as part of the rollout process.

Building on this approach, BdC management emphasized the prestige of participating in microfinance at annual meetings and training sessions. This was aided by public discussions of microfinance by top officials in the Egyptian government, including President Mubarak. Furthermore, the rollout of microfinance coincided with a period during which some bank officials were arrested for fraud, including a few BdC Branch Managers, which made other Branch Managers eager to please. Ultimately, however, the momentum, energy, and positive performance of microfinance at BdC contrasted with other branch operations, making the product hard to ignore for Branch Managers.

Despite some success in fostering cultural change, problems persist. The relatively small number of microfinance staff at each branch, who have adopted a new style of management, work side-by-side with branch employees who still operate under the former style of credit management. This co-existence has not been easy. Microfinance staff feel comparatively overworked and non-microfinance branch staff have difficulty accepting that microfinance staff, with shorter tenure and fewer credentials than they have, may enjoy higher compensation.

MICROFINANCE PERFORMANCE

BdC's performance has been impressive in the speed of its client and portfolio growth and the consistency of its portfolio quality. BdC is now the largest microcredit provider in Egypt, after only four full years of operation. As of November 2005, BdC's microfinance program was serving over 86,000 clients with a gross loan portfolio of EGP 189 million ($32 million).

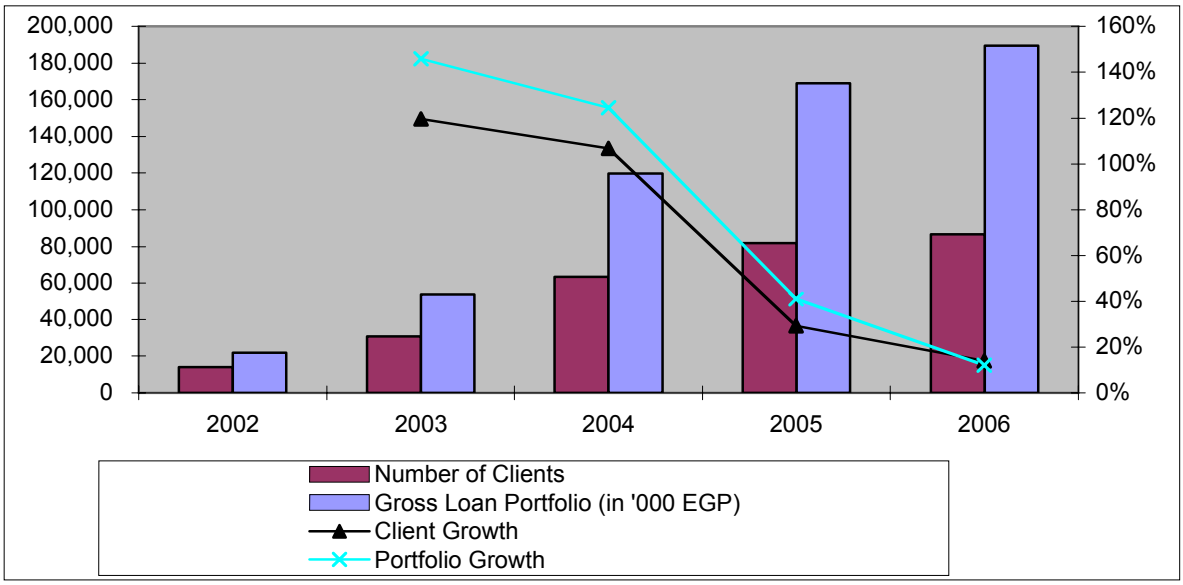
GROWTH AND OUTREACH

BdC's growth in clients served was more than 100 percent annually through 2004, as it expanded operations from the first 10 branches to 97. In FY2005, branch growth was limited and annual client and portfolio growth rate declined to 29 percent and 41 percent, respectively (see Figure 6). Client growth for the BdC clients and portfolio is likely to be below 20 percent in FY2006. At the same time, the new Banque Misr branches will likely grow at much higher rates. Each of the three BdC branches interviewed believed that the market has become increasingly competitive, but that growth of 10 percent in BdC branches for the current fiscal year is a reasonable target.

Outstanding loan sizes have remained approximately 25 percent of GNI per capita. Average loan size has been increasing slowly (in Egyptian Pounds, although decreasing if converted to U.S. dollar equivalents), driven by the larger loan sizes for repeat clients (see Table 13). Client turnover[43] has been 27 percent for the past two years, which moderates the overall growth of the portfolio. There is no official poverty line for Egypt, but the World Bank approximates it to be $2 per day or $730 per year. This compares with an average loan size (disbursed) of $506. BdC does not monitor other indicators that could be used as a proxy for the economic depth of BdC's lending.

[43] Defined as (Active Clients, End of Period + New Clients – Active Clients, Beginning of Period)/(Average Active Clients).

FIGURE 6: CLIENT AND PORTFOLIO GROWTH



Source: BdC

TABLE 13: LOAN SIZE AND GROWTH

	Jun-04	Jun-05	Nov-05
Average Outstanding Loan Size	1,890	2,064	2,186
Average Loan Disbursed	3,121	3,358	3,383
Average Outstanding Loan Size (in USD)	306	341	376
Average Loan Disbursed (in USD)	506	554	583
GNI Per Capita	1,390	1,310	N/A
Growth in Gross Portfolio	124%	41%	12%*
Growth in Average Loan Disbursed	7.5%	7.6%	0.7%*
Consumer Price Index (CPI)	11.3%	16.9%	5.0%*

Sources: BdC, Economist Intelligence Unit, Country Profile of Egypt, 2005, Central Bank of Egypt Website

*Annualized for five months June–November 2005

BdC's average loan balance is relatively high compared to other major microlenders in Egypt, whose outstanding loan balances have dropped from an average of more than $300 to less than $200, as business associations and NGOs expand their group lending operations and move down market (see Table 14.

TABLE 14: COMPARATIVE OUTSTANDING LOAN SIZES

(as of June 2004, in USD)	BdC	ABA	DBACD	USAID/Egypt Programs	Arab Large/Medium
Average Loan Outstanding	341	192 / (291)[44]	184/ (262)[45]	236	394

Source: Planet Rating, AViD, and *MicroBanking Bulletin*

FINANCIAL PERFORMANCE

Evolution of Financial Performance Monitoring

Measuring microfinance financial performance requires many assumptions and several manual procedures. BdC did not actively track many of the direct costs of the microfinance program until FY2004. Management and the Board initially believed that because the microfinance program was absorbing excess staff in existing branches, two unavoidable or "fixed" costs, its success should be measured without consideration of staff costs or overhead. BdC was only concerned with its net financial margin less the cost of loan losses, all of which was easily tracked in the EM system. With the expansion of the Microfinance Department, the National Product Manager began to apply a more rigorous standard, which includes most of the cost of staff that is exclusively dedicated to microfinance. Measuring the marginal costs (that is, staff) of a new venture has merits, particularly when the new venture utilizes much of the same infrastructure.

As the product is rolled out, however, management should determine the all-in cost, including the utilization of existing infrastructure. BdC has started to do this by allocating a small portion of BdC's overhead to the microfinance operations when analyzing profitability. The Microfinance Department Finance staff now brings together information from different sources, such as the EM system, FlexCube, and BdC's personnel department, to develop basic financial statements, based on a set of assumptions. The Microfinance Department produces monthly reports on the portfolio, disbursements, portfolio at risk, clients, staff, and basic revenue and expenses. While portfolio quality is tracked closely and follows standard microfinance practices, there is no separate balance sheet or cash flow statement for BdC's microfinance operations, which limits analysis.

Reported Profitability

The following section presents BdC's income statement, as calculated by the Microfinance Department (see Table 15). This is followed by an adjusted income statement calculated by the authors of this case study. As the reader will note, the differences are substantial and neither the BdC figures nor the adjusted figures are entirely accurate. They rely on different assumptions on if and how to allocate the large infrastructure and operating expenses of the bank to what is a relatively

[44] Denotes the average outstanding loan size of individual loans only.

[45] Denotes the average outstanding loan size of individual loans only.

small project. Both the Microfinance Department and the authors lacked complete information on the breakdown of the bank's expenses, which further complicated any financial analysis. Both the unadjusted and adjusted figures have merit—the former considers the marginal expenses of entering a new business and the latter considers the long-term viability of the new business.

TABLE 15: BDC MICROFINANCE PROFIT AND LOSS STATEMENT

Note	*(EGP)*	FY2004	FY2005	FY2006 YTD*
	Financial Revenue	22,420,405	40,651,232	20,992,257
1	**Financial Expense**	7,919,340	13,494,354	6,554,304
	Net Financial Income	14,501,065	27,156,878	14,437,953
	Impairment Losses on Loans	176,908	539,381	451,282
	Operating Expense	14,492,348	20,237,597	9,505,819
2	Personnel Expense	13,647,176	16,955,020	7,906,051
	Administrative Expense	845,172	3,282,577	1,599,768
3	Depreciation and Amortization Expense	197	133,172	79,478
	Other Administrative Expense	844,975	3,149,405	1,520,290
4	Share of Gen & Admin Costs	844,975	642,985	113,685
5	Other Direct Costs	0	204,697	290,555
6	**Registration Taxes**	0	2,301,723	1,116,050
	Net Operating Income	(168,191)	6,379,900	4,480,852
	Net Non-Operating Income/(Expense)	0	0	0
	Net Income (Before Taxes and Donations)	(168,191)	6,379,900	4,480,852
	Taxes	0	0	0
	Net Income (After Taxes and Before Donations)	(168,191)	6,379,900	4,480,852
	Donations	0	0	0
	Net Income (After Taxes and Donations)	(168,191)	6,379,900	4,480,852

Source: BdC

*June–November, 2005.

Notes:

1 The Microfinance Department calculates financial expenses using the following formula: Financial Expenses = (Average Gross Loan Portfolio for Period x BdC Cost of Funds). The cost of funds is provided by the BdC Investment Department each month and has been identical to the Bank of Egypt discount rate, currently at 10 percent.

2 Personnel expenses include salaries and incentives. They do not include benefits paid to the state for employees or the annual bonus that is provided to all BdC employees.

3 Includes only fixed assets purchased directly by the Microfinance Department, including computers for microfinance staff in the branches. All other fixed assets are depreciated as part of BdC's income statement, included as part of general and administrative (G&A) expenses.

4 Microfinance operations' share of the bank's G&A expenses is calculated as (microfinance Portfolio/BdC Portfolio x BdC G&A expenses). BdC G&A includes all salaries, depreciation, and administrative expenses. The rate for 2005 was 0.04 percent.

5 Other costs of Microfinance Department headquarters only.

6 Taxes are for registration of loan documents by local branches.

Financial revenue is tracked through the EM system. Revenue has grown consistently in the past three years, mirroring the growth in the loan portfolio. Financial expenses are a "shadow" charge to microfinance rather than the actual cost of raising funds for the program. This cost is the discount rate set by the CBE, which has remained at 9 percent for the past three years, and it is applied to the entire portfolio. The interest paid on BdC's overall funding liabilities[46] was 5.9 percent in FY2004 (see Table 18, below). However, the higher rate makes sense in consideration of the blended cost of equity and liabilities.

Personnel expenses include the salaries of Loan Officers, Supervisors, and the Microfinance Department staff. They do not include personnel taxes or other benefits. The costs of tellers, Branch Managers, and any other staff that support the program are missing. Administrative expense are even less representative, as they only include the depreciation of the single dedicated computer for microfinance at each branch and some minor headquarter expenses. Since 2004, the Microfinance Department has tracked the cost of registration taxes, a fee paid to the government for each loan contract.[47]

According to the Microfinance Department, the allocation of the bank's G&A costs should be calculated based on the microfinance portfolio as a percentage of the BdC's average portfolio of loans to customers and banks. In 2004 and 2005, that percentage was 0.5 percent and 0.44 percent, respectively.

According to the Microfinance Department's calculations, the microfinance program has performed well compared to the bank overall (see Table 16). The yield on BdC's microcredit portfolio is 28 to 29 percent, which is more than three times the bank's recent average overall yield of 9.6 percent.[48] In addition, the cost of the impairment losses on loans (loan loss provision expense) is only 1 percent of interest revenue, compared to a startling 39 percent for the bank itself. This figure alone might suggest that microfinance is more profitable than the bank's overall activities, although it does not take into consideration the different operating cost structures, which tend to be much higher in microfinance operations due to their labor intensive nature, smaller loan size, and higher portfolio turnover ratios.

TABLE 16: COMPARISON OF MICROFINANCE AND CONSOLIDATED BANK PERFORMANCE

In EGP	Microfinance		Banque du Caire FY2004
	FY2005	FY2004	
Financial Revenue	40,651	22,420	4,071,869
Interest Revenue from Loan Portfolio	40,651	22,420	2,232,426
Income from Treasury Bills and Bonds	0	0	493,213
Other Operating Income	0	0	1,346,230
Financial Expense	13,494	7,919	2,301,771
Net Financial Income	27,157	14,501	1,770,098
Impairment Losses on Loans	539	177	879,482

[46] Funding liabilities include deposits and borrowings. BdC's funding liabilities are 95 percent customers' deposits.

[47] The cost is 0.06 percent for each loan agreement greater than EGP 10,000 and 0.08 percent for agreements less than EGP 10,000.

[48] Yield is calculated according the SEEP Framework.

In EGP	Microfinance		Banque du Caire FY2004
	FY2005	FY2004	
Operating Expense	20,238	14,492	848,763
Net Operating Income	6,380	(168)	41,853
Net Non-Operating Income/(Expense)	0	0	73,244
Net Income (Before Taxes and Donations)	6,380	(168)	115,097
Taxes	0	0	60,917
Net Income (After Taxes and Before Donations)	6,380	(168)	54,180
Donations	0	0	0
Net Income (After Taxes and Donations)	6,380	(168)	54,180

Source: BdC

Adjusted Profitability

The authors of this study sought to adjust BdC's income and expense account for benchmarking purposes.[49] To a limited degree, this allows BdC's performance to be compared with other Egyptian and Arabian MFIs. The results are shown in Table 17. The microfinance program's performance on an adjusted basis reveals slower progress to profitability. The major factor adversely affecting the adjusted numbers is the allocation of the cost of using BdC's branch network, which is relatively expensive.

[49] The method use follows that of the SEEP Framework and the MicroBanking Bulletin.

TABLE 17: ADJUSTED PROFIT AND LOSS STATEMENT			
In EGP	FY2004	FY2005	FY2006 YTD
Financial Revenue	22,420,405	40,651,232	20,992,257
Financial Expense (adjusted)	7,919,340	13,494,354	6,685,232
Adjustment for Subsidized Cost of Funds	0	0	0
Adjustment for Inflation	0	0	0
Net Financial Income	14,501,065	27,156,878	14,437,953
Impairment Losses on Loans (adjusted)	176,908	539,381	451,282
Adjustment for Impairment Loss Allowance	0	0	0
Operating Expense (adjusted)	30,969,882	39,951,726	18,168,455
Personnel Expense (adjusted)	15,604,193	22,078,526	10,264,028
In-Kind Subsidy Adjustment to Personnel Expense	1,957,017	5,123,506	2,357,977
Salaries (unadjusted)	13,647,176	16,955,020	6,825,852
Incentives (unadjusted)	0	0	1,080,199
Administrative Expense (adjusted)	15,365,689	17,873,199	7,904,428
Depreciation and Amortization Expense	197	133,172	79,478
Other Administrative Expense	844,975	3,149,405	1,520,290
In-Kind Subsidy Adjustment to Administrative Expense	14,520,517	14,590,622	6,304,660
Net Operating Income	(16,645,725)	(13,334,229)	(4,181,784)
Net Non-Operating Income/(Expense)	0	0	0
Net Income (Before Taxes and Donations)	(16,645,725)	(13,334,229)	(4,181,784)
Taxes	0	0	0
Net Income (After Taxes and Before Donations)	(16,645,725)	(13,334,229)	(4,181,784)
Donations	0	0	0
Net Income (After Taxes and Donations)	(16,645,725)	(13,334,229)	(4,181,784)

Three categories of adjustments were reviewed: subsidies, inflation, and nonperforming loans. All adjustments are applied using the methodology outlined in the SEEP Framework.[50] No subsidized cost of funds adjustment is needed, as the cost of funds currently applied to BdC's microloan portfolio matches the discount rate and is higher than the bank's all-in cost for funding liabilities.

[50] See *Measuring Performance of Microfinance Institutions A Framework for Reporting, Analysis and Monitoring*, available at www.seepnetwork.org

The in-kind subsidy adjustment is significant. It includes five major additions to expenses, namely:

1) **Full-time equivalent cost of the Branch Managers**. Based on discussions with branch staff, the use of nondedicated microfinance staff appears to be fairly consistent across branches. Branch Managers spend a minimum of one hour per day on microfinance, meeting with clients, Supervisors, and Loan Officers, as well as reviewing and submitting reports.[51]

2) **Cost of branch tellers who serve clients**. The Branch Managers interviewed estimate that microfinance requires the full-time equivalent of one teller each day. While other branch staff contribute—including controllers and administrative staff—their time is negligible and therefore not included.

3) **Cost of other headquarters staff that is collectively involved in microfinance**. In terms of overall headquarters staff and administrative expenses, the policy of allocating bank costs according to the relative size of the loan portfolio appears to be a reasonable approach. Microfinance involves little headquarters staff involvement beyond that of the Microfinance Department, although it does attract the attention of senior management. For the most part, microfinance operates outside of the bank's systems. As a result, the adjustment for headquarters overhead net of the Microfinance Department direct costs is fairly small.

4) **Cost of the depreciation and other administrative costs of the branch network**. The largest adjustment is for the administrative cost of the branch network. This adjustment required allocating a portion of G&A cost for the branches net of personnel costs to microfinance. Microfinance staff accounted for 5.6 percent, 7.3 percent, and 7.6 percent of total BdC in FY2004, FY2005, and FY2006 to date, respectively. The number of staff is closely linked with branch administrative costs (which includes depreciation of property and fixed assets). Therefore it seems appropriate to allocate administrative expenses according to the percentage of staff involved in microfinance. This results in a significant, admittedly inaccurate adjustment.

5) **Cost of EQI's technical assistance**. EQI's technical assistance lasted through December 2004, with an estimated value of $15,000 per month.[52]

No inflation adjustment is needed because BdC's capital structure is assumed to be 100 percent liabilities, to which BdC's cost of funds is applied. Therefore, there is no equity against which a cost of inflation can be applied.

The adjustment for nonperforming loans is limited to a small write-off adjustment. The evaluators assumed that balances of loans more than 120 days past due that migrated from one period to the next were more than 365 days past due and therefore should be written-off. Given BdC's low level of delinquency and large portfolio, this amount was EGP 767,365 over three years—too small to affect BdC's performance ratios.

As Table 18 illustrates, BdC shows strong movement to profitability, even on an adjusted basis. Its margins are the highest in the bank and its provision expense the lowest. As a product line, it may rival the civil servant loan in terms of profitability.[53] After four years, BdC is only slightly behind

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[51] This estimate is conservative. The three managers interviewed spend more time on microfinance. However, they represent branches with a fairly large client base.

[52] Estimate by EQI.

[53] Civil servant loans are 8 percent flat per annum and have two levels of recourse: the state-owned employer and the Government of Egypt. They are also reinsured by a private company to avoid any lengthy delays in government reimbursement. Maintenance is minimal since payments are deducted directly from the employee's paycheck.

other large Arab MFIs on an adjusted basis, even though BdC has a lower portfolio yield and applies a higher cost of funds than the Arab average.

TABLE 18: COMPARISON OF KEY PROFITABILITY RATIOS

	Microfinance (Adjusted)			BDC	Benchmarks	
	FY04	FY05	FY06 YTD (annualized)	BDC FY04	Arab Medium/ Large 2002	All Arab 2002
Operational Self-Sufficiency (OSS)	99%	119%	127%	101%	127%	117%
Financial Self-Sufficiency (FSS)	57%	75%	83%	N/A	112%	106%
Return on Assets (ROA)	0%	4%	6%	0.1%	N/A	N/A
Adjusted Return on Assets (AROA)	-19%	-9%	-6%	N/A	2.2%	0.7%
Yield on Gross Portfolio	26%	27%	28%	9.6%	39%	38.2%
Cost of Funds Ratio	9%	9%	9%	5.9%	N/A	N/A
Adjusted Cost of Funds	9%	9%	9%	N/A	2.5%	2.9%

Source: BdC Annual Report, Benchmarking Arab Microfinance

BdC's microfinance program would likely reach break-even or a moderate level of profitability with an adjusted ROA similar to that of its Arab peers in the coming year. However, several factors are slowing portfolio growth and may effectively limit its profitability in the future. Client growth is slowing considerably, client turnover remains above 20 percent, and clients are reaching their maximum loan amounts, given the current product offering and limitations. Loan Officers are approaching the maximum allowable levels of clients and portfolio (see section on Efficiency, below). On the other hand, the merger with Banque Misr may allow the merged bank to achieve outreach and profitability levels higher than its Arab peers. Client growth will likely increase if microfinance is rolled out across new Banque Misr branches over the next few years and if staffing costs can be reduced (for example, if new, lower-cost staff are used). The addition of new products, particularly the SME loans, could also boost portfolio growth.

PORTFOLIO QUALITY

The EM system allows for monitoring of loan performance on a daily basis. Rather than using BdC's overall provisioning policies, the Microfinance Department provisions based on PAR, based on the original SEEP guidelines[54] that are suggested in the EM system. BdC provisions 100 percent for all loans past due more than 120 days. However, no loans have been written off since the program's inception, as this requires Board approval.

In 2004 and 2005, BdC's portfolio at risk was slightly lower than its peers and the Arab MFI benchmark (see Table 19 and Figure 7). BdC's PAR ratios were remarkably low in FY2002 and

[54] The provisioning rates are based on the 1995 SEEP guide, *Financial Ratios for Microfinance*.

FY2003, when other MFIs saw rates rise into the high single digits. In general, Arab countries demonstrate strong portfolio quality that far exceeds the global average. At the same time, BdC's ratios may be somewhat skewed, given the rapid growth in the portfolio.[55]

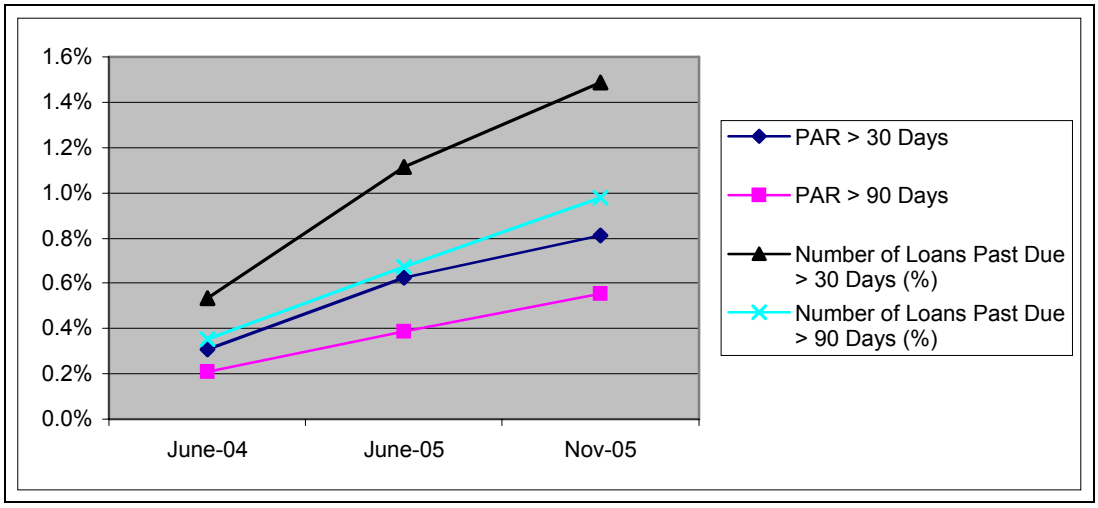
TABLE 19: PORTFOLIO AT RISK > 30 DAYS COMPARISON FOR 2004

	BdC Microfinance	ABA	DBACD	Arab Large/Medium	Arab All
PAR > 30 days	0.3%	0.7%	0.93%	1.4%	1.1%

Source: Mix Market, MicroBanking Bulletin

Branch Managers are permitted to reschedule loans if a loan is 30 days past due. Two Branch Managers indicated that they have rescheduled a few loans each year (two and five, respectively) for clients who have experienced a personal problem that prevents repayment. However, information regarding rescheduled loans was not made available to the authors. Clients with loans that are past due more than 90 days are not eligible for repeat loans.

FIGURE 7: HISTORICAL PORTFOLIO AT RISK



[55] Rapid growth causes the denominator of the PAR ratio, the average gross loan portfolio, to distort the PAR ratio in favor of a lower PAR.

BdC has been pleasantly surprised with the low delinquency rates, which it attributes to the EQI lending methodology. Supervisors note that the gradual increase in credit and the manageable loan sizes are key to maintaining low delinquency. According to branch staff, clients are not used to having regular contact with bank staff and respond to collection visits. Low PAR is also encouraged through the incentive scheme for Loan Officers and Supervisors. BdC's experience stands in contrast to Banco do Nordeste, which experienced significant losses during its expansion phase after a successful pilot. Although Banco do Nordeste also began with a single standardized product, its portfolio trouble was due to insufficient training of staff and lack of controls. In this respect, BdC's experience more closely resembles that of Khan Bank, which has maintained nonperforming loans at or around 1 percent since its entry into microfinance. Like Khan Bank, BdC had staff available in branches, including nonmicrofinance staff, to assist in closely monitoring loans during the expansion phase.

An analysis of BdC's PAR does reveal one negative trend: more than a third of PAR is greater than 120 days past due and is growing (see Table 22, below). In other words, the amount of loans migrating from one day to 120 days past due is growing as fast or faster than the portfolio itself. This reveals a collection problem with delinquent loans. Given that loans are not written off, this proportion of PAR > 120 days will likely grow faster as the portfolio growth slows. It is also likely that a high percentage of loans past due more than 120 days are uncollectible. If BdC were to write off the value of loans that are more than 365 days past due, it is likely that write-offs would be 0.5 to 1 percent of the portfolio. This would still be a relatively low figure, but significant when PAR > 30 days is less than 1 percent.

TABLE 20: NON-PERFORMING LOANS > 30 DAYS

	Jun-04	Jun-05	Nov-05
PAR Ratio	0.31%	0.62%	0.81%
Adjusted PAR Ratio	0.31%	0.63%	0.81%
Write-off Ratio	0.0%	0.0%	0.0%
Adjusted Write-off Ratio	0.1%	0.2%	0.5%
Risk Coverage Ratio	1.01x	2.28x	2.16x
Adjusted Risk Coverage Ratio	1.02x	3.20x	2.63x

Source: BdC

TABLE 21: PORTFOLIO REPORT

Note	In EGP	July 1 2005 to Nov 30 2005		July 1 2004 to June 31 2005	
		Number of Loans	Value of Portfolio	Number of Loans	Value of Portfolio
	Portfolio Activity				
	Loans Disbursed	129,882	439,330,000	156,359	525,029,000
	Loans Outstanding	86,666	189,421,829	81,878	169,027,690
	Movement in Impairment Loss Allowance				
	Impairment Loss Allowance, Beginning of Period		1,860,577		313,158
	Impairment Loss Allowance, End of Period		2,707,212		1,860,577
1	Loans Written Off	0	0	0	0
	Provision for Loan Impairment		451,282		539,381
	Loans in Recovery or Recovered	0	0	0	0

Source: BdC

Notes: 1 BdC write-offs require Board approval. None has been written off to date.

TABLE 22: PORTFOLIO AGING REPORT

Note	*(as of 30 Nov 2005)* In EGP	Number of Loans	Value of Portfolio	Loss Allowance Rate (%)	Impairment Loss Allowance
	Current Portfolio	84,755	187,109,663	0.0%	0
	PAR 3 to 30 days	623	772,376	10.0%	77,238
	PAR 31 to 60 days	272	288,447	25.0%	72,112
	PAR 61 to 90 days	168	201,092	50.0%	100,546
	PAR 91 to 120 days	117	137,065	75.0%	102,799
	PAR over 120 days	731	913,186	100.0%	913,186
1	Renegotiated portfolio <= days	0	0	100.0%	0
	Renegotiated portfolio > 1 days	0	0	100.0%	0
	Loans Outstanding	86,666	189,421,829		1,265,880

Source: BdC

Notes 1 BdC does not track renegotiated loans. While rescheduling loans is possible, Branch Managers report that it is not done frequently.

EFFICIENCY

It is difficult to critique BdC's efficiency when one of its goals has been to maximize the number of staff involved in microfinance rather than maximize the efficiency of the staff. Its self-reported operating expense information indicates an average operating expense ratio of 15 percent. On an adjusted basis, the ratio is closer to 30 percent. DBACD and ABA reported adjusted ratios of 14 percent and 15 percent in 2004, respectively, although average for the region is near 30 percent (see Table 23). The same pattern is evident when comparing cost per borrower.

TABLE 23: OPERATING EXPENSE RATIO IN 2004

	BdC Micro-finance	ABA	DBACD	Arab Medium/Large 2002	Arab All 2002
Operating Expense Ratio*	16.7%	N/A	N/A	N/A	N/A
Adjusted Operating Expense Ratio*	36%	14.9%	13.8%	29.3%	30.9%
Adjusted Cost per Active Borrower (USD)	107	31	27	97	99

Source: BdC, authors' calculations

*Over the average gross loan portfolio

The trend at BdC has been positive, with expense ratios declining, but the rate of decline is slowing. This supports the earlier observation that BdC has limited room to maximize efficiency, given its current growth strategy and limited product offering, as existing markets become saturated and client and portfolio growth slows.

Comparing staff efficiency between institutions is somewhat easier and shows that BdC has performed quite well. The ratio of BdC's borrowers per staff member is similar to DBACD and higher than ABA. It is approaching the Arab benchmark of 125 for large MFIs. Real personnel productivity may be lower, as BdC offers a single product, whereas most other MFIs in Egypt offer a greater number of financial services. BdC's borrowers per Loan Officer ratio is also similar to ABA and DBACD, but it is significantly lower than the Arab average of 232. (See Table 24). BdC's Board is considering imposing a maximum caseload of 130 for Loan Officers, which would further limit future efficiency gains.

TABLE 24: EFFICIENCY RATIOS FOR BDC MICROFINANCE

	FY2004	FY2005	FY2006 YTD
Operating Expense Ratio	17%	14%	13%
Adjusted Operating Expense Ratio	36%	27%	24%
Cost per Active Client	308	279	271
Cost per Active Client (in USD)	50	46	47
Adjusted Cost per Active Client	658	550	517
Adjusted Cost per Active Client (in USD)	107	91	89
Borrowers per Loan Officer	102	128	131
Active Clients per Staff Member	86	107	109
Client Turnover	27%	27%	13%

Source: BdC, authors' calculations

The addition of the microfinance units might have improved efficiency somewhat, due to lower staff costs per loan officer. The merger with Banque Misr may allow the new bank to further improve efficiency. Banque Misr has branches in untapped markets and has a model of employing new and less expensive staff. It remains to be seen what model the merged entity will pursue.

THE MERGER WITH BANQUE MISR

MICROFINANCE AT BANQUE MISR

Banque Misr (BM) began microfinance operations in the first quarter of 2004, working with the International Finance Corporation (IFC) PEP-MENA facility. The BM Board responded positively to IFC's presentation and agreed to share the cost of technical assistance. As with BdC, the bank's management and Board have been strongly committed to the microfinance project's success.

BM followed a process similar to that of BdC in testing microfinance with donor support (in this case, IFC) and received technical assistance from EQI. The IFC also offered some direct support to EQI, working to incorporate a credit-scoring module in the EM system. Otherwise, the product design, training, and pilot test were virtually the same as that of BdC. BM hired a respected consultant, Dr. Akmal Bassili, to oversee the implementation of microfinance at BM, and an IFC project manager reviewed the technical assistance output delivered by EQI.

As with BdC, the pilot project was successful. BM selected five pilot branches in Upper Egypt and pursued the pilot in relative isolation. It hired 25 new Loan Officers, who were trained by EQI, and hired Supervisors internally. By the end of 2005, its 30 Loan Officers were serving approximately 4,500 clients with EGP 15.5 million in outstanding loans and an average loan size of EGP 3,400. It has maintained a 99.9 percent repayment rate. The bank hired two female Loan Officers to attract more female clients. It is interesting to note that BM's borrowers-to-loan officer ratio is 150, higher than that of BdC.

BM has since August 2005 been expanding its operations into five new branches, all in Upper Egypt. This will bring the total number of branches to 15. BM now has nine microfinance staff at headquarters to monitor operations and train new staff. BM's staffing structure is similar to that of BdC.

IMPLICATIONS OF MERGER

Microfinance Strategy

Like BdC, BM's donor partner influenced its strategy. IFC's PEP-MENA facility (then North-Africa Enterprise Development) has a mandate to increase access to finance to SMEs in Egypt. BM's strategy reflects a focus on SMEs—its management sees microfinance as a means to work with the more experienced, more successful micro and small enterprises and help grow them as clients. BM seeks to "penetrate the closest layer [of microenterprises] to existing bank clients" and make them bankable. Management clearly stated that they do not see themselves as competitors with NGOs and they have no intention of reaching down to the lower poverty levels; they prefer to leave this market segment to the NGOs.

Discussions with Banque Misr's Vice Chairman confirm that microfinance is considered a core product line of the merged bank. He indicated that the microloans are a good start, but that the new

bank will need SME products as well and believes that if the correct training and software are available, the new bank will become more active in the SME arena, perhaps even reorienting some overlapping BdC or BM branches to specialized MSME branches. He correctly acknowledged the dangers of "double dipping" by clients and the lack of a credit bureau to exchange client names with other lenders. Their cautious start in Upper Egypt in part reflects their concern that clients in the more competitive Cairo and Alexandria markets could easily take loans from more than one institution, which will ultimately lead to higher defaults.

Continued strong management will be very important. The director, Mr. Bassili, is considered to be "very smart" and a "strategic thinker" by his competitors and colleagues in BdC. He acknowledged the need for the new bank to develop a clear vision based on a clearer understanding of the market segments. This requires understanding the different poverty levels. He noted that the new bank needs to monitor microloans as a product line by directly tracking revenues and allocating costs in FlexCube and new Oracle-based cost-allocation software developed by BM.

Since the announcement of the merger, very little has been done to actually merge the two institutions' operations at any level. As of the drafting of this report, no decision had been announced as to who will manage retail operations or microfinance. At the beginning of 2006, the Board created a committee—comprised of BdC and BM executives, including Mr. Abouesh of BdC—to look into the merging of retail operations. This committee has a subcommittee on microfinance, but few meetings have taken place and little had been decided by the time of this case study.

Neither Mr. Bassili nor Mr. Abouesh anticipates much difficulty merging microfinance operations. The banks' product, policies/procedures, and MIS are nearly identical.

Products and Services

BM's microloan product is identical to that of BdC. However, BM has not introduced the larger loan sizes (above EGP 10,000) in later loan cycles. BM has been far more cautious and incremental than BdC, perhaps because it does not have the same level of excess staff to absorb. BM has hired most of its microfinance Loan Officers from outside the bank and put them through a training program similar to that of BdC. BM's Director and a BM Branch Manager both stated that the new staff are more productive than existing staff and the participating branch staff sees that microfinance is quickly becoming a major source of income for the branches. BM reports a zero percent default rate on its microfinance portfolio.

BM stated that it has new products under development without significant assistance from EQI. It will pilot test Islamic microlending in its specialized Islamic banking branches in the first quarter of 2006 and is interested in testing a microleasing ("Ijara") product. However, despite its stated client migration strategy, BM does not yet have an SME product and lacks a clear strategy on how to move its clients to larger loan products and integrate them as "regular"customers.

Points of Service

BM has 480 branches. By the second quarter or 2006, it is planned that BdC branches will be rebranded as BM, giving the new institution a combined network of more than 600 branches throughout Egypt. Only 112 of these (and five units) have microfinance operations. The organizational and physical structure of BM and BdC is similar and there is some overlap in the geographical footprint of their branch networks. It is not uncommon to find the two banks located next to each other.

The financial structure of BM's microlending branches appears to be similar to that of BdC: loan assets account for only 10 to 20 percent of the total deposit base and microfinance accounts for 10 to

20 percent of loan assets. As with BdC, microfinance's share of branch assets is growing. BM also offers salary loans to SOE employees and some branches participate in SFD's small enterprise lending program. BM does a significant amount of lending to municipalities and for construction—lending to private firms that are building buildings, roads, and other infrastructure for government entities.

Messrs. Bassili and Abouesh seem to agree that the expansion of microlending throughout the merged entity's network will need to take into account the overlapping branches and the combined bank's excess staff capacity. Mr. Abouesh halted the creation of new BdC units and Mr. Bassili agrees that new units are "not attractive" in light of the merger. Mention was made that some redundant branches might specialize in micro and small business lending.

4. LESSONS AND CONCLUSIONS

The state-owned retail bank (SORB) Research Framework developed for USAID under the Financial Services Knowledge Generation (FSKG) project poses a number of key questions for consideration when analyzing SORB downscaling into microfinance. This case study on BdC has attempted to address some of these questions.

KEY QUESTIONS

WHAT MARKET FACTORS JUSTIFY SORB DOWNSCALING?

Size of the Market

In the case of BdC, the size of the Egyptian microenterprise market has played a crucial role in its success. Despite the market having already been served by business associations, NGOs, local cooperatives, the SFD, and the PBDAC for some time, there was still much room for growth. It is likely that almost a quarter of a million households had some access to micro and small loans by the time BdC entered the market, but market penetration appears still to be relatively low, given Egypt's population of 71 million and the immensity of the estimated microenterprise market, ranging from 2 to 4 million potential microfinance clients or more. The potential market has been widely underserved.

BdC's internal drive to absorb excess branch staff led it to expand indiscriminately and compete with existing MFIs in the more saturated markets of Cairo and Alexandria. Some BdC branches estimate that up to 50 percent of their clients come from existing MFIs. BdC and BM began with similar strategies in the pilot phase. Both chose to begin their microfinance operations in less competitive areas in Upper Egypt, most of which lacked established providers. However, BdC then decided to expand rapidly into all areas, whereas BM chose a slower and more cautious approach to expansion.

BdC KEY SUCCESS FACTORS AND KEY CHALLENGES

Key success factors:

- Commitment of the Board and Senior Management
- Large and underserved market
- Extensive branch network
- Brand recognition (prestige) of bank in market
- Tested product with broad market acceptance
- Availability of portfolio funding and staff
- Own funds at risk
- Long-term technical assistance

Key challenges:

- Product differentiation and diversification
- Lack of innovation
- Saturation in certain markets
- Political instability
- Merger with Banque Misr

A large potential market provides a compelling incentive for SORB downscaling into microfinance, as was the case with BdC. Pursuing unserved or underserved portions of the market may be a more politically acceptable justification, but these markets are often less attractive than those served by the private sector and therefore present a more difficult business case, particularly for start-up operations. SORBs need not limit themselves to these markets alone. SORBs can also successfully compete against NGOs and other MFI providers for clients. From the SORBs' institutional perspective, there may be value in doing this in order to gain experience, expand quickly, and establish a presence. There may be costs, however, in doing so.

Without a functioning credit bureau or client information exchange system, it is unclear if BdC has unwittingly damaged those markets by lending to existing (or rejected) borrowers and over-indebted microentrepreneurs. It can be argued that BdC's entry into the Cairo and Alexandria markets merely displaced existing providers, squeezing out the private sector. At the same time, BdC's competition may have forced other MFIs to streamline procedures, cut interest rates, and diversify into other products—to the benefit of clients.

Fragmented Microfinance Service Provision with Limited Ability for Significant Market Penetration

The business associations, NGOs, and NBD lack the funding and infrastructure to significantly penetrate the market. USAID/Egypt guarantees and collateral funds facilitated several million dollars in funding to many of the microfinance providers that it assisted. However, many of these providers have limited prospects to scale up their funding for microfinance beyond what they have or can receive through grants. BdC, on the other hand, has excess liquidity and has already put more than $30 million of its own resources at risk. It also has a branch network that will allow for greater penetration of the market than any other existing provider, as well as the ability to continue mobilizing deposits, which enjoy an implicit government guarantee, to fuel expansion

SORB is Most Attractive Provider

Most private commercial banks in Egypt are still absent from the microfinance sector, viewing it as too risky, costly, or both. They also lack the branch network of the state-owned banks. Despite recommendations in Egypt's National Strategy for Microfinance to create a legal and regulatory environment to allow NGOs to transform into specialized deposit-taking institutions, NGOs are probably not ready and the central bank shows little appetite to take on more prudential risk, increase the number of banks, or create a new class of licensed financial institutions.

Another state-owned option includes further promoting PBDAC, which has been used to channel SFD funds for rural credit but is considered to be ineffective and has a poor repayment record. For over a year there has been discussion of introducing microfinance through the National Postal Authority (NPA) and its 3,600 offices. The NPA has significant outreach for savings services among low-income segments of the population and its legal mandate does not allow it to use this capital for the provision of credit. Furthermore, it has no experience with credit and the NPA is not interested in putting its own depositors' funds at risk. Proposals have centered on an arrangement whereby the NPA would manage SFD funds. This proposed arrangement would seem to introduce moral hazard and has been viewed with concern by existing MFIs, BdC, and others who believe that the project would be implemented poorly and unsustainably.

Excess Labor

BdC's decision to enter microfinance was based on its inability to release redundant staff. As a state-owned enterprise, its staff is civil servants, unionized, and not easily fired. BdC saw opportunity in this constraint to absorb its excess labor in a labor-intensive activity. Using existing staff did provide a few advantages: staff are loyal, invested in the institution, and familiar with procedures. Ironically, few of the microfinance staff actually had a credit background—credit is largely a desk job in BdC and BM and the staff are not at ease or well suited for on-site client interaction. Nearly 8 percent of all staff is currently occupied by microfinance and BdC is achieving respectable caseloads compared to its competitors. Management at BdC and BM agree that based on Loan Officer productivity and cost, it would be better to hire new Loan Officers rather than retrain existing staff. The adjusted cost

ratios support this conclusion. The lesson is that while utilizing excess labor may not be a good reason to go into microfinance, it can be done.

WHAT LEVEL OF GOVERNMENT COMMITMENT IS REQUIRED?

Environment Supporting Financial Liberalization

BdC's downscaling into microfinance was facilitated by financial liberalization and reform that had taken place in the Egyptian financial sector in preceding years. The removal of government restrictions in areas such as interest rates—and more recent government efforts to promote private sector-oriented management at BdC and other SORBs—supported BdC's move into microfinance. To varying degrees, the other SORB downscaling case studies reviewed under FSKG also experienced increased liberalization of the financial sector prior to downscaling into microfinance.

Commitment to SORB Reform

BdC and BM's entry into the microfinance market was not catalyzed by government initiatives or privatization. Rather, it was enabled by financial sector liberalization and SORB reform. BdC's new Chairman was free to make decisions, driven by internal considerations, market opportunities, and profitability. State-owned banks in Egypt are relying less on purchasing government securities and lending to large and/or state-owned companies, and are now searching for retail clients. Retail banking remains underdeveloped in Egypt and is a logical market for banks to explore, particularly those with large branch networks. This client base has become increasingly attractive as the large corporate market becomes increasingly saturated and subject to competition from international banks, and as Egyptian banks adapt new retail technologies, including ATMs and smart cards. BdC's new management team has been given virtual autonomy in reorienting BdC toward retail banking, including the decision to pilot microfinance.

Acceptance/Support of Microfinance

Three government institutions (represented by three influential individuals) will continue to have influence over the new (merged) BM. The Ministry of Investment and the Ministry of Finance are effectively BM's shareholders and ultimately have the most influence. Both ministers are interested in SME promotion and the Minister of Investment was part of the National Strategy discussion. CBE's acknowledgement and understanding of the sector is growing. It participated in the development of the National Strategy for Microfinance and is the gatekeeper for any new financial institution or any expansion of an existing one. It is notable that the CBE-approved BdC's request to open new microfinance units at a time when it had been rejecting other requests for new licenses or branch openings. The CBE may not be interested in creating a new class of licensed MFIs at this point, but it sees microfinance as an acceptable business line for banks.

Deposit Security

For better or worse, the perception that BdC or BM are too big for the Government of Egypt to allow them to fail will help it continue to raise deposits used to fund microfinance. This is effectively a form of deposit insurance that provides these SORBs access to large amounts of relatively inexpensive funding liabilities.

Competition

State-owned banks have traditionally been the largest players in the Egyptian banking sector. Now they are also the largest in the Egyptian microfinance sector. There is concern among other MFIs that the merger will create a microfinance provider that will grow to have a virtual monopoly. BdC and BM's combined client base will exceed that of all the other major players combined. Their combined branch network will be nearly 10 times that of the rest of competition. This could hurt the long-term development of the industry if formidable competitors do not (or are not allowed to) develop.

Credit Information

In the long term, the growth of microcredit is likely be hindered by a lack of mechanisms to share client credit information. This gap should be considered by SORBs, other MFIs, government agencies, and donors in thinking about the long-term prospects of the sector.

WHAT CHARACTERISTICS AND INTERNAL CAPACITIES SHOULD A SORB DEMONSTRATE TO HAVE A SUCCESSFUL MICROFINANCE FOCUS?

The Consultative Group to Assist the Poor (CGAP) summarizes the key elements for commercial banks to successfully enter microfinance (see accompanying text box). Each of these factors holds true for SORBs and the most crucial element appears to be the same: commitment from the Board and management, and strong internal champions.

Commitment and Champions

Having the commitment of Chairman Al Bardei (and other member of the Board and management) to microfinance was particularly important, given that BdC, like most SORBs, is a large and bureaucratic organization. The Chairman and others used the hierarchy of the bank and prestige of their positions to demand and honor the participation of Branch Managers in microfinance. Position and prestige helped win converts in the beginning, before the actual results were convincing. It remains to be seen if microfinance will be as prominent in the merged BM and if microfinance will be viewed as a core function of the bank. In the case of BRI, despite decades of serving microenterprises, no members of BRI's senior management come from the ranks of its microfinance program. To some degree, despite its formidable performance, its Unit Desa program is still viewed as a political and social commitment rather than a business decision.[56]

WHAT MAKES FOR SUCCESS?

- **Commitment** from Board and management, strong internal champions, and alignment with the bank's core commercial strategy
- **Knowledge** of microfinance best practices and how to serve micro-clients
- **Infrastructure** located conveniently for clients
- **Products** especially adapted for low-income and informal markets
- **Systems and Procedures** adapted to microfinance operations
- Appropriate staff **training** and incentives on new clients, products, and delivery systems.

Source: *Commercial Banks and Microfinance*, CGAP Focus Note No. 28

[56] Based on the authors' conversations with other microfinance providers and donors in Aceh, Indonesia.

Infrastructure, Decentralized Authority, and Standardization

BdC has a large branch network that has historically focused on banking services, such as mobilizing deposits and corporate lending. Furthermore, its branches are located in areas of high population density with easy access for clients.

As with ASCI and Khan Bank, the standardization of operations has worked well. Decentralization of approval authority in BdC's case has less to do with geographic distance or lack of communication. Rather, it results from the history and culture of the institution. Branches, particularly Branch Managers, have considerable credit authority, and it is culturally difficult to take that away. Rather than try to centralize the decision-making and management of microfinance, Branch Managers were integrated into microfinance in a manner that was well defined by headquarters. The Branch Manager is part of a standardized process—meeting each client, giving final approval, and signing loan documents. This process ensures consistency and efficiency while still holding the Branch Manager ultimately responsible and accountable for final decisions.

Bureaucratic Controls

The bureaucratic nature of BdC has also played an interesting role. The tendency to bureaucratize initially threatened to undermine the program as branch staff tried to add additional steps to a relatively unencumbered process. However, the Microfinance Department discovered ways to use the bureaucracy to its advantage by utilizing existing branch staff in simple and limited control functions, such as reviewing documents and disbursing funds. To do this, management rewrote procedures to make clear the exact function and authority of each participant in a transaction. Ultimately, the use of branch staff has strengthened controls and further integrated microfinance into the branch without delaying the process.

Appropriate Information Systems

The EM system has been instrumental in BdC's success in many ways. The system piqued the interest of the Bank's IT Manger, Mr. Salem, and led him to take initial responsibility for the pilot. The speed and ease with which managers were able to track information on microloans was unprecedented at BdC, which had historically relied on paper rather than electronic data for information. The system also provides a method for the Microfinance Department to maintain a managerial and control role over the branches by having real-time access to data.

However, BdC is unable to quickly and easily view its product profitability and, unlike BRI or ASCI, BdC is unable to determine which branches are the most profitable or most efficient. This may be a material issue for BdC's Microfinance Department, as it will be difficult to justify Board and management support in the medium term if they are unable to clearly measure profitability—particularly pertinent in the context of a merger, where managers typically battle for resources.

Integrated Strategy

Any downscaling SORB, including BdC, needs an understanding of microfinance and a coherent strategy for how it fits into the bank's overall operations and how the clients fit into the bank. There is a need to proactively drive innovation and the development of new products. In contrast to Khan Bank, ASCI, and Landbank, BdC remains focused on a single product and has made little effort to cross-sell other bank products, even basic deposit accounts that could be easily used by microfinance clients. BdC also lacks a clear strategy to grow with these clients or "graduate" them to other products. Furthermore, a clear career path for microfinance staff within the bank is needed to ensure integration and staff interest and commitment.

HOW IMPORTANT IS LONG-TERM TECHNICAL ASSISTANCE?

BdC's microfinance products, systems, procedures, and training all came from EQI through USAID/Egypt funding. While the monetary value of EQI's assistance is minor compared to the resources committed by BdC to fund the portfolio and staff the program, the value of technical assistance for initiating microfinance at BdC should not be underestimated—but nor should it have continued. What BdC now needs is assistance to develop new and innovative products and services.

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ANNEX B: RESOURCE PERSONS

Alexandria Business Association

- Motaz el Tabaa, Executive Director

Banque du Caire (BdC)

- Amro Abouesh, Head of Retail/ Advisor to Chairman – M/SME Loans, Member of Executive Committee
- Maha Shawky, Advisor to the Chairman – Credit Control Division
- Sherif M. Rehab, Advisor to the Chairman – Risk Management

Microfinance Department:

- Mohammed Hafez, Deputy General Manager Microfinance Dept./National Product Manager
- Samir Nirouz, Operations Manager & Deputy National Product Manger, Microfinance Dept.
- Atef A. Alghohary, Coordinator (Controller), Microfinance Dept.
- Yasar Kamal, Asst. Coordinator (Assistant Controller), Microfinance Dept.
- Tawfek Semary, Economic Analyst, Microfinance Dept.
- Amr Galal, Coordinator, MIS, Microfinance Dept.
- Fathey Shabeb, Regional Team Leader, Microfinance Department
- Hassam Alsisi Team Leader, Microfinance Department

BdC Branch Khlousy – Shobra branch:

- Mohamed abdul Basset, Branch Manager
- Fatma Safid, Asst. Branch Manager
- Yousef Amin, Supervisor
- Group of 4 Loan Officers

BdC Branch in Alexandria:

- Branch Manager
- Mostafa Ahmed Moussa Supervisor
- Group of four Loan Officers

BdC Branch in Qena:

- Branch Manager
- Supervisor
- Group of two Loan Officers

Banque Misr

Board (merged – Banque Misr and BdC):

- Mohamed Ozalp, Vice Chairmen
- Mona Yassine, Non-Executive Board Member & Chairwomen of Egyptian Competition Authority

Microfinance Department:

- Dr. Akmal Bassili, Development Consultant
- M. Tarek Tawfik, Officer Customer Accounts

Banque Misr Branch in Qena:

- Ahmed Ali, Branch Manager
- Supervisor

Credit Guarantee Corporation (CGC)

- Amr Hammouda, Executive Director, Small & Emerging Enterprise Unit

CGC Consult/ FinBi

- Naglaa Bahr, Executive Director (CGC Consult), Development Director (FinBi)
- Riham Khalifa, Project Coordinator, FinBi

EQI

- Amr Hegazi, Senior Finance Analyst, Financial Advisory Services
- Yasmine Hafez, Vice President for Enterprise, Development and Microfinance

National Bank for Development

- Mona Mubarak, General Manager, Microfinance Dept.

Social Fund for Development

- Hanan Abou El azm, Head of Microfinance Sector
- Nevine Badr El-Dean, Operations Department Manager, Microfinance Sector

USAID/Egypt

- Joseph Ryan, Associate Mission Director for Policy and Private Sector
- Magdy Khalil, Team Leader Small Business Development, Finance & Information Technology Division
- Greg Wiitala, Leader, Private Sector Programs
- Rizkallah Zayat, SME Project Officer, Economic Growth

ANNEX C: ADJUSTMENT CALCUATIONS

TABLE C1: ALLOCATION OF IN-KIND SUBSIDIES ASSUMPTIONS

		July 2003 - June 2004	July 2004 - June 2005	July 2005 - November 2005
	In-Kind Subsidy Adjustments			
	Adjustment to Salary Expense			
1	**Teller Allocation**			
	Cost of Teller	14,400	14,400	6,000
	Average No. of Branches with MF	73	103	106
	Percent of Time of Teller	100%	100%	100%
	Total Teller Adjustment	1,044,000	1,483,200	636,000
2	**Branch Manager Allocation**			
	Cost of Branch Manager	66,000	66,000	27,500
	Average No. of Branches with MF	73	103	106
	Percent of Time	13%	13%	13%
	Total Branch Manager Adjustment	598,125	849,750	364,375
3	**HQ Staff Allocation**			
	% HQ Staff to Total Staff[57]	19%	19%	19%
	Average % MF Portfolio to Total BdC Portfolio	0.06%	0.62%	0.73%
	Estimated BdC Personnel Costs[58]	557,138,400	467,119,800	194,633,250
	Less Direct MF Costs	13,647,176	16,955,020	7,906,051
	Net BdC Personnel Costs	543,491,224	450,164,780	186,727,199
	Allocation of HQ Staff Costs	314,892	2,790,556	1,357,602
4	**Overhead Allocation**			

[57] Assumes 2000 headquarters staff, estimated by Microfinance Department

[58] Assumes 70 percent of total G&A costs are for personnel, estimated by Microfinance Department

	G & A net of Personnel[59]	238,773,600	200,194,200	83,414,250
	Average % MF Staff to HQ Staff	5.6%	7.3%	7.6%
	Allocation of Overhead	13,410,097	14,590,622	6,304,660

[59] Assumes 30 percent of total G&A costs are for overhead, including depreciation.

TABLE C2: IN-KIND SUBSIDY ADJUSTMENTS

In-Kind Subsidy Adjustment			
Personnel Expense Adjustment			
Branch Manager			
Estimated Cumulative Cost (YTD)	598,125	849,750	364,375
Actual Cumulative Paid (YTD)	0	0	0
Cumulative Adjustment (YTD)	598,125	849,750	364,375
Teller			
Estimated Cumulative Cost (YTD)	1,044,000	1,483,200	636,000
Actual Cumulative Paid (YTD)	0	0	0
Cumulative Adjustment (YTD)	1,044,000	1,483,200	636,000
Headquarters Staff			
Estimated Cumulative Cost (YTD)	314,892	2,790,556	1,357,602
Actual Cumulative Paid (YTD)	0	0	0
Cumulative Adjustment (YTD)	314,892	2,790,556	1,357,602
Total Adjustment for Personnel Expenses	*1,957,017*	*5,123,506*	*2,357,977*
Administrative Expense Adjustment			
Branch Network General and Administrative			
Estimated Cumulative Cost (YTD)	13,410,097	14,590,622	6,304,660
Actual Cumulative Paid (YTD)	0	0	0
Cumulative Adjustment (YTD)	13,410,097	14,590,622	6,304,660
EQI Technical Assistance			

Estimated Cumulative Cost (YTD)	1,110,420	0	0
Actual Cumulative Paid (YTD)	0	0	0
Cumulative Adjustment (YTD)	1,110,420	0	0
Total Adjustment for Other Administrative Expenses	*14,520,517*	*14,590,622*	*6,304,660*

ANNEX D: EGYPTIAN BANKING AND MICROFINANCE SECTOR

As of late 2004, the CBE listed 55 banks in operation within Egypt's licensing framework; 38 banks were fully licensed local institutions, including:

- 4 state-owned commercial banks
- 23 private commercial banks
- 11 private non-commercial banks (also refereed to as business and investment banks)

In practice, the distinction between private commercial and private non-commercial classifications has become blurred, with some of the most recognized names in the Egyptian retail banking market officially listed as non-commercial. Furthermore, state-ownership of private bank shares persists. In addition to fully licensed local institutions, the banking sector includes:

- 14 foreign-registered banks with operation in Egypt under non-commercial foreign branch licenses. 6 others hold licenses, but have closed their branches in Egypt.
- 3 state-owned specialized banks intended to bolster national development by providing industrial and agricultural credit. These include the Industrial Bank of Egypt, Principle Bank for Development and Agricultural Credit (PBDAC), and Egyptian Arab Land Bank.

Several other state-owned banks, founded under special degrees as part of the social welfare system, operate outside of the CBE's licensing framework. These include the National Investment Bank, which hold pension funds and postal accounts, as well as the Arab International Bank and the Nasser Social Bank, two banks founded as part of the country's social welfare system. Also outside of the official banking sector is the National Postal Authority (NPA), which is a major savings institution, with an estimated EGP 25 billion ($4.3 billion) in deposits from 10 million customers.[60]

The table below illustrates the dominant role of state-owned commercial banks in Egypt's financial sector. However, the Government of Egypt has repeatedly stated its intention to further privatize the sector. Recently, the Government of Egypt indicated that it would privatize the Bank of Alexandria and announced a merger of Banque du Caire and Banque Misr.

TABLE D1: STATE-OWNED COMMERICAL BANKS

Bank	Assets (EGP millions, June 2003)	Market Share (%)
National Bank of Egypt	123,090	21.41
Banque Misr	84,200	14.64
Banque du Caire	43,960	7.65
Bank of Alexandria	33,140	5.76
Total State-Owned Commercial Banks	284,390	49.46
Total Market	575,000	100.00

Source: Economist Intelligence Unit, Country Finance Report for Egypt, December 2004

[60] Economist Intelligence Unit, Country Finance Report for Egypt, December 2004.

Egypt's banking sector has suffered from low profitability in recent years primarily due to non-performing loans, which is a major issue at state-owned banks, and is associated with the recession, limited expertise in credit risk management, and corruption. During 2002 and 2003 a number of highly publicized bad debt cases resulted in the arrest and eventual conviction of several bankers and businessmen on fraud and corruption charges. Starting in early 2004, the Government of Egypt, the CBE, and state-owned banks began to move away from their policy of aggressively prosecuting private sector bad debtors. Instead, banks have focused more on rescheduling loans and seizing real property collateral in lieu of loan payments.

Bank lending in Egypt is largely based on collateral or guarantees, which, among other factors, has restricted financing to micro, small, and medium enterprises, despite high levels of bank liquidity. MSMEs have a high percentage of "dead collateral," which refers to assets to which the owner does not have clear title.

LEGAL AND REGULATORY FRAMEWORK

The Central Bank of Egypt is the regulatory body for the banking sector. The CBE issued a moratorium on the issuance of new bank licenses in 1983 and is currently overseeing the reform and consolidation of the banking sector. The new Unified Banking Law of 2003 increased the minimum amount of required paid-in capital from EGP 50 million to EGP 500 million (approximately $8.5–85 million), with foreign bank branch operations required to have local paid-in capital of no less than $50 million. The required increase in paid-in capital is expected to lead to consolidation in the sector.

Semi-formal financial service providers, such as business associations and NGOs are regulated and supervised by the Ministry of Insurance and Social Affairs. As such, these organizations are not allowed to mobilize deposits and are not subject to prudential regulations. Informal financial service providers, such as rotating savings and credit associations, operate beyond any regulatory framework.[61]

Currently, there is no separate law for microfinance in Egypt. Several existing laws including the NGO law, the SME law, the Companies Law and the Banking Law, affect Microfinance providers. Under the existing laws, the types of institutions that can legally offer some or all microfinance services in Egypt are banks, business associations, and NGOs. Firms registered under the Companies law are not allowed to engage in insurance, banking, savings or investment of funds and there is no existing law for non-bank financial institutions. While business associations and NGOs are not given the full capacity to engage in all financial intermediation, they are not restricted from engaging in credit services. No other legal structure is allowed to engage in credit, deposit taking, insurance or other form of financial intermediation.

DEMAND—MICROENTERPRISES

There is no standard definition for a micro or small enterprise accepted by MFIs and donors.[62] A 2004 Law defines micro-enterprises as those with fewer than five employees and with less than EGP 50,000 ($8,600) paid-in capital. It defines small enterprises as those with between 5 to 49 employees and paid-in capital between EGP 50,000 and EGP 1 million ($8,600 and 173,000).

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[61] AVID, *Final Report of Mid-Term Evaluation of USAID/Egypt Small and Emerging Business Program*, 2004.

[62] USAID's definition of micro-enterprises, as defined by USAID Washington, is firms with up to 10 employees. Ministries in Egypt, such as the Ministry of Agriculture or the Ministry of Industry, each uses its own separate definition.

There is also no consensus on the size of the market. USAID/Egypt reports that small and micro enterprises make up 98-99 percent of nonagriculture private sector enterprises, and employ 2 million people (60 percent of Egypt's private non agriculture labor force). However, MFIs visited during this study indicate they believe the market to be much larger than that, perhaps up to twice that when households and underemployed persons are included.

The *Profile of M/SMEs in Egypt*[63] update of 2004 indicates that 93.7 percent of all businesses in Egypt are microenterprises. Most microenterprises in Egypt are involved in survival activities rather than growth activities. Despite the relatively low proportion of women in the workforce, it is estimated that women operate a higher percentage (nearly 50 percent) of the informal enterprises that earn the least—between EGP 5 to 10 per day (approximately $1 to $2 dollars). The M/SME profile update also revealed that the MSME growth rate in Egypt ranges from 1.06 to 1.25 percent, with the bulk of the growth in the microenterprise sector. As for their share in employment generation, microenterprises in Egypt are estimated to create approximately 75,000 new jobs each year.

The Economic Research Forum (ERF) study noted the following, based on a sample of 5,000 micro and small enterprises in Egypt:

- 62 percent of MSEs are in urban areas while 38 percent are located in rural areas
- 64.7 percent of MSEs surveyed are in trade activities, 19.5 percent are in services, and 16.7 percent are in industry
- Only 6 percent of the community of MSEs are headed by women
- 67.1 percent of owners of MSEs surveyed relied on their own savings as a source of initial capital, while only 3.5 percent used formal loans, and 2.6 percent used informal loans

A 2005 study titled *Microfinance Sector Development Approach,*[64] identified the most pressing constraints of micro and small enterprises and ranked them as follows:

1. Inadequate access to financial services
2. Insufficient supply of skilled labor, especially in modern management, accounting and technical skills
3. Limited access to markets and market information
4. Limited access to modern technology
5. An over-regulated business environment with arbitrary taxation practices, bureaucratic market entry procedures and abundant employer regulations as particular constraints

It is clear that micro and small enterprises represent a large market in Egypt and access to finance has been one of their primary constraints.

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[63] Published by Ministry of Economic-SMEoL,1998 and updated by UNCDF 2004.

[64] Egyptian Micro-Finance Strategy funded by UNDP, KFW, and USAID; published in November 2005.

SUPPLY—MICROFINANCE PROVIDERS

In the past few years, banks in Egypt have become the dominant force in the microfinance market due to their branch networks, excess liquidity, and superior back office systems. However, to date, banks have been slow to exploit their ability to offer a wider range of financial products, such as micro-savings, insurance, and consumer loans.

COMMERCIAL BANKS

Only three commercial banks in Egypt are currently active in microfinance. The table below indicates the year in which each bank initiated microfinance operations indicates the sources of support received.

TABLE D2: COMMERICAL BANKS INVOLVED WITH MICROFINANCE

Commercial Bank	Year Microfinance Initiated	Donor Support	Technical Assistance Provider
National Development Bank (NBD)	1987	USAID/Egypt	ACDI/VOCA
Banque due Caire in (BdC)	2001	USAID/Egypt	EQI
Banque Misr	2004	IFC	EQI

These banks have targeted the upper end of the microenterprise market, leaving the lower end of the market to NGOs and CDAs, which have both individual and group lending products.

NBD was the first commercial bank to lend to microenterprises, beginning in 1987 and assisted by USAID/Egypt, which financed some of NBD's microfinance operating costs and capitalized most its microloan portfolio. Thirty-three of NBD's 69 branches have separate, but co-located microfinance operations. In addition, microfinance "windows," which offer microfinance services after normal bank working hours are present at an additional 11 branches. Furthermore, NBD's microfinance presence is augmented by approximately 20 mobile units.

NBD offers an individual loan product with a flat rate of 16 percent per annum for the loan itself, but also requires embedded microinsurance costing 4.75 percent and charging a 3 percent transportation fee as well as a 6 percent late payment penalty fee.[65] Clients nominally pay a flat rate of 29.75 percent per annum, which with 10 percent mandatory savings, results in an effective rate of around 60 percent per annum.[66] NBD is the only microfinance provider in the market currently offering insurance.

BdC and Banque Misr both offer individual loan products at rate of 16 percent flat, resulting in an effective rate of approximately 30 percent per annum. Detailed information on BdC and Banque Misr's microfinance operations are provided later in this case study.

BUSINESS ASSOCIATIONS

Business associations, while registered as NGOs, are required to have a larger Board structure than a regular NGO and many have received government permission to operate beyond their initial governorate. USAID supported the creation and development of business associations through grants

[65] Penalty fee is reimbursed to client, if all payments are made on time.

[66] See NBD case studies.

for operating expenses and capitalization funds. Table 5 provides outreach statistics on the larger business associations. Until the entry of BdC, USAID' business association partners dominated the microfinance market. The bank's entry and successful expansion in the market is, in part, due to the inability of the business associations to match the extensive branch networks of the banks involved in microfinance.

NONGOVERNMENTAL ORGANIZATIONS AND OTHER INFORMAL PROVIDERS

There have been a wide variety of NGOs active in microfinance, including international NGOs (such as CARE and Catholic Relief Services), Egyptian NGOs, and CDAs. The international NGOs have taken the role of capacity building, while the Egyptian NGOs have been direct providers. There are thousands of NGOs registered in the country, many of which incorporate credit as part of their overall integrated community development programs. CDAs, which are primarily village-focused, are likely to have the greatest depth of outreach. NGOs rarely extend their services beyond the home governorate, which, together with the legal restrictions on their product range, is often a constraining factor for their growth.

In addition, there are numerous informal sources of finance in Egypt, the most common being the *Gamiya* or rotating savings and credit associations and moneylenders both of which primarily cater to the lower-income market segments.

SUPPORTING INSTITUTIONS

DONORS

Microfinance in Egypt begins and, until recently, ended with donors. USAID/Egypt is the largest and most influential. All MFIs and banks offering microfinance in Egypt are closely linked to a donor who has provided funding, but also the strategy, technical training, and products and services.

USAID/Egypt

Since 1990, USAID/Egypt has been the largest financier of microfinance initiatives in Egypt, estimated to support more than 70 percent of all activities in this sector. Over time, USAID/Egypt has had partnerships with seven business associations, two commercial banks, and a private credit guarantee company. This was done, most recently, through USAID/Egypt's SEB Project, which started in 1999 and ended in 2004. USAID/Egypt will begin a new support project in the first quarter of 2006, which will reportedly focus less on direct support to MFIs and more on supporting the meso and micro levels of the microfinance sector.

USAID partner organizations currently operate more than 200 lending units nationwide, managing a consolidated outstanding loan portfolio of EGP 365 million (approximately $60 million) serving about 265,000 active borrowers, as of June 2004. USAID/Egypt's targets for 2007 include that these partner organizations have EGP 1 billion in outstanding loans and 700,000 active borrowers, including 75 percent female heads of households.[67] The table below highlights the performance of USAID/Egypt's partners.

[67] From the USAID request for proposal.

TABLE D3: PERFORMANCE OF USAID/EGYPT PARTNERS			
Institution	**Active Clients As of June 2004**	**Outstanding Portfolio EGP**	**Outstanding Portfolio USD**
ABA	39,917	52,497,503	$8,467,339.19
AsBA	49,432	48,834,300	$7,876,500.00
DBACD	26,752	30,808,235	$4,969,070.16
ESED	39,097	52,150,467	$8,411,365.65
SEDAP	5,078	6,862,083	$1,106,787.58
SBACD	15,585	19,054,168	$3,073,252.90
LEAD	3,474	1,820,414	$293,615.16
SPDA Fayoum	2,397	2,558,750	$412,701.61
SCDA Sohag	1,164	3,755,372	$605,705.16
Aswan	366	821,272	$132,463.23
Banque du Caire	63,426	118,341,519	$19,087,341.77
NBD	19,000	N/A	N/A
Total	265,688	337,504,083	$54,436,142.42

Source: NCBA/EQI Quarterly Report April-June 2004 from AVID report

Social Fund for Development

The Social Fund for Development (SFD) was originally created in 1991 as a donor-funded organization to mitigate the impact on the poor of World Bank and IMF sponsored reform programs. While still a donor-funded organization, the SFD's role has expanded to include poverty alleviation through the funding of micro and small enterprises directly or through NGOs. In 2004, government legislation gave the SFD responsibility for coordinating financial and non-financial support to microenterprises and SMEs. The SFD must coordinate with local and foreign organizations to obtain and channel funding for its activities. International donors include the Canadian International Development Agency, the EU, KfW, UNDP, the World Bank, the Arab Fund, and the Kuwait Fund.

Beyond its involvement in the multi-stakeholder process to develop a national strategy for microfinance, the SFD funds technical assistance for NGOs involved with microfinance, provides wholesale (subsidized) loans to CDAs, NGOs, and financial institutions for on-lending to microentrepreneurs, and has future plans to provide fee-based loan portfolio guarantees to commercial banks for microfinance, using a grant from KfW. With respect to the SFD's wholesale lending, some of the SFD's donors, such as the Arab Fund and the Kuwait Fun, have insisted on subsidized rates, while other donors, such as KfW, UNDP, and the EU, have channeled their funds into activities that do not impose interest rate caps. The SFD has invested EGP 172 million ($28

million) in microfinance and is estimated to be reaching 125,000 micro clients through CDA, NGOs, and financial institutions[68].

Additionally, the SFD has worked with the Principle Bank for Development and Agricultural Credit (PBDAC), a state-owned specialized bank, to provide small loans to farmers using SFD funds. Little information is available on loan volume, but delinquency is believed to be high.

Other Donors

In addition to the donors involved with the SFD, the Egyptian Swiss Development Fund (ESDF) provides microfinance through providing grants to NGOs and CDAs. The fund also supports the provision of non-financial services to micro clients, such as establishing marketing opportunities and awareness. In addition, the International Finance Corporation (IFC), through its regional PEP-MENA facility, has funded technical assistance to Banque Misr, a state-owned retail bank, to develop and implement microfinance services.

TECHNICAL ASSISTANCE PROVIDERS

There are a limited number of technical assistance and training providers for MFIs in Egypt. Environmental Quality International (EQI) is the largest of these providers and has been USAID's primary local implementing organization to date. However, other providers, such as Save the Children, Catholic Relief Services, Egyptian Banking Institution, and Sanabel, are also established in Egypt.

Environmental Quality International (EQI)

EQI is an Egyptian consulting firm founded in 1981 as a limited partnership. It began with environmental consulting, but later entered the areas of governance and enterprise development. Over time, EQI's work in enterprise development has emerged as the central focus of much of its integrated development activities. EQI's approach in this sector is to present NGOs and banks with a "package" or toolkit that they can rollout for their microlending operations.[69]

EQI, previously in partnership with NCBA, has been USAID's primary microfinance technical assistance provider in Egypt. USAID/Egypt awarded over $15 million in contracts to provide technical assistance from June 23, 1993 to January 31, 2005, most of which went to NCBA/EQI. [70] USAID recently awarded a microfinance technical assistance contact to Chemonics International, which has subcontracted EQI as the primary provider of technical assistance in the country.

THE CREDIT GUARANTEE CORPORATION (CGC)

The CGC was established in 1989 as a private company owned by eight banks and an insurance company. It acts as an intermediary for donor funds and provides non-cash guarantees. The CGC has three primary units: SME, microenterprises, and health care providers. CGC offers guarantees to specific MFI "units" (branches, agencies) to facilitate the unit's access to overdraft lines of credit from commercial banks. USAID provides CGC capital funds for collateral for the guarantees that

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[68] Avid Report

[69] Avid Report

[70] This includes a contract for $1.5 million with ACDI/VOCA as well as three contracts with NCBA/EQI for $13,693,376.

CGC provides lenders. CGC intended to expand in the microenterprise segment by providing loan portfolio guarantees to commercial banks. BdC was the first applicant. However, the execution of the enhancement to BdC was delayed. In the interim, BdC determined the cost of losses was far less than the cost of the guarantee and opted out of the arrangement.

EMERGING TRENDS IN MICROFINANCE

Commercialization of the microfinance industry in Egypt has been a clear trend. The entry of BdC and, to a lesser degree, Banque Misr, has increased competition, decreased the time needed for transactions, and forced existing microfinance providers to innovate. It has also transformed a subsidy-dependent sector to one primarily financed through deposits and demonstrated that an effective means of satisfying the vast demand for microcredit in Egypt is to utilize the considerable excess liquidity and branch networks of commercial banks. However inadvertent, the interim period between USAID/Egypt's support programs forced the non-banks to discover other sources of funding, most of it unsubsidized.[71] There are encouraging signs that commercial banks that are not interested in retail microfinance might provide wholesale funds and other services to non-bank MFIs.

During the same time, industry stakeholders have come together to draft a national strategy, which encourages a financial systems approach that not only recognized the importance of enabling different types of providers, but also highlights the need for the providers to expand their product and services to better suit the market. There is also a growing recognition of the demand for microfinance services by various client groups that are currently underserved (most notably women, the rural poor, youth, and startup businesses).

It remains to be seen how integrated microfinance will become in the financial sector. The credit reference bureau should also be functioning in 2006, providing greater information exchange between all providers. While the national strategy highlights the potential to utilize PBDAC or the NPO branches to deliver microcredit, there has been no clear commitment from the government or donors to improving the portfolio quality of SFD funded loans (disbursed through PBDAC.[72] Discussion regarding an SFD partnership with the NPO to provide microfinance has been met with concern and suspicion that it could harm the market if done incorrectly.

[71] USAID/Egypt has provided a number of its partners with funds to be utilized as collateral with commercial banks.

[72] Repayment rates and PAR are not available publicly, but those interviewed for this study believe them to be low.